Market Strategy
by STRATEGAS A BAIRD COMPANY

BAIRD
Private Wealth Management

Market Gauge
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GAUGE TO NEUTRAL AS RISK VS. REWARD DYNAMICS SHIFT

Every quarter, we sort 16 building blocks of market strength into two categories: favorable to market conditions, or unfavorable. We use the difference between the two to gauge the overall environment for U.S. stocks. This most recent iteration shifted the weight from Favorable (+2) to Neutral (+0).

Favorable	Unfavorable
Administration	Budget/Trade Deficits
Corporate Earnings	● Commodity Prices
Economic Growth	Demographics
Fiscal Policy	Global Trade
Liquidity	Inflation
Monetary Policy	Sentiment
Technical Picture	Valuation
U.S. Dollar	War vs. Peace

● Newly Favorable ● Newly Unfavorable

WHY NEUTRAL?

For this update, we move back to Neutral as we downgrade commodities (oil, copper, grain, etc.), which have broadly and rapidly appreciated in price over the past few months. This will drive up inflation and could pressure both company profit margins (many of whom rely on commodities as raw material inputs into their products) and consumer wallets (rising gas and food prices, etc.). It wouldn't surprise us to see this move continue in the near-term.

Despite our Neutral weighting, we remain broadly optimistic. Economic growth, bolstered by housing and manufacturing, should remain an asset as the economy reopens and service industries rev up. The corporate sector has proven similarly resilient through the crisis, as evidenced by another strong earnings season in 4Q20. Liquidity, bolstered by historic fiscal and monetary policy, remains robust, and recent breadth data evidences broad market strength.

On the "unfavorable" side of the ledger, both valuation and sentiment remain a concern. Thus far, rising interest rates have challenged some of the more high-flying corners of the market—time will tell if the price weakness can help shake out elevated valuations and often-euphoric sentiment. Elsewhere, inflation remains a concern as the economy reopens, stimulus-boosted savings get spent, and supply-side bottlenecks pop up. The Fed will look past 2021, but will the market?

The Strategas Market Gauge is meant to be a snapshot of a moment in time, and not a predictive tool. See page two for more on our 16 building blocks, and what we look for to label each one "favorable" or "unfavorable."

HOW DO WE DECIDE HOW TO CATEGORIZE EACH BUILDING BLOCK?

Administration: Are the White House priorities market-friendly? How do they view taxes, regulation, trade/tariffs, etc.?

Budget/Trade Deficits: Are deficits growing or shrinking? Are they projected to grow or shrink over coming years?

Commodity Prices: Do commodity prices (e.g., gold, copper, oil) reflect economic growth or contraction?

Corporate Earnings: Are the earnings of U.S. companies growing? Are profit margins expanding?

Demographics: Is the demographic trend (population growth, average citizen age, worker-to-retiree ratio) positive?

Economic Growth: Did GDP grow or drop in the previous quarter? Are leading indicators rising or falling?

Fiscal Policy: Are the major policy initiatives from the White House and Congress pro-growth and market-friendly?

Global Trade: Are current attitudes pro-globalization and free trade or pro-nationalism and protectionism?

Inflation: Is there price stability around the Federal Reserve's new target? Are we experiencing deflation or hyperinflation?

Liquidity: Is there more money or less money circulating in the financial system than there has been recently?

Monetary Policy: Are interest rates accommodative or tight? Are other central bank programs market-friendly?

Sentiment: Are investors broadly optimistic (a negative) or pessimistic (a positive) about the market?

Technical Picture: What is current price action telling us? What do market breadth, trend, and momentum look like?

U.S. Dollar: Is the dollar strengthening or weakening versus other world currencies? What are the factors causing the move?

Valuation: Do stocks look expensive or cheap vs. historical averages?

War vs. Peace: What do the world's geopolitical tensions look like? Are they inhibiting global economic growth?