



MANAGED ASSET PORTFOLIOS

MAP VIEWS Third Quarter 2021

Stocks marched higher during the past three months, marking the fifth consecutive quarterly advance since the pandemic-induced crash last year. Value stocks continued their upward momentum but did give up some of their gains relative to growth stocks in June. The latter were bolstered by interest rates that declined modestly during the quarter, despite rising inflation. Stocks that carry higher valuations tend to be more sensitive to interest rate changes than those with lower valuations.

The decline in interest rates is a bit of a conundrum as inflation fears continue to mount. A review of your daily living expenses should bear this out, with a trip to the gas station about 45% more expensive today than a year ago, and 30% since the beginning of 2021.¹

Last week, General Mills announced that it expects inflation to run around 7% this year, a much higher estimate than many of its food peers. However, they have an outsized reliance on agriculture commodities, such as corn and soybeans, which have rallied over 20% this year. While inflation has been running much hotter than the Fed's two percent target (recall the May CPI figure of 5.0%²), many on the Federal Reserve Board believe this is only transitory and that inflation will cool off next year.

Those in the "transitory" camp cite the recent sell-off in lumber prices over the past six weeks as an indicator. Recall that lumber prices soared approximately 400 percent from pre-pandemic levels until recently, as lumber mills could not keep up with demand. In June, prices tumbled around 45% but are still more than double pre-COVID levels. Shortly after the first rounds of fiscal and monetary stimulus last year, we expressed concerns over the possibility of increasing inflationary pressures. Fast forward a little over a year, and our concerns have only increased. The problem as we see it is that in order for inflation to prove transitory, we need continued strong economic growth and for supply chains to resolve their issues, or governments can raise taxes and take money out of the system. However, as we will discuss below, our expectations for future GDP growth and tax increases are unlikely to be sufficient to rein in the inflation that has already taken hold. With that in mind, over the past year, we have made numerous portfolio adjustments to better position portfolios for a higher inflationary environment. We have added some utilities (the first time in over a decade), some of which have exposure to natural gas and oil and renewable energy opportunities. In addition, we added some retailers that we believe have some pricing flexibility and should continue to benefit from fiscal stimulus and a rebounding economy.

We believe the dichotomy between the low level for interest rates and percolating inflation rates stems from the Fed's continuation of quantitative easing programs, which are artificially depressing interest rates. Specifically, the Fed continues to purchase about \$80 billion of Treasury securities and \$40 billion of mortgage-backed securities monthly. Additionally, the U.S. government has printed an unprecedented amount of money since 2009: more than \$10 trillion.³ Putting this into perspective, new money printing now exceeds the total cost of our most expensive wars.³ Remarkably, as much as the money supply has increased 250%, inflation has remained low.³ With that said, perhaps a better gauge for future economic activity and inflation would be the U.S. dollar. The currency market is much larger than the U.S. bond market and is not subject to the Fed's actions the way the bond market and interest

rates are. Although blipping a tad higher over the past few weeks, the dollar has been trending lower since the Fed began its aggressive monetary stimulus during the early stages of the COVID-19 pandemic.

For accounts invested in our Global Balanced strategies, bond weights are approximately 30%, which is the lowest permitted within the strategy's structure. We continue to keep maturities short (weighted-average around one year) and have added Treasury Inflation-Protected Securities (TIPS) to our holdings.

The global economy is enjoying a rebound from depressed levels stemming from the global pandemic. The rebound will not be smooth or linear as some geographies struggle with different variants more than others. Longer-term, we continue to believe that an excessive amount of debt in the global financial system will dampen longer-term growth rates.

Adding an additional layer of complexity to the investing environment is the continued rumblings surrounding possible tax increases. While some increases are likely to occur, we believe they will be more moderate than those proposed by President Biden. Additionally, we anticipate Congress will take a more tepid approach towards tax increases until after the November 2022 elections. Historically, the party in power loses seats during mid-term elections. Should this not materialize in 2022 and the Democratic party gains seats, we believe that more aggressive tax increases would occur at that juncture. Such actions would likely hurt corporate earnings, equity valuations, and the broader economy.

In summary, we continue to believe that the Fed will remain accommodative for the foreseeable future, as the economy is still lagging pre-COVID levels. Specifically, despite recent job gains, 7.13 million fewer Americans are employed as of June 30, 2021, than during the February 2020 peak. Although the Fed has broached the subject of tapering, we believe actual tapering will not occur until the lag in the job market is substantially reduced. Such an environment should be conducive for stocks, but we believe that future returns may be more subdued than those enjoyed over the past five quarters. Lastly, we note that the market seems to move on daily headlines. One day, it looks like the economy is not rebounding as quickly as forecast, and interest rates tumble along with inflation plays. The next day a headline comes out contrary to the previous, and rates move higher, and inflation plays rebound. We encourage investors to step aside from the day-to-day fluctuations and focus on the bigger, long-term picture.

Thank you for your confidence and loyalty. We do not take either for granted, as we work diligently every day in our effort to deliver the best risk-adjusted returns to our clients. We wish everyone a safe and enjoyable summer.

Managed Asset Portfolios' Investment Team
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¹<https://www.eia.gov/petroleum/>

²<https://www.bls.gov/news.release/cpi.nr0.htm>

³[https://www.advisorperspectives.com/articles/2021/07/05/inflation-is-looming-and-hiding-in-plain view](https://www.advisorperspectives.com/articles/2021/07/05/inflation-is-looming-and-hiding-in-plain-view)