IRONSIDES MACROECONOMICS

With Barry Knapp

‘It’s Never Different This Time’

AAII Presentation

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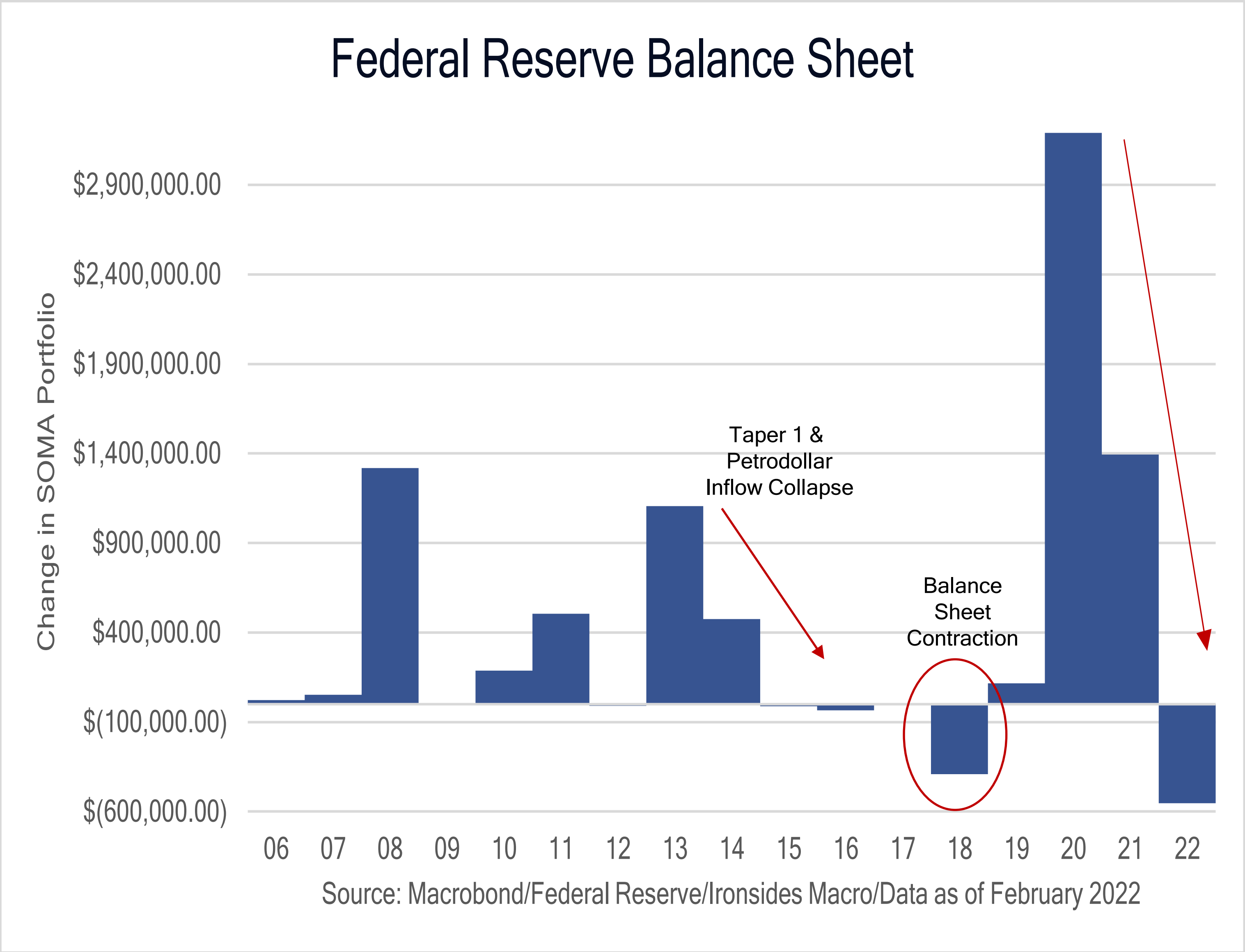
IRONSIDES MACROECONOMICS LLC

2020 Outlook: Inflation Policy & Politics

2022 Outlook: Inflation Policy & Politics (substack.com)

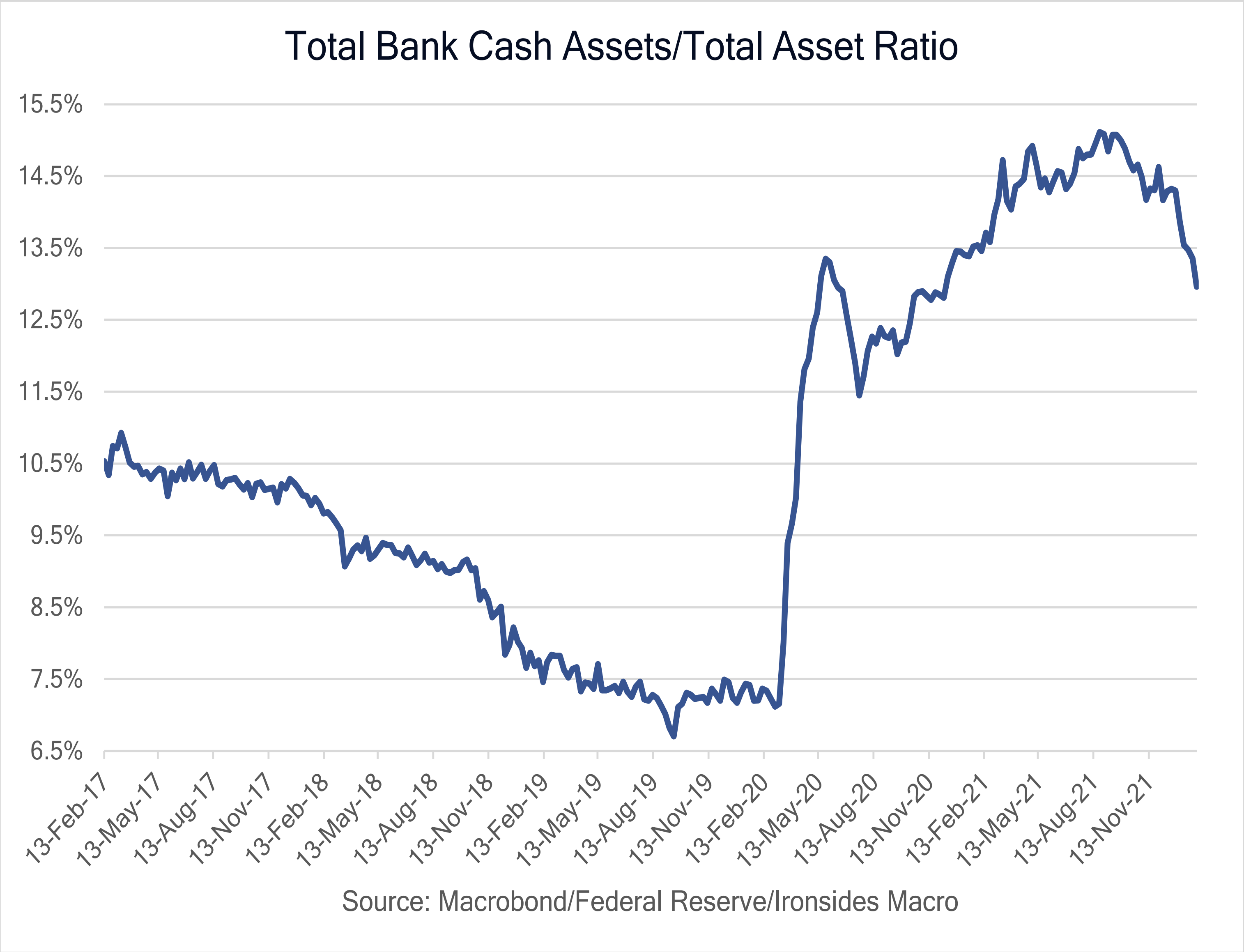
Liquidity Trickle

The Treasury General Account balance declined from $1.7 trillion to $100 billion in 2021. In 2022, following a debt ceiling deal, Treasury will rebuild balances which will drain liquidity from the banking system. Fed purchases will end, and we expect the Fed's balance sheet to begin contracting in May.



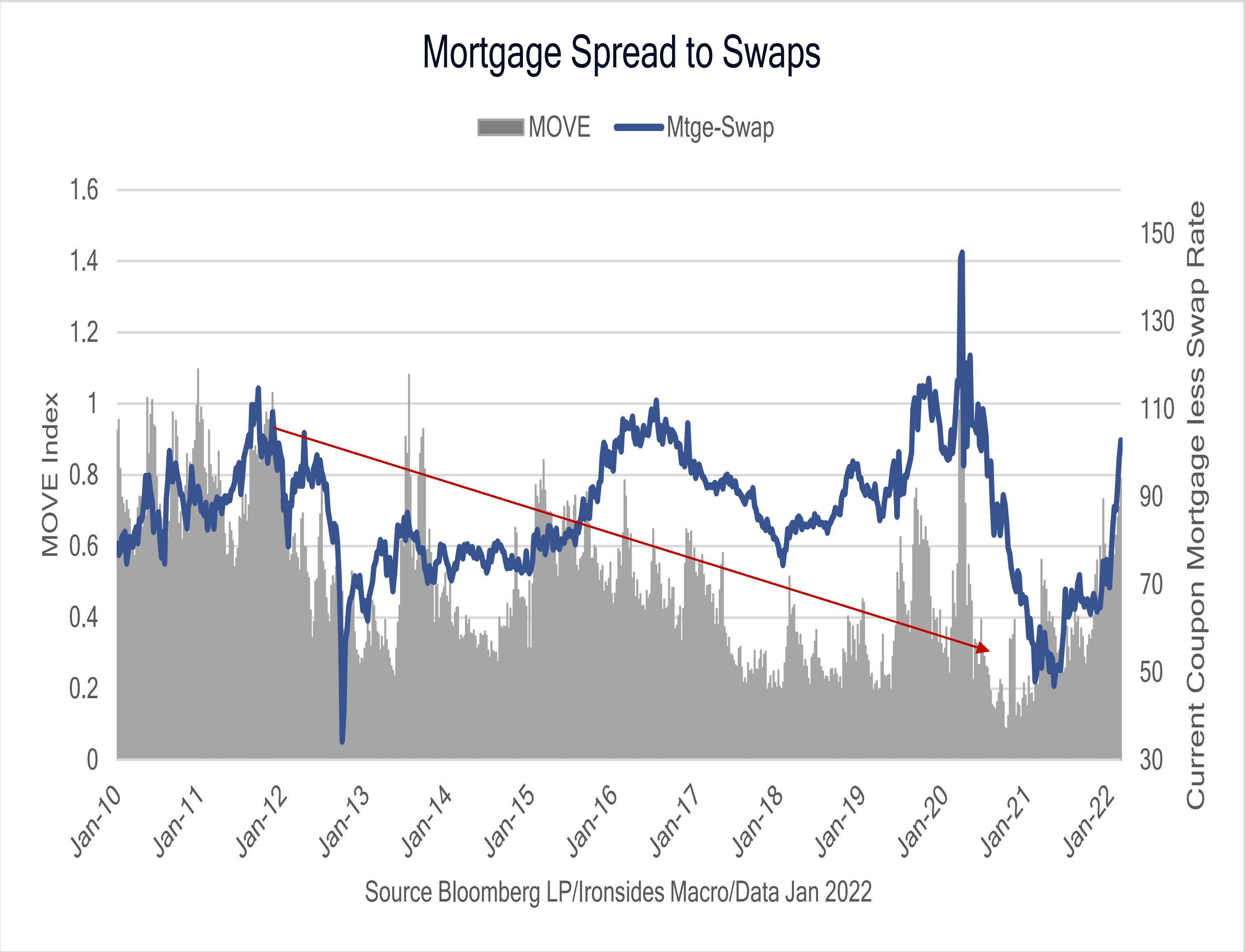
Liquidity Trickle

Bank cash assets increased from $1.1 to $3.0 trillion during the pandemic. The liquidity was excessive and hurt bank profitability. Return on equity increased in 2018-19 as cash assets were falling. While reduced liquidity is likely to impact markets, it will improve bank profitability and is at worst neutral for economic activity and credit creation.



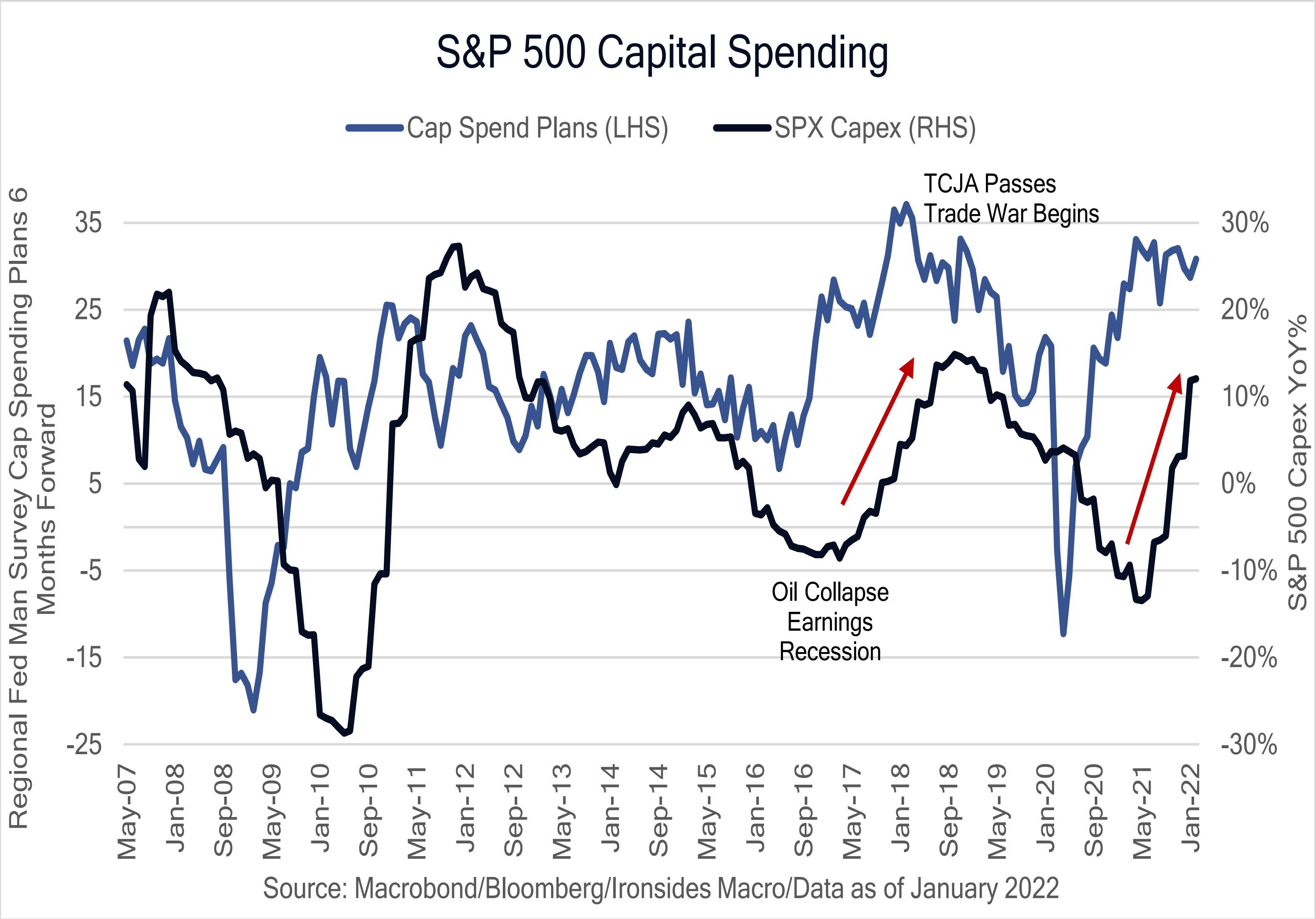
Liquidity Trickle

During pandemic QE, the Fed was buying 100% of net TIPS and agency MBS supply. New purchases and to an even greater extent, reinvestment, suppressed real rates and implied volatility. The only way to tighten financial conditions is to reduce the balance sheet to increase longer maturity rates and spreads (steepen the yield curve).



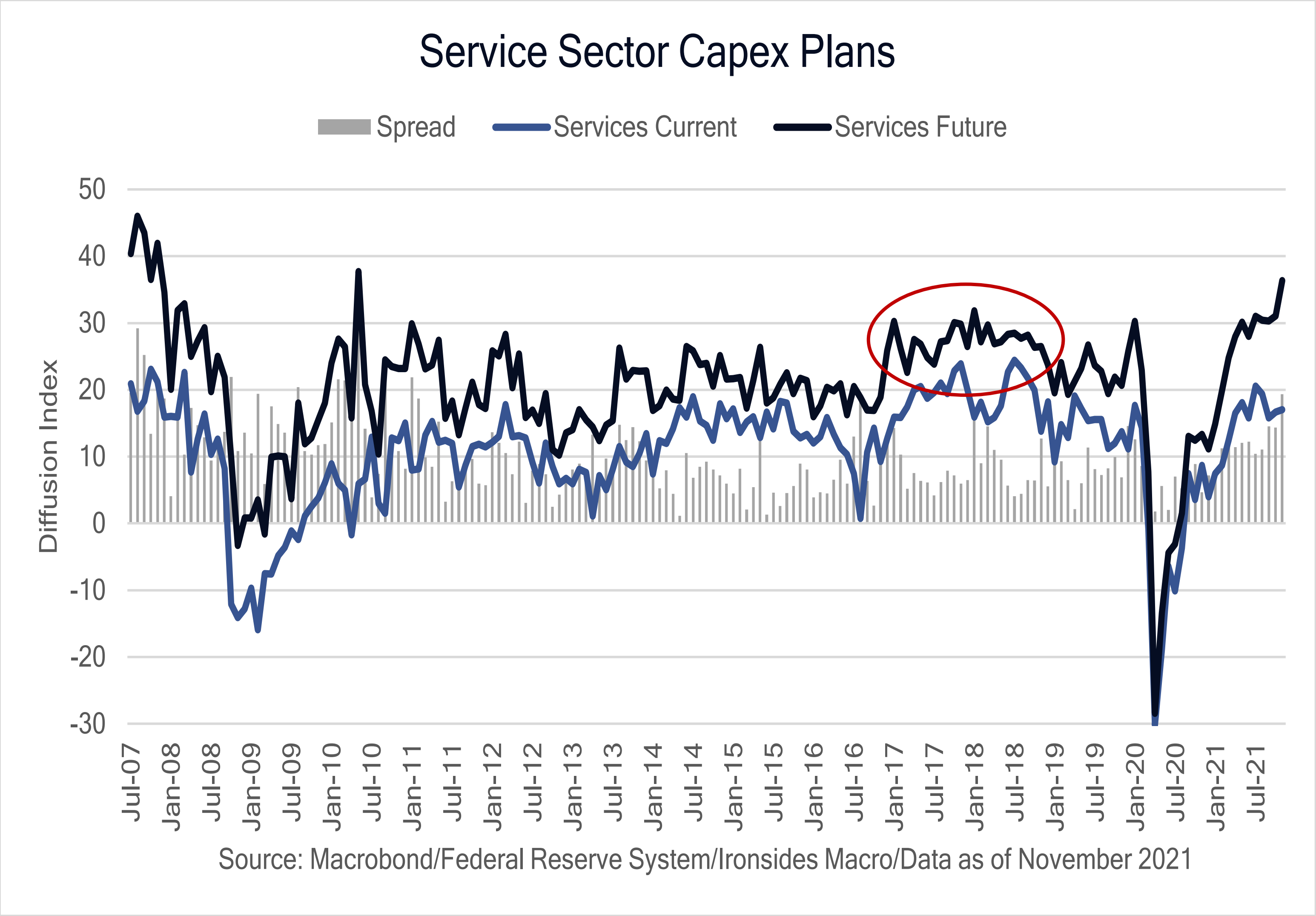
Persistent Pandemic Effects

The corporate sector has the means, due to record cash flow and margins, and the justification, restructuring supply chains, for a capital investment boom.

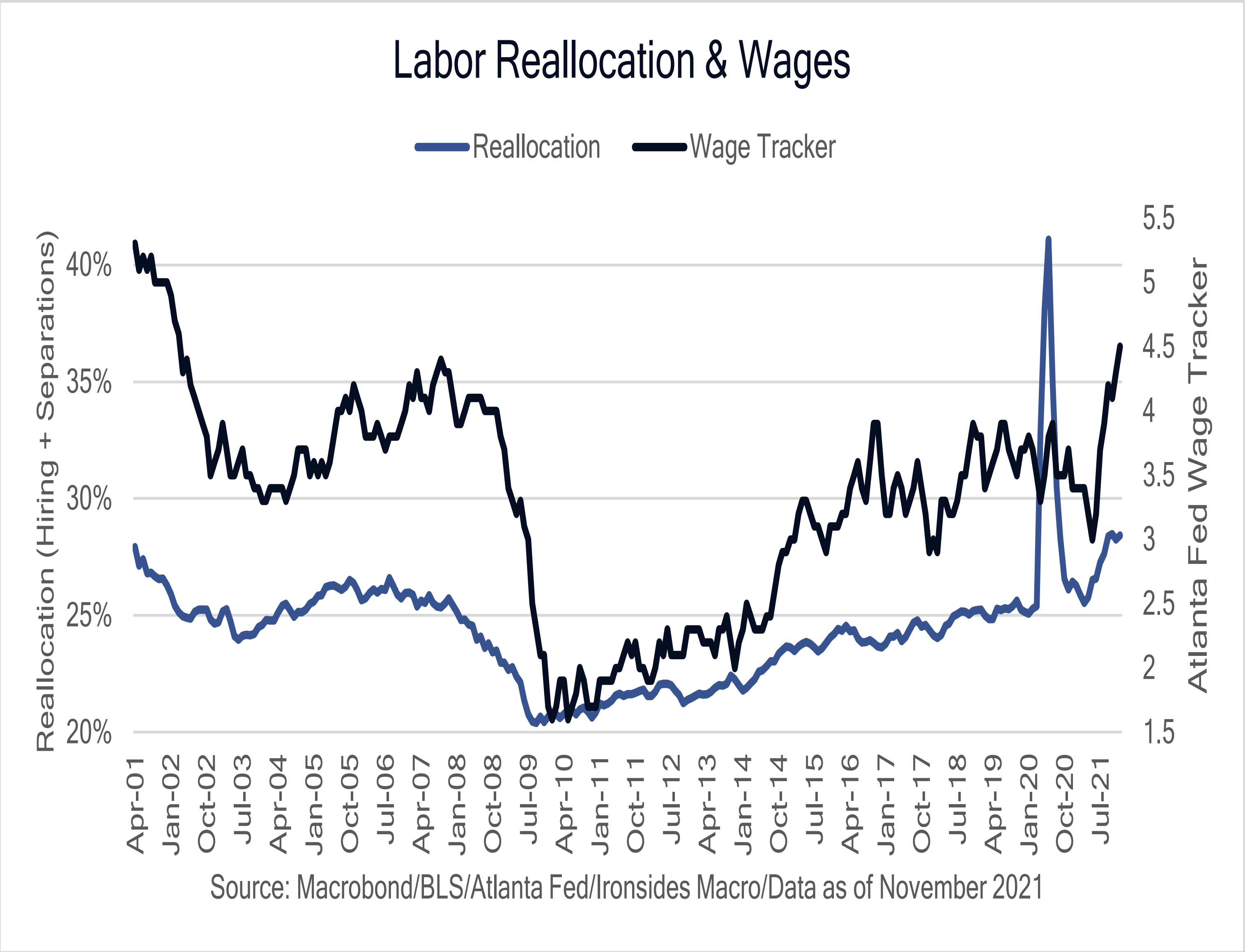


Persistent Pandemic Effects

Service sector productivity improved late last cycle, the pandemic accelerated technology innovation adoption and faster productivity growth.

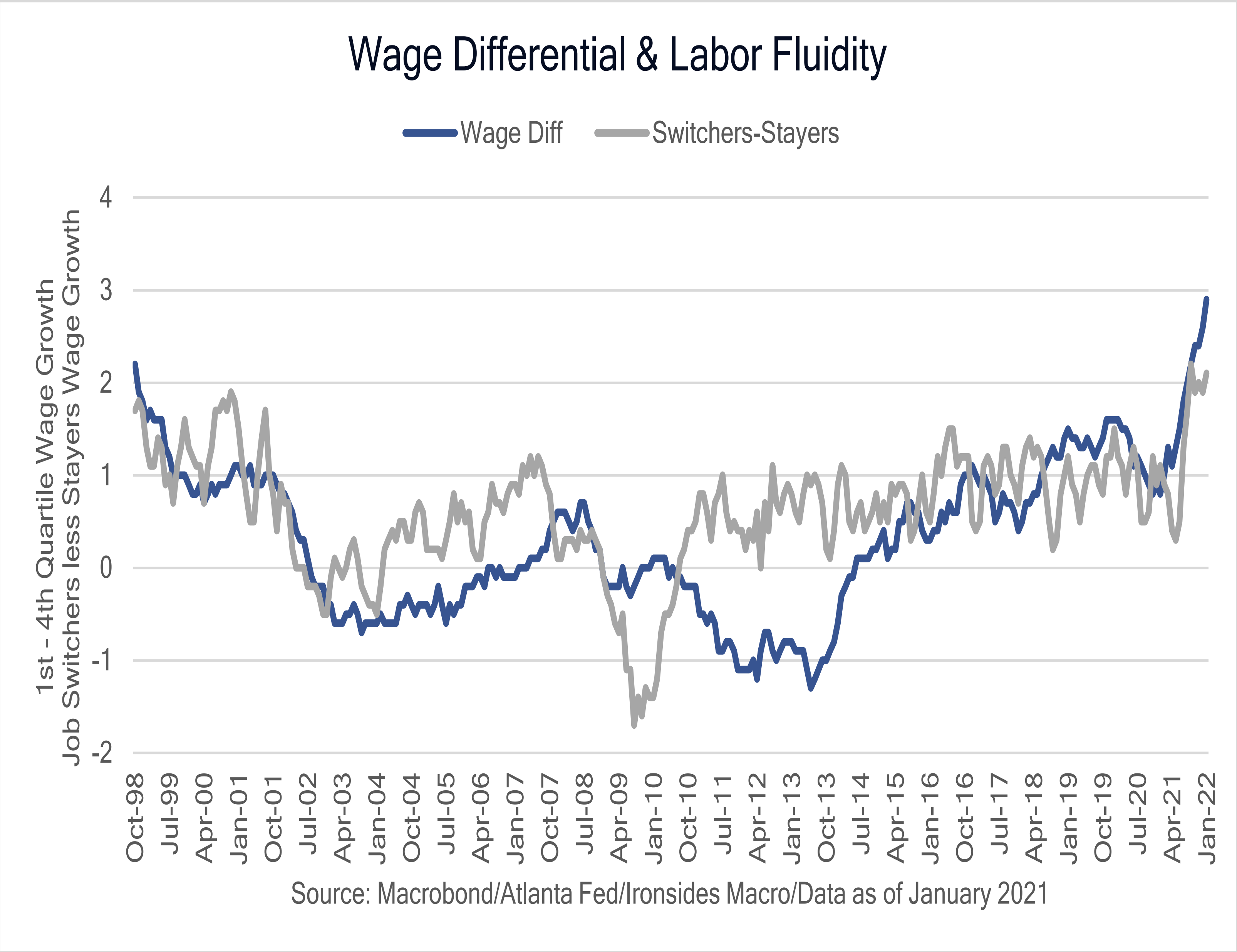


Persistent Pandemic Effects
Labor reallocation, the quarterly sum of hiring and separations as a percent of the workforce, was steadily rising through the '10s. The pandemic accelerated this trend as well. A dynamic or fluid labor force increasing productivity. See *"Labor Market Fluidity and Economic Performance', David & Haltiwanger*



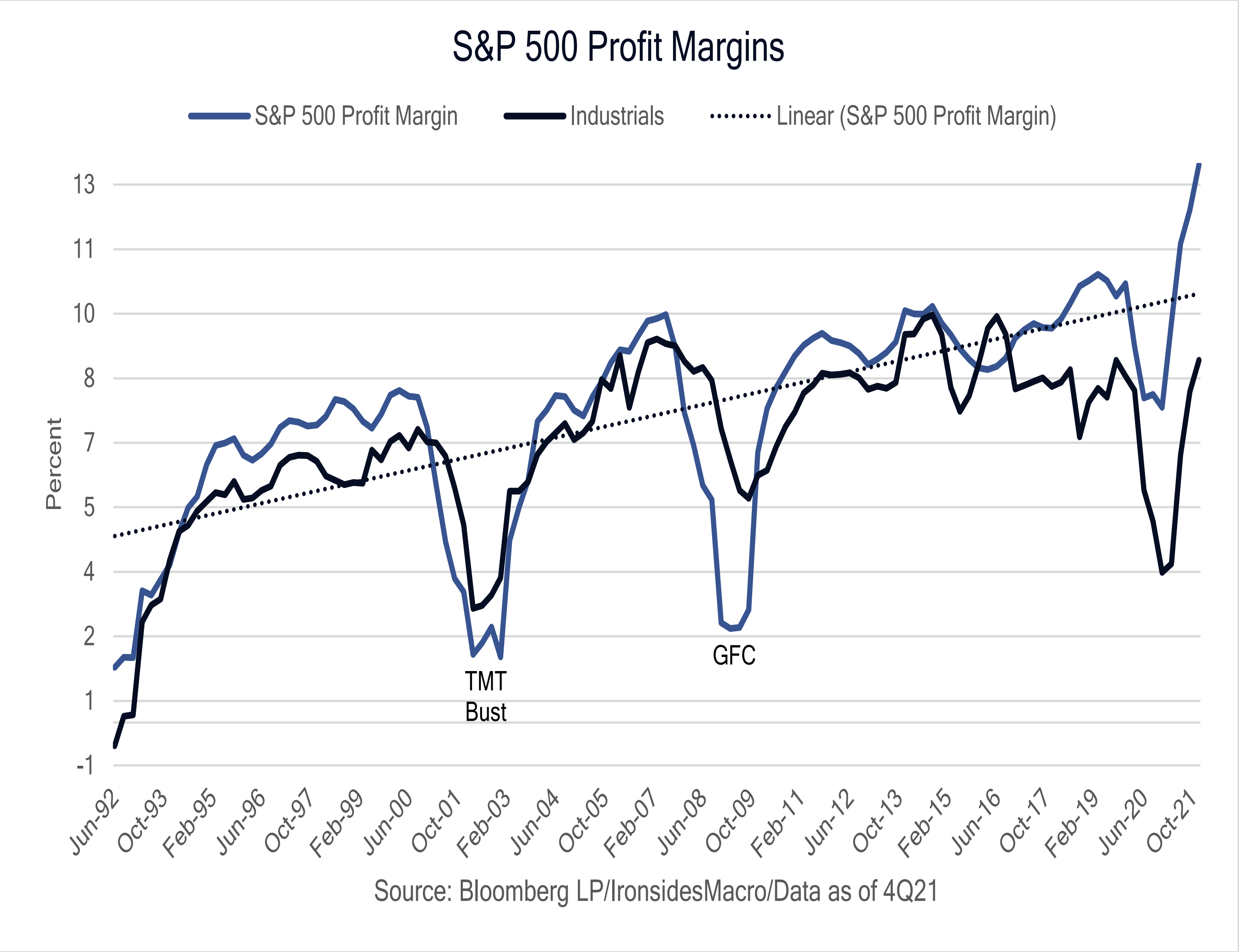
Persistent Pandemic Effects

Another method of determining whether diminished slack of dynamism is driving wage growth is using the Atlanta Wage Tracker data. Given that bottom quintile wages are rising much faster than the highest quintile and job switcher wages are rising faster than stayers, this data implies both factors are contributing.



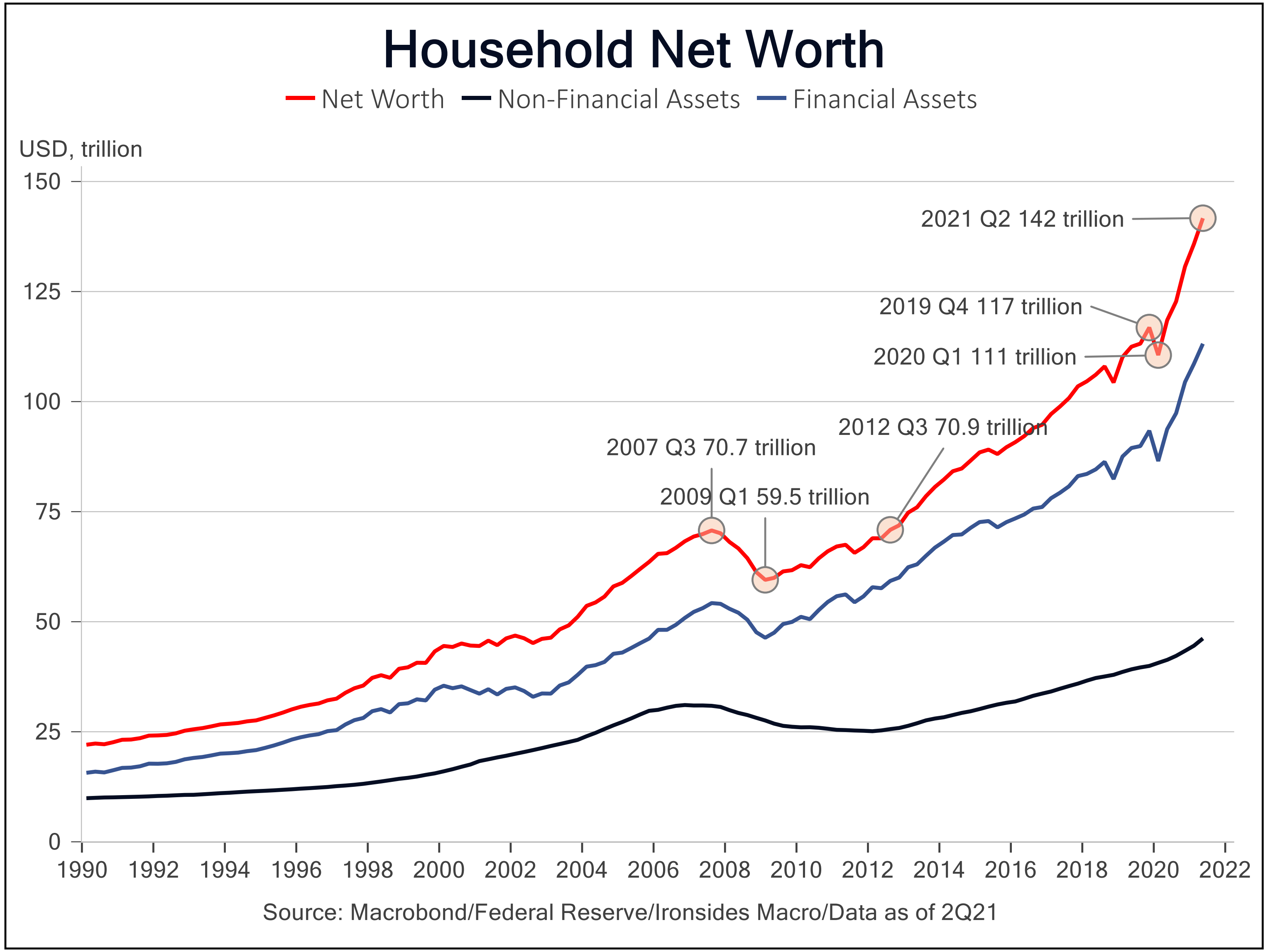
Persistent Pandemic Effects

Productivity is difficult to measure in real time, the best way to observe the effects of capital deepening, labor productivity and technology innovation adoption is profit margins. This is crucial for the outlook and length of the business cycle.



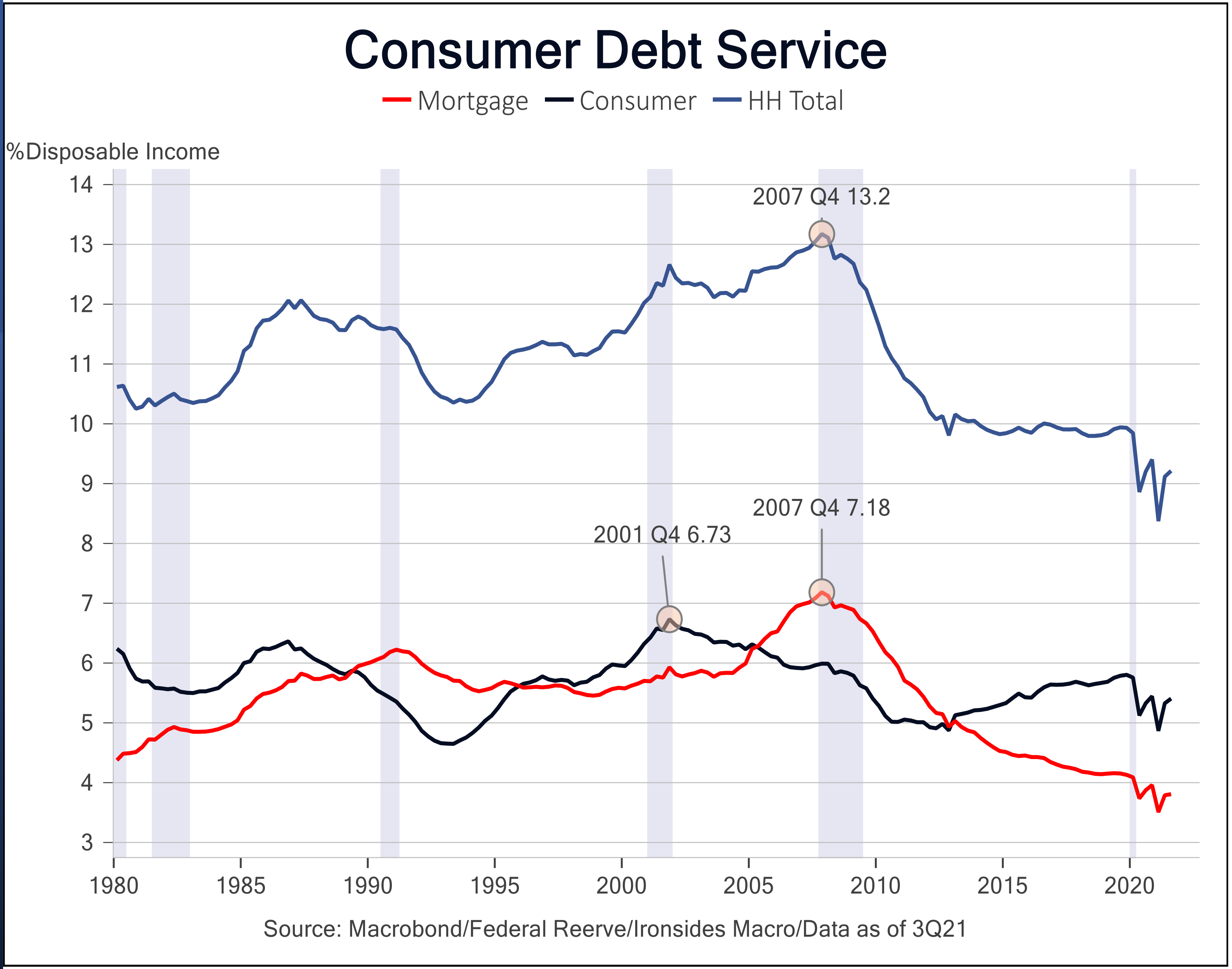
Inflation Policy & Politics

It took 3 ½ years for household net worth to recover following the financial crisis. An important QE channel is the wealth effect. Given how strong household balance sheets are following the pandemic, we think the Fed 'put strike' is significantly lower this cycle. We do not expect a QE5 until the next recession.



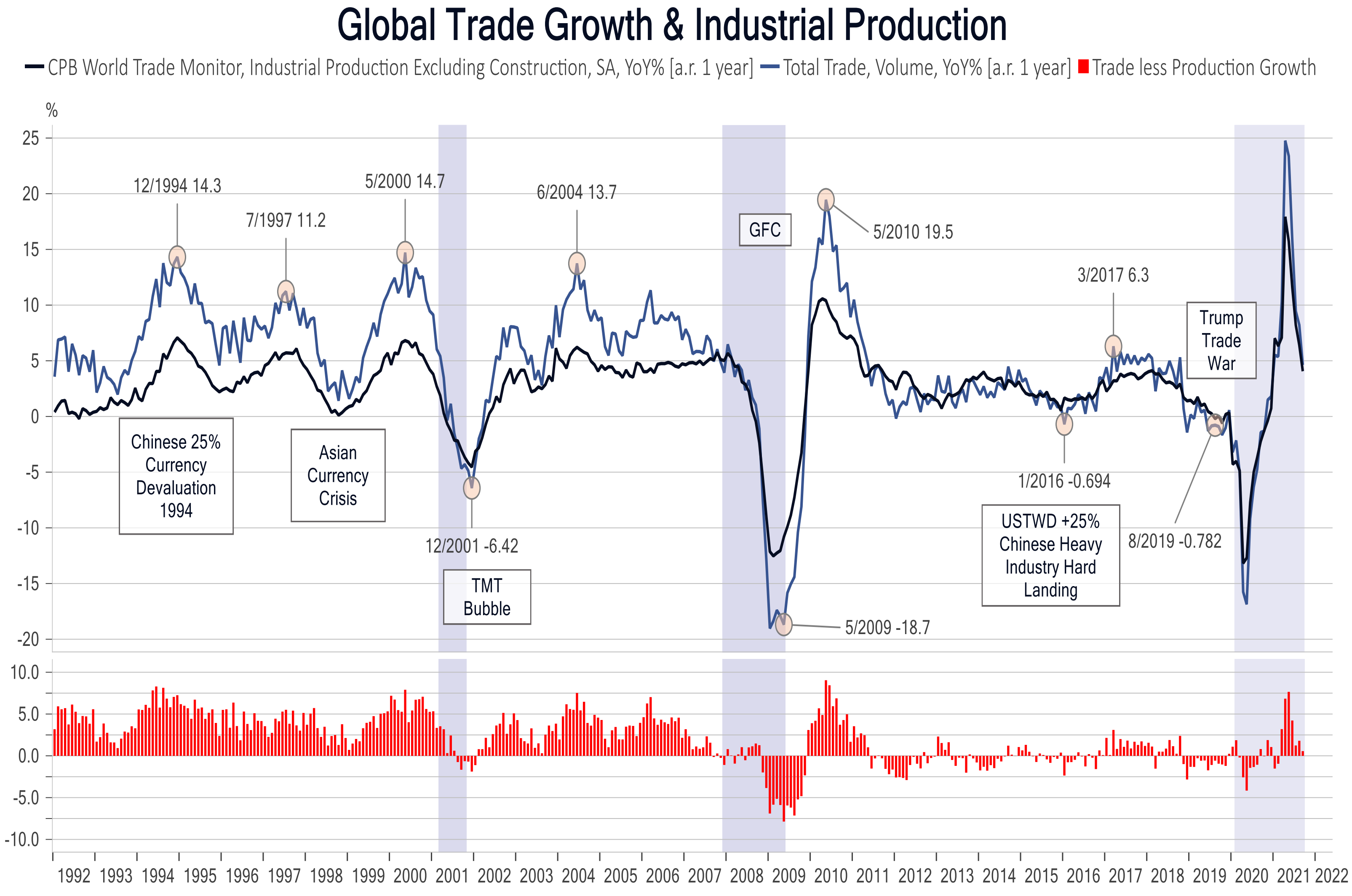
Inflation Policy & Politics

Household cash flow is very strong, interest obligations ratios are at their best levels since the Fed began tracking interest obligations as a percent of disposable income in 1980.



Persistent Pandemic Effects

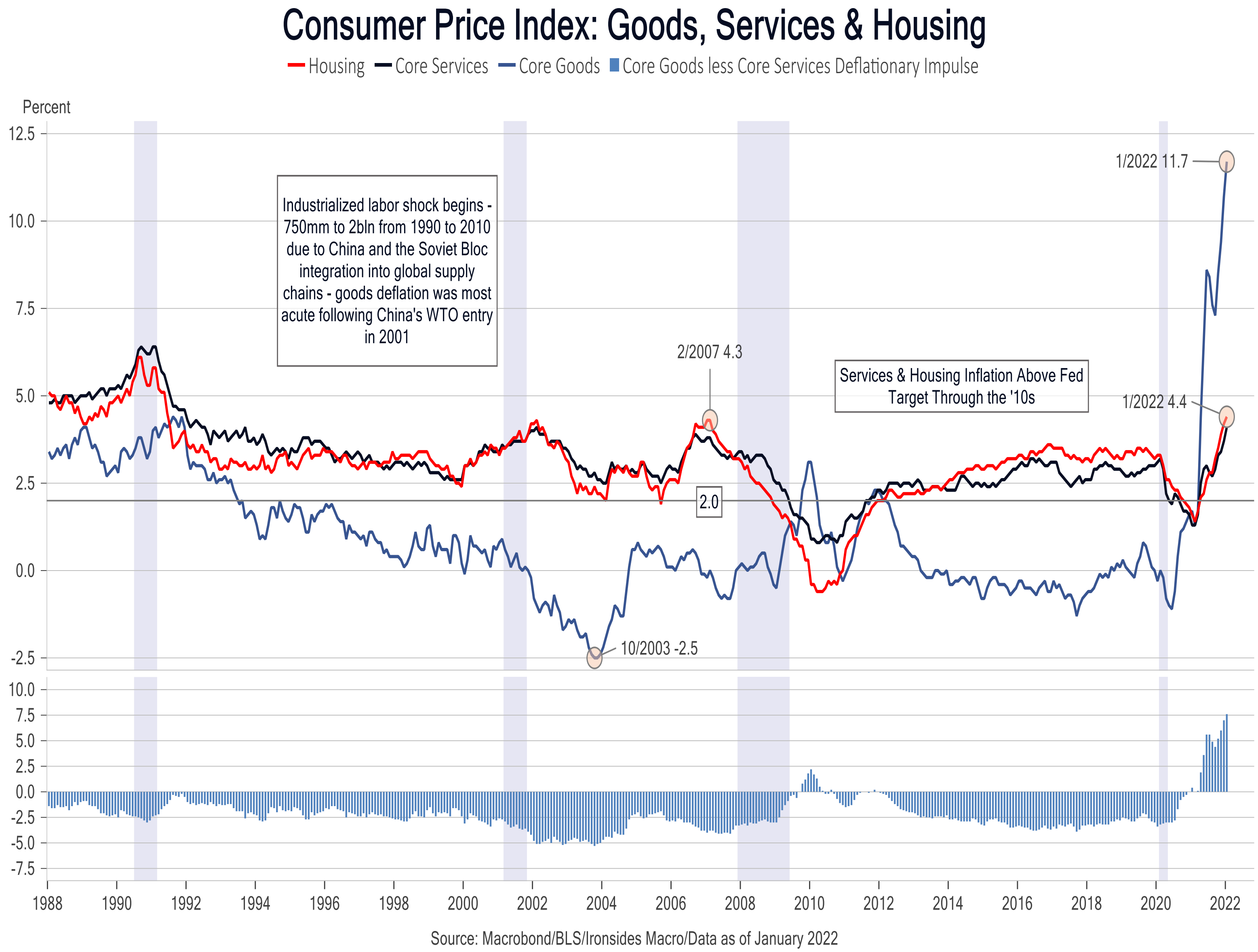
Global trade growth slowed notably in the ‘10s to 3.1% from 6.9% during the ‘00s and 7.7% in the ‘90s expansions. Global industrial production growth slowed as well from 3.6% in the ‘90s and 3.8% in the ‘00s to 2.4% in the ‘10s. The ratio of trade relative to industrial production can be considered a globalization proxy, and that ratio was 2.2 in the ‘90s, 1.8 in the ‘00s and 1.4 in the ‘10s.



Source: Macrobond/CPB/Ironsides Macro/Data as of 3Q21

Persistent Pandemic Effects

As goods prices inflation normalizes in 2022, albeit at levels above the '90s-'10s, transitory services disinflation will end and the trend of domestically determined core services price inflation is likely to be higher than the 3% '10s trend in part due to policy. Correlation of the components has not been this high since the '70s.



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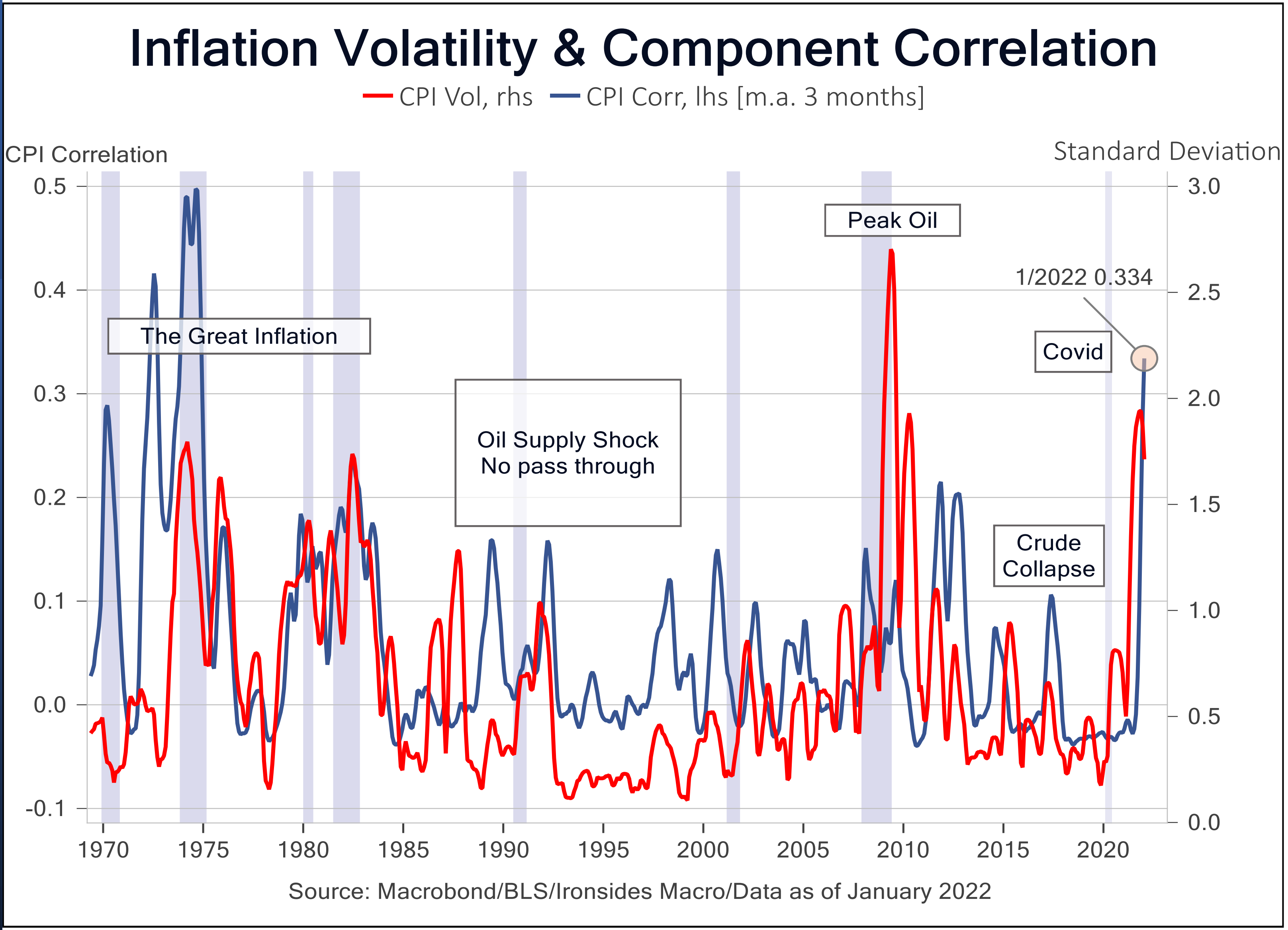
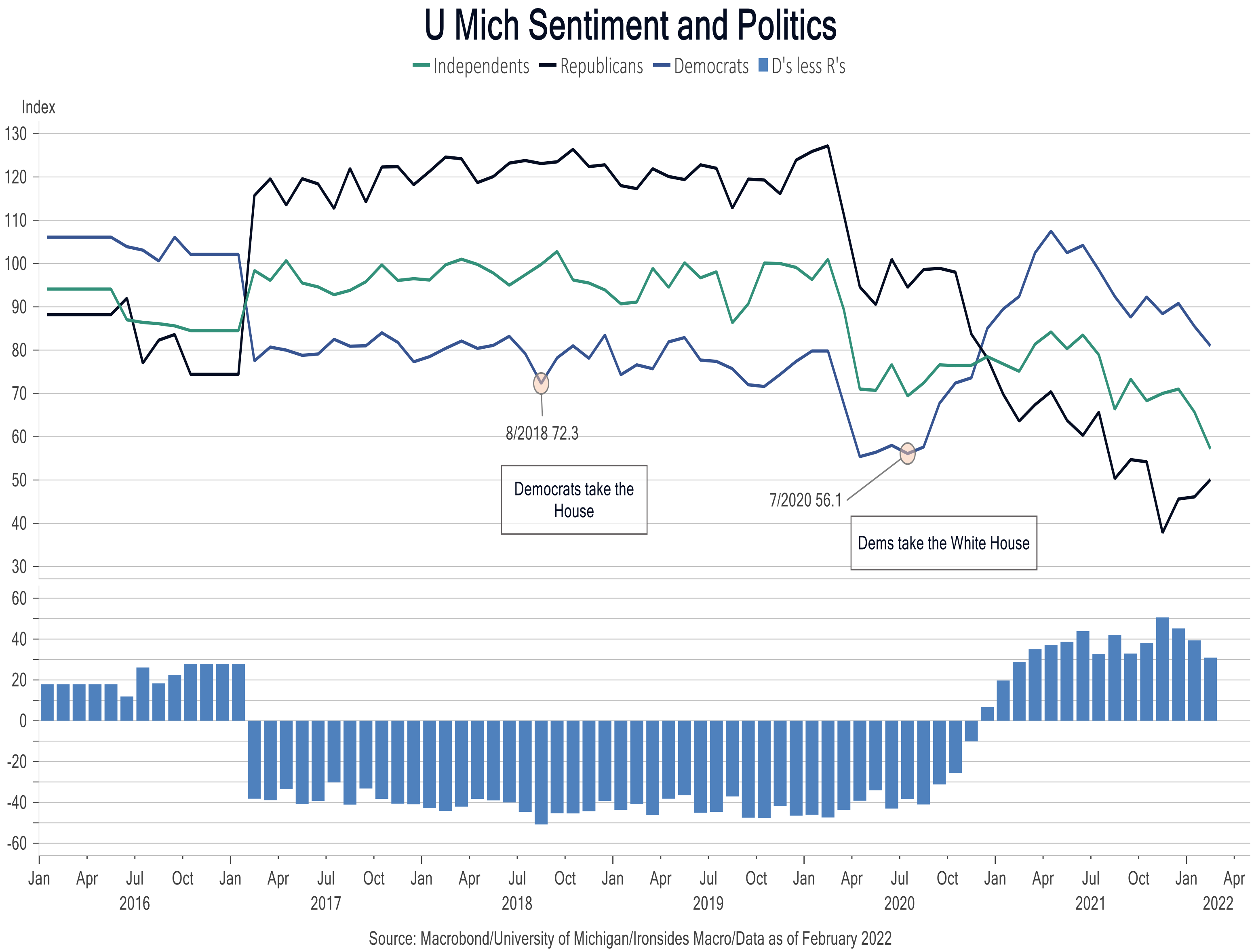


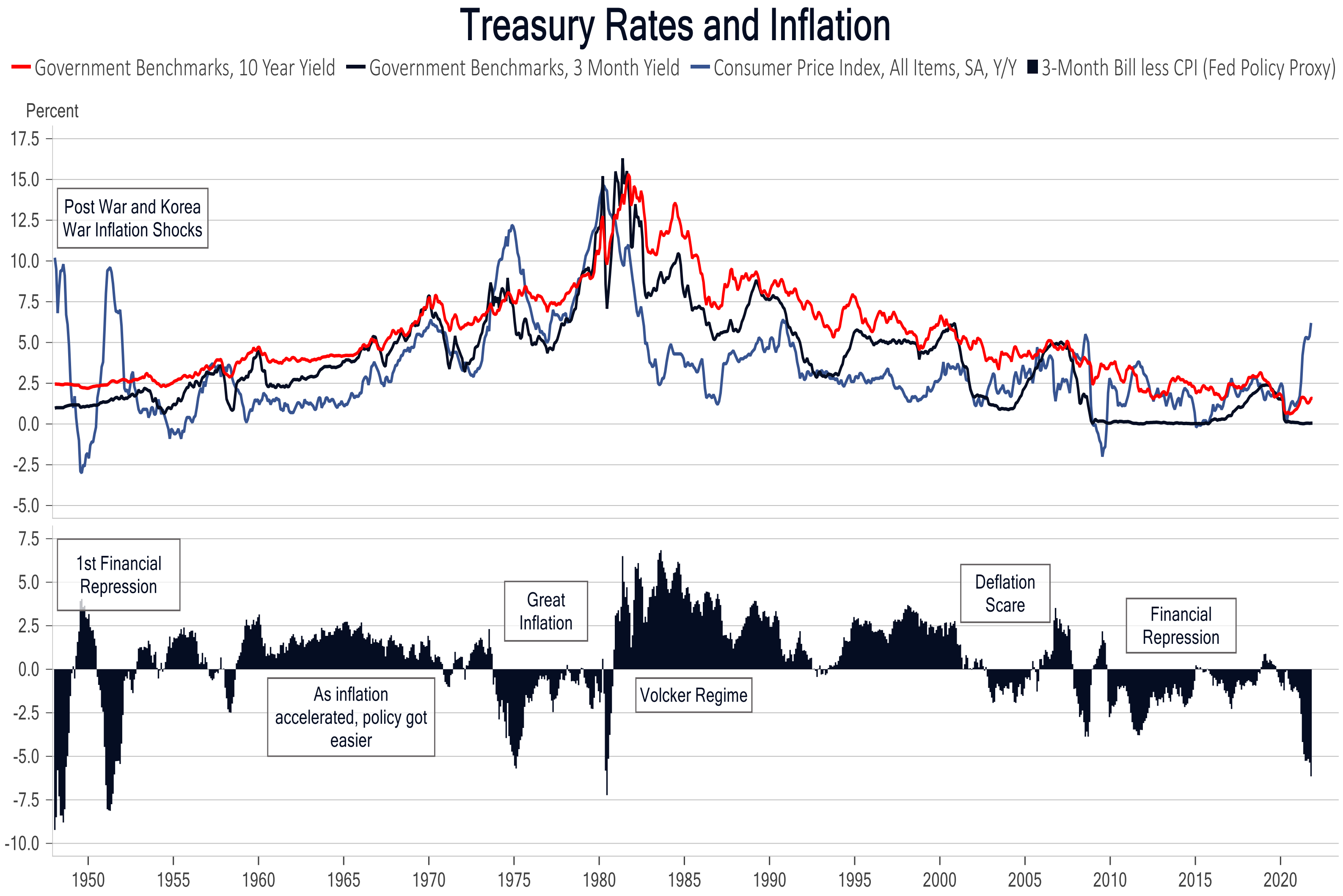
Inflation Policy & Politics

Consumer confidence surveys are of little use in forecasting consumption. They are useful for projecting elections. The Democrats appear headed for a drubbing in the midterms. This doesn't change the regulatory outlook, but it does imply that tax policy will be stable until at least 2024.



Inflation Policy & Politics

Monetary policy has not been this easy since the ‘70s. We believe the terminal funds rate is higher than the Fed Summary of Economic Projections or market is discounting. The debt, demographics and technology dynamics are very different than during the ‘10s.



Source: Macrobond/Federal Reserve/BLS/Ironsides Macro/Data as of November 2021

Disinflation, Reflation & Inflation
‘60s Déjà Vu All Over Again

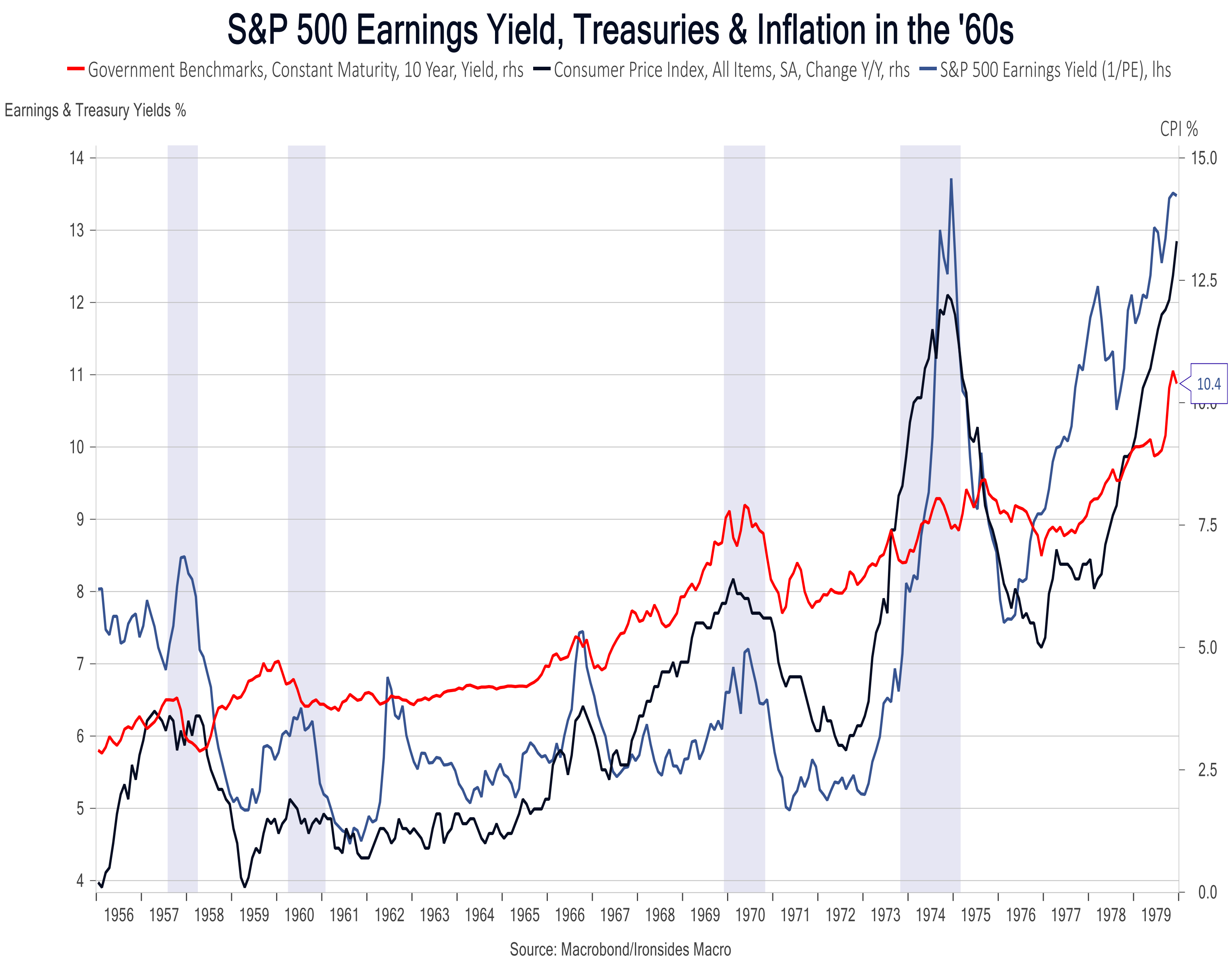
“The years 1961-71 were a part of the Keynesian interlude dominated by a strong belief that government was responsible for stabilizing an unruly private sector. The distinguishing characteristics were two related beliefs: (1) that policymakers could adjust their actions in a timely way to smooth fluctuations, and achieve full employment with high growth and low inflation, and (2) that policymakers could choose and achieve the right, possibly optimal, combination of inflation and full employment. Keynesian economists called their program “the new economics” to signify the departure from prevailing orthodoxies.”

“A History of the Federal Reserve, Volume 2, Book 1, 1951-1969”, Allan H. Meltzer

[Disinflation, Reflation and Inflation: '60s Déjà Vu All Over Again - by Barry C. Knapp - Ironsides Macroeconomics 'It's Never Different This Time' (substack.com)]

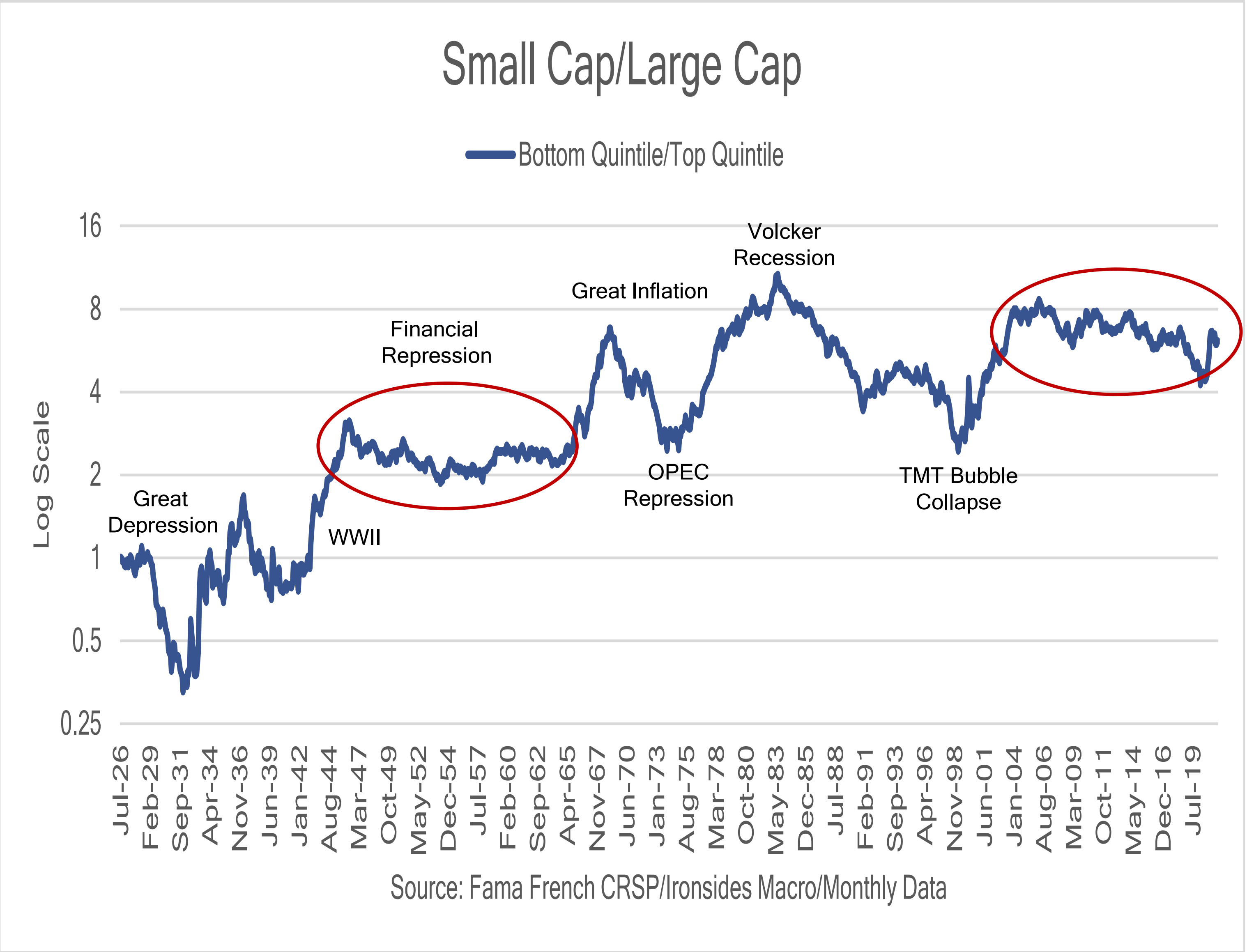
Reflation is Good, Inflation is Not

Despite sluggish earnings growth and weak capital investment the stock market performed well in the ’50s. When JFK was elected the PE of the S&P 500 was 20, it held that rich valuation during the early ‘60s likely due to faster earnings growth. Bond returns were negative, when inflation accelerated above 4% valuation came under pressure.



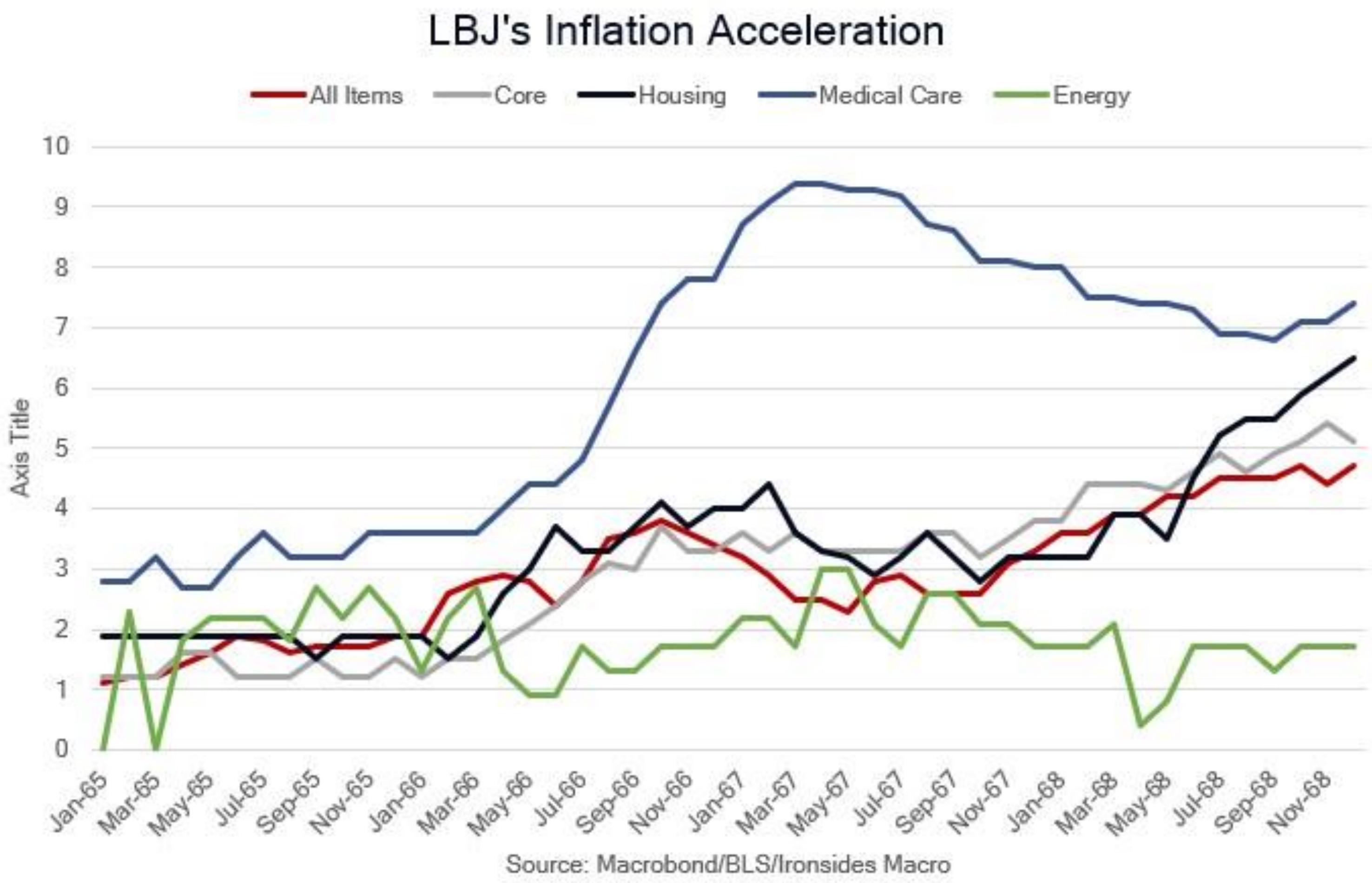
Small Caps in the ‘60s

We used Famma/French size quintiles to create a proxy for small cap performance over the last nearly 100 years. They performed strongly during the reflation of the ‘60s and Great Inflation of the ‘70s.

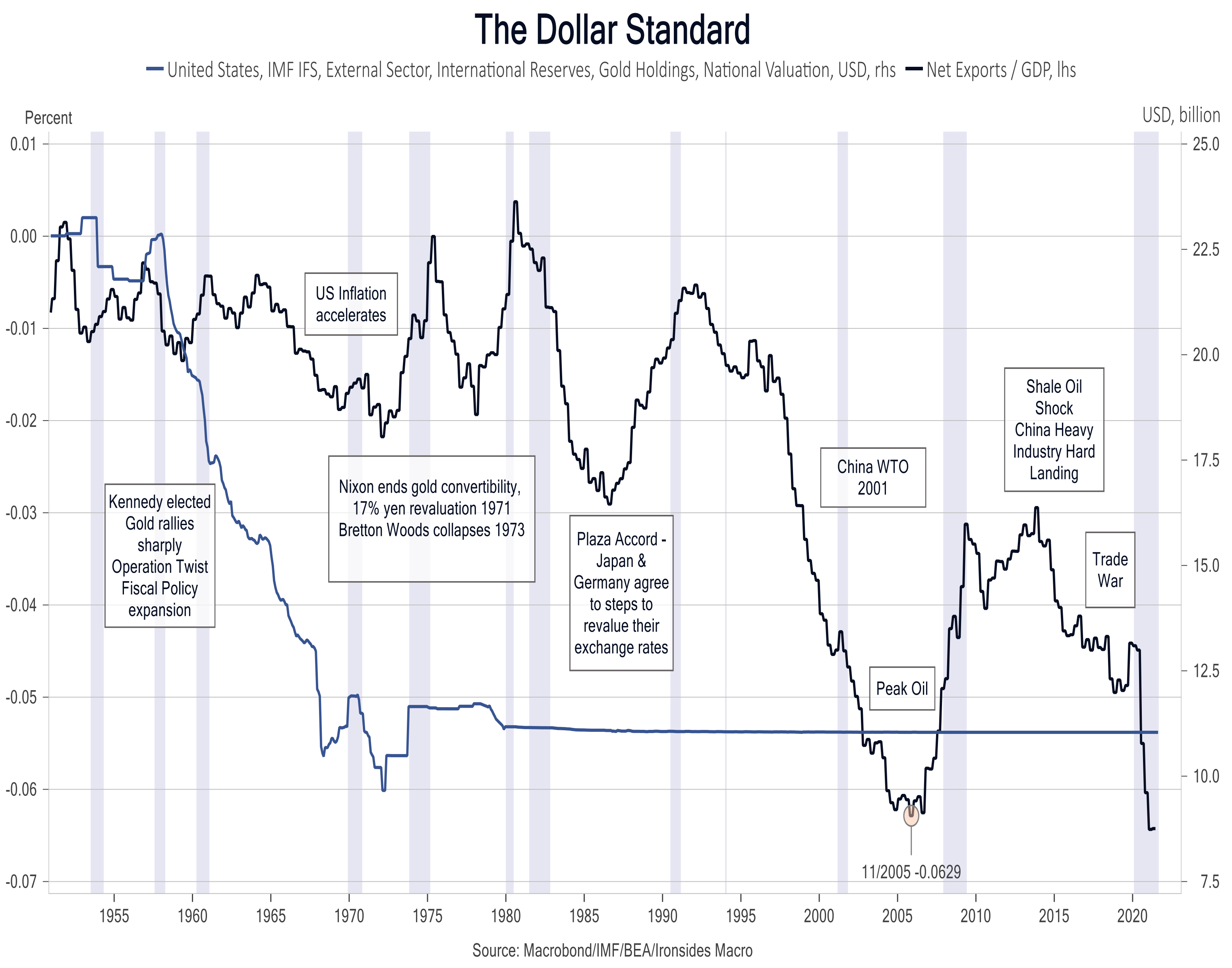


The Biggest Risk: Straight to the '70s

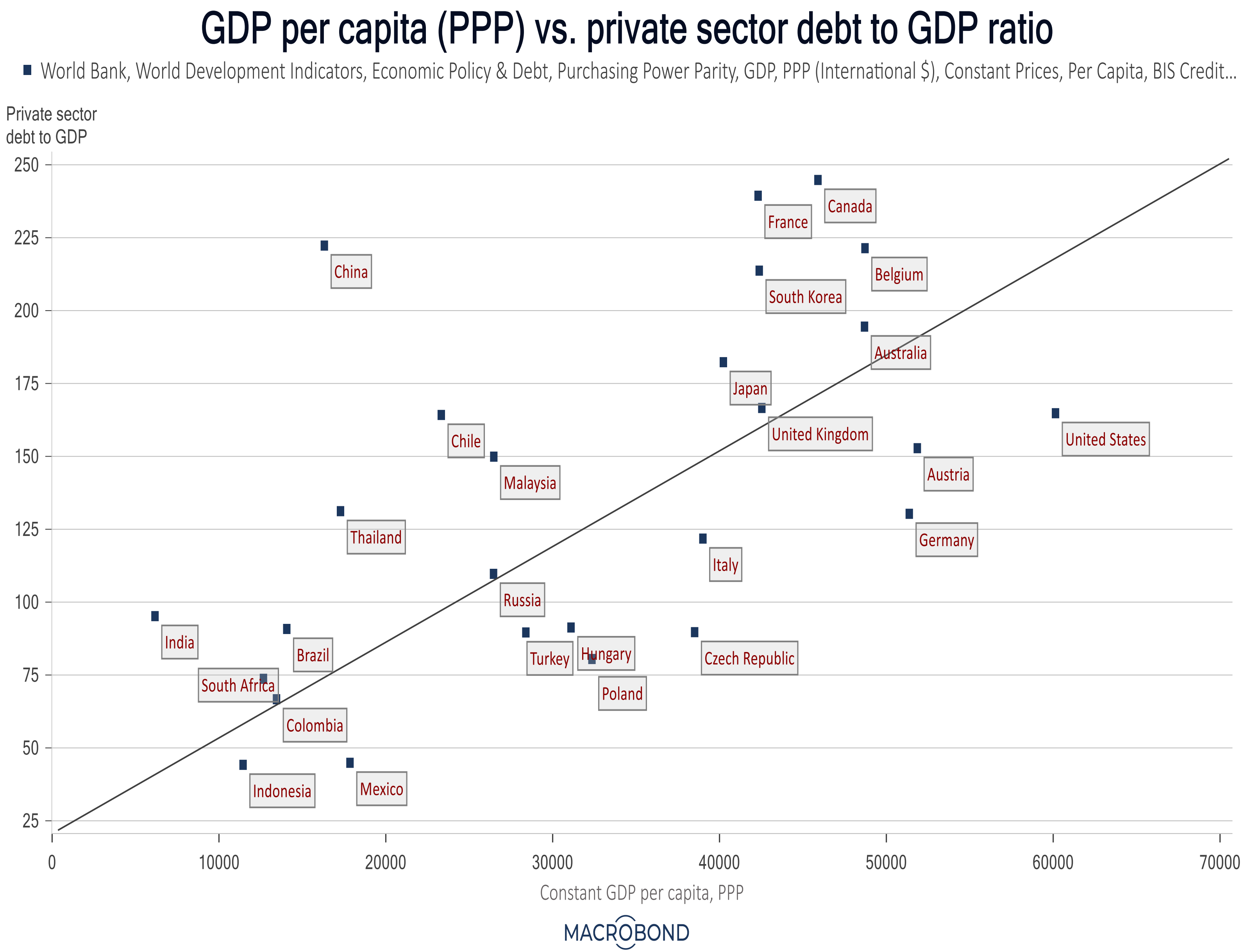
In 1965, only 25% of the population over 65 had health insurance. Nonetheless, Medicare sparked significantly higher medical care inflation. One important difference from the '60s and current environment is that the supply shock (OPEC embargo) occurred after policy sparked higher inflation.



The Dollar/Gold Standard
Bretton Woods was intended to be a flexible, but managed, exchange rate system with the both the pound and dollar convertible into gold. The Brits dropped out before European currencies became convertible. The ‘60s is referred to as the ‘golden age’ of the Bretton Woods, however as the US current deficit was widening, gold reserves were falling, and the system was crumbling.

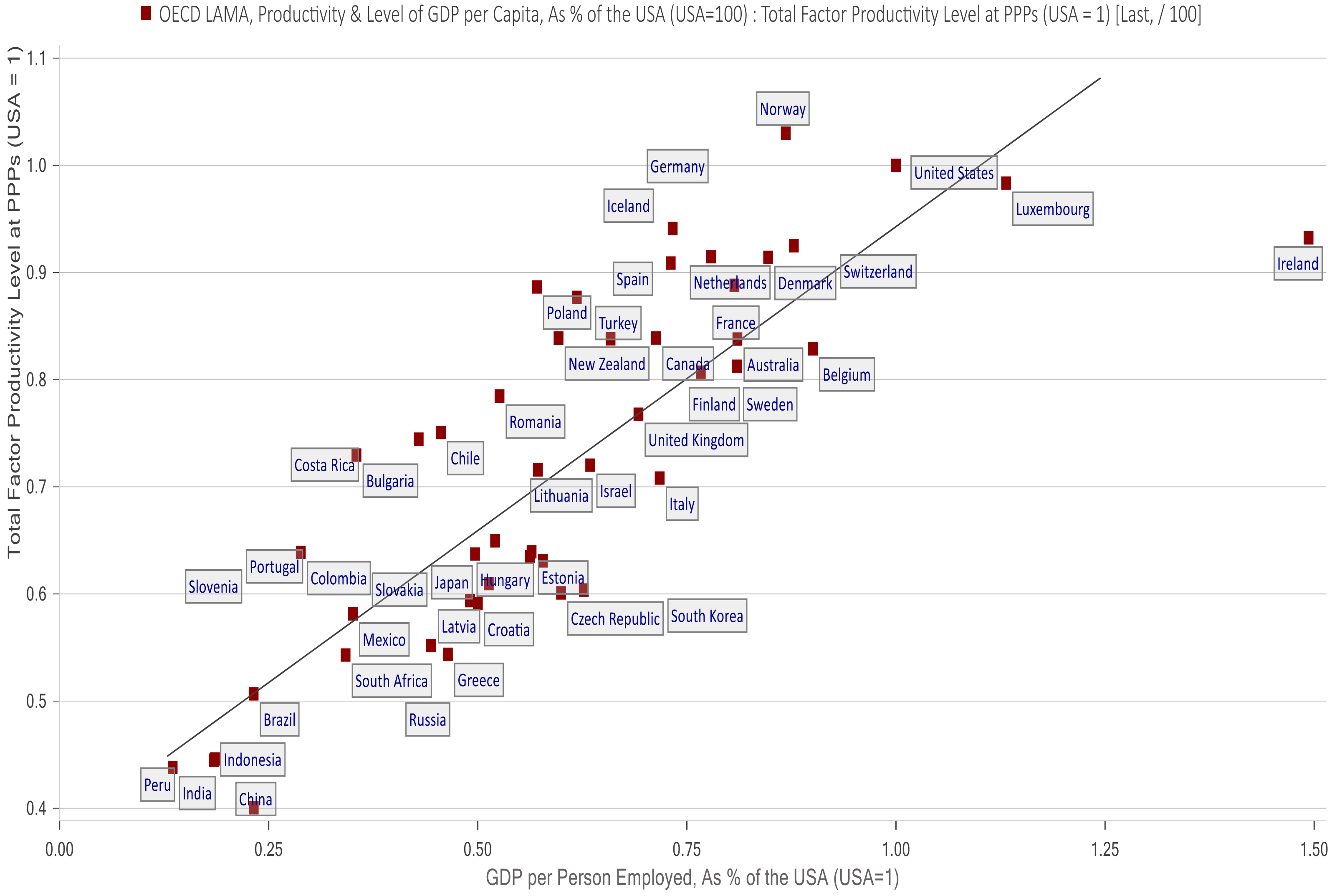


China Struggles
Tighter monetary policy in the developed world will squeeze China due to their soft-currency peg. Slowing export growth will tempt the Central Committee to allow for a weaker exchange rate that could spark outflow pressures. They doubled down on SOEs making their productivity and debt problems worse. Real estate malinvestment is far larger with worse demographics than the US in the ‘00s. This is our favorite macro short.



China Struggles
Macro policy has been shifting resources to inefficient SOEs, this further exacerbates China's productivity issues. China is in the lower left of this scatter plot of total factor productivity (technology innovation adoption) and per capita GDP. Top-down technology investment in AI, semiconductors, etc. is not translating into faster productivity growth.

Innovation and General Welfare - Total Factor Productivity & Per Capita GDP



Source: Macrobond/Ironsides Macro/OECD

Another Difficult Year for the 60/40 Model

We like reflation beneficiaries; we are market weight technology sector(s) due to our view that the benefits of digitization and movement to the cloud will be accrue to the users of that technology rather from the producers.

US Equity Market Valuation Index/Sector	PE	Fwd PE	P/S	P/B	EV / Sales	EV / EBITDA	Z-score	Ironsides Strategic Recommendation	ERP	ERP Z-Score
SPX	22.56	19.55	2.82	4.38	3.22	15.46	1.43	Market	5.64%	-0.34
Discretionary	36.02	26.33	2.56	9.94	2.87	19.11	2.34	Market	4.32%	-0.25
Financials	13.52	14.93	2.71	1.68	2.91	7.62	-0.17	Overweight	7.22%	-0.41
Technology	29.21	24.78	6.62	10.25	7.03	21.15	1.76	Market	4.56%	-0.03
Comm Services	19.68	17.38	3.35	3.78	4.02	12.44	1.40	Market	6.28%	-0.37
Industrials	27.75	19.97	2.24	5.14	2.64	15.38	1.67	Overweight	5.53%	-0.38
Materials	17.02	15.62	2.18	3.13	2.59	11.23	0.95	Market +	8.89%	-0.97
Energy	16.88	11.95	1.28	2.19	1.65	10.44	0.36	Overweight	8.89%	-1.27
Healthcare	19.27	15.42	1.89	4.90	2.13	16.19	0.12	Overweight	7.01%	-0.64
Staples	22.70	21.96	1.72	6.93	1.96	16.58	1.68	Underweight	5.08%	-0.40
Utilities	20.10	19.17	2.62	2.18	4.55	14.31	2.14	Underweight	5.74%	-0.16
Real Estate	48.39	41.93	8.07	8.07	11.02	24.36	0.92	Underweight	2.91%	0.14
Russell 2000	84.84	22.20	1.25	2.48	#N/A N/A	1.88	0.65	Overweight	5.00%	-1.14

Source: Bloomberg/Ironsides Macro/Data as of Feb 2022

About Ironsides Macroeconomics LLC

We are an independent provider of macroeconomic and public policy strategy for institutional and sophisticated individual investors, banks and corporations. We have no affiliation with a broker dealer.

Integral to our approach is utilizing corporate or micro data to analyze macroeconomic secular and cyclical trends. Additionally, we have long written reports under the title, 'It's Never Different This Time' underscoring our use of historical analogs to better inform the business cycle. We analyze economics and policy from the lens of a long-time market participant, in other words, our focus is on sustainable trends and assets we believe that are either under, or over-valued given our economic and policy outlook as well as risks underappreciated by markets.

The managing partner of Ironsides Macro is Barry C. Knapp. Barry was most recently a Senior Managing Director and Head of Macro & Public Policy Strategy at Guggenheim Securities. Previous roles included Managing Director and Head of Thematic Strategies for BlackRock Fundamental Fixed Income, Managing Director and Chief US Equity Strategist at Barclays Capital and Managing Director in principal trading and equity derivatives at Lehman Brothers.

https://ironsidesmacro.substack.com