Inflation Expectations

Mar 3, 2021

Firm AUM/AUA
$1.69 billion

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About the Manager

Main Management, LLC is an SEC-registered investment advisor established in 2002. The firm takes an investor-centric approach to all that it does, with a focus on generating strong post-fee, post-tax results. By implementing its strategies with ETFs, Main Management provides portfolio solutions that are diversified, liquid and transparent. The firm's time-tested investment process is applied consistently and implemented by a seasoned Investment Committee that has been intact since the firm's inception. Main Management specializes in serving high net worth individuals and institutional investors. In addition, the partners maintain significant investments in the firm's investment strategies.

Framing Inflation Expectations

1) Post recessions 10 Year US Treasury bonds typically rallies 100bp. This was delayed due to fears of virus induced "double dip". Today we are 147bp for the 10 Year US Treasury, or +96bp from low. Very typical.
2) 5-year US Treasury bonds Break Evens are 2.4%, which is also very typical post-recession move, but there is an inversion with 10 year Break Even at 2.1%, and this inversion last happened in 7/2008, but wasn't this wide. (See *Figure 1*) The market is implying near term inflation (Biden $1.9t bill passes, or Fed will raise rates faster and sooner), but less long-term inflation.

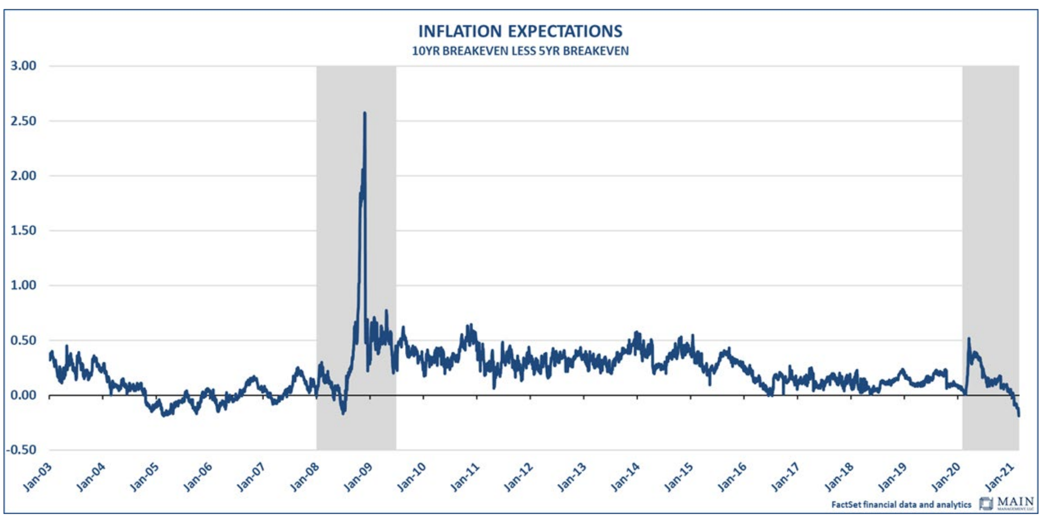

Figure 1. Inflation Expectations.

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3) Commodity inflation appears real and fast: CRB Index up 35% since election day, and oil is +70% during that time. (See *Figure 2*)

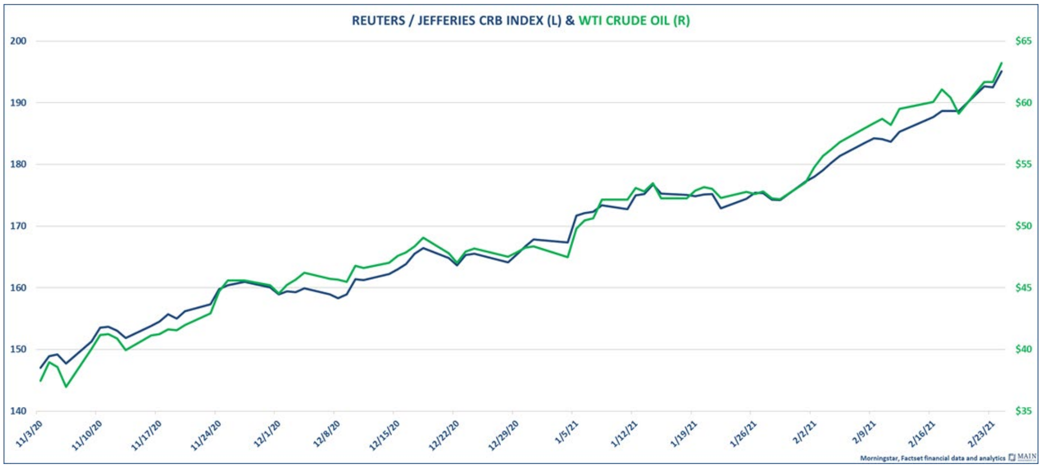

Figure 2. Commodity Research Bureau Index and Crude Oil Comparison.

4) Wages, according to Goldman Sachs are 13% of S&P500 revenues, making it hard for systemic inflation to "grab hold".

5) 4 headwinds: technology/productivity/demographics (global rate of growth is ½ of what it was in late '70's)/debt (large stock of debt means a lot of people debt buckets are full, think Japan who loaded debt on debt, and hasn't seen inflation in 3 decades) = tougher, not impossible for real raging inflation.

6) Last 20 years inflation has consistently been "over-estimated".

7) 10 year US Treasury minus Fed Funds Rate = 140bp vs 300-400bp before the peak. (See *Figure 3*) This is what you are looking to hedge against.

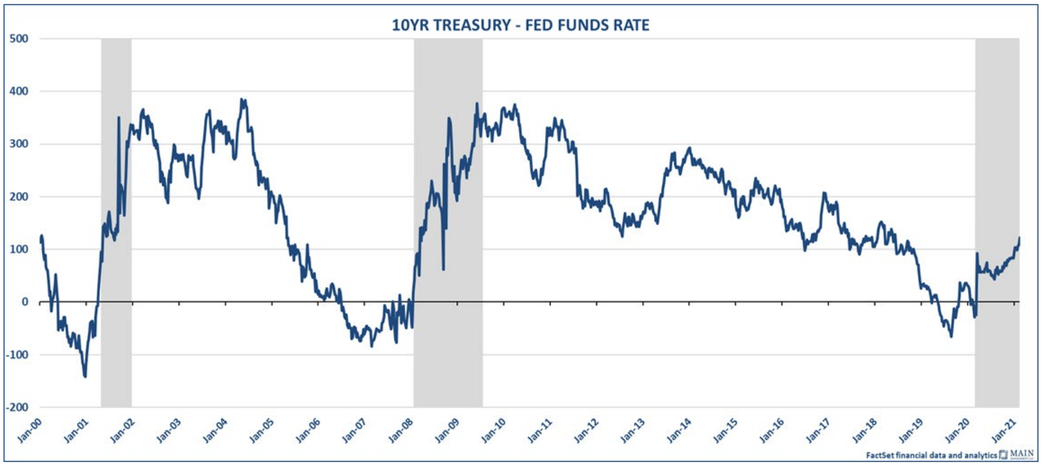

Figure 3. 10-Year Treasury Minus Fed Funds Rate.

Potential Plays for Inflation:

1) Gold doesn't like rising real rates (real rates, 30 Year US Treasury, are +11bp vs -45bp in Aug 2020 at the lows/10-year real rates are still negative).

2) Value stocks relative to growth stocks generally respond positively to bottoming real rates, and are turning higher. Current situation=VLUE/SCHV=2.6% yield=dividend CAGR 7+%.

3) Energy stocks (Larry Fink hates them due to his ESG/Climate Change/Millennial/etc), but at 2.5% of SPX, oil +26% YOY vs XLE flat YOY=4.3% yield=opportunity.

4) Financial Stocks: Net Interest Margins are lowest since 1984…yes 1984 (2.68% 3Q20 vs 3.5% in 1Q19) but yield 1.65% and price to book 1.5X have rallied from below 1x BV. European Financials (EUFN)=1.3% yield (German 10 year -22bp, so +150bp vs US +15bp) and 0.85x P/B=opportunity (forward P/Es ½ of the market) and earnings revisions positive.