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Astra Ventures

Recession? Inflation? Both? Possible Economic Scenarios and Strategies to Trade Each

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RECESSION? INFLATION? BOTH?

**POSSIBLE ECONOMIC SCENARIOS
AND STRATEGIES TO TRADE EACH**



ASTRA VENTURES

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MANAGEMENT TEAM

➔ Ed Lalanne - Chief Investment Officer



Experience

- Tse Capital Management (NYC) – Investment Analyst for a \$1 billion+ global macro hedge fund
- Bloomberg (NYC)
- Macro Risk Advisers (NYC)
- Lehman Brothers (NYC)

Education

- MBA – Kellogg School of Management at Northwestern University (2008)
- BA – Dartmouth College (1999)

Interesting Facts

- Avid sailor: competed on a top-10 nationally ranked team in college
- Sailed across the South Pacific for six months
- Married to Natasha Lalanne
- Has 1 daughter (Julie Mae Lalanne)

 @edlalanne

➔ Stephen Buehler - Founder, Chief Operating/Compliance Officer



Experience

- Blackstone (NYC) – Managing Director & Chief Operating Officer of a \$9.5 billion business within the hedge fund division
- Merrill Lynch (NYC)
- KPMG (Memphis)
- Arthur Andersen (Memphis)

Education

- MBA – Kellogg School of Management at Northwestern University (2008)
- BA/BBA – Mississippi State University (2000)

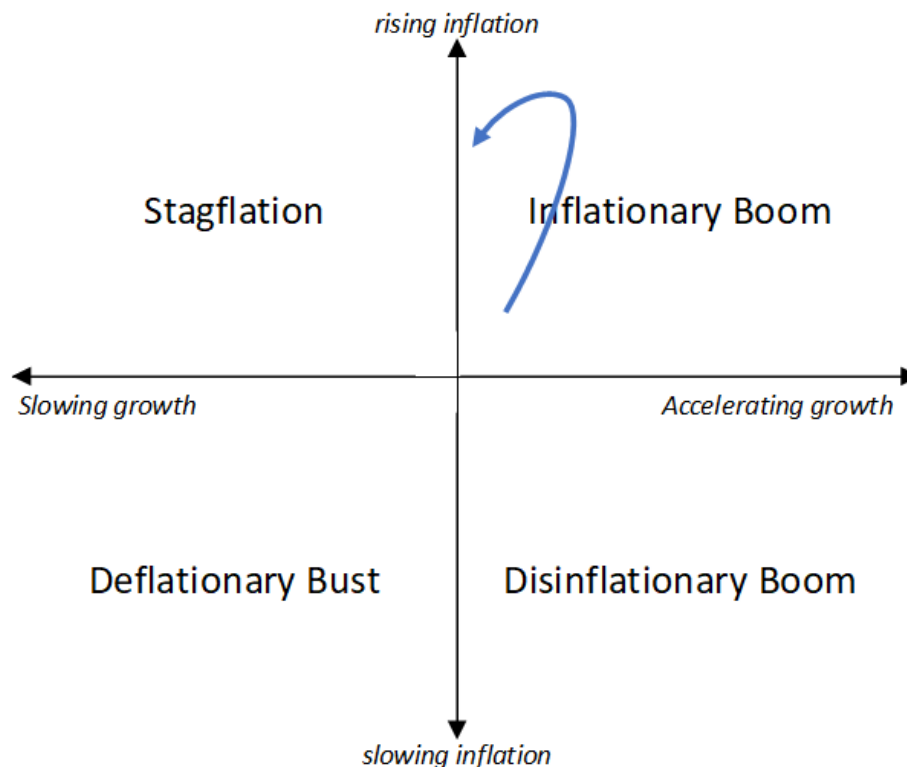
Interesting Facts

- SCUBA on Great Barrier Reef & ran with bulls in Pamplona, Spain
- Named one of the "Top 100 Graduates in First 100 Years of MSU's College of Business"
- Married to Jennifer Stieber Buehler
- Has 1 daughter (Bethany Maria Buehler)

 @stephen_buehler

COMPLEX SIGNALS / SIMPLE FRAMEWORK

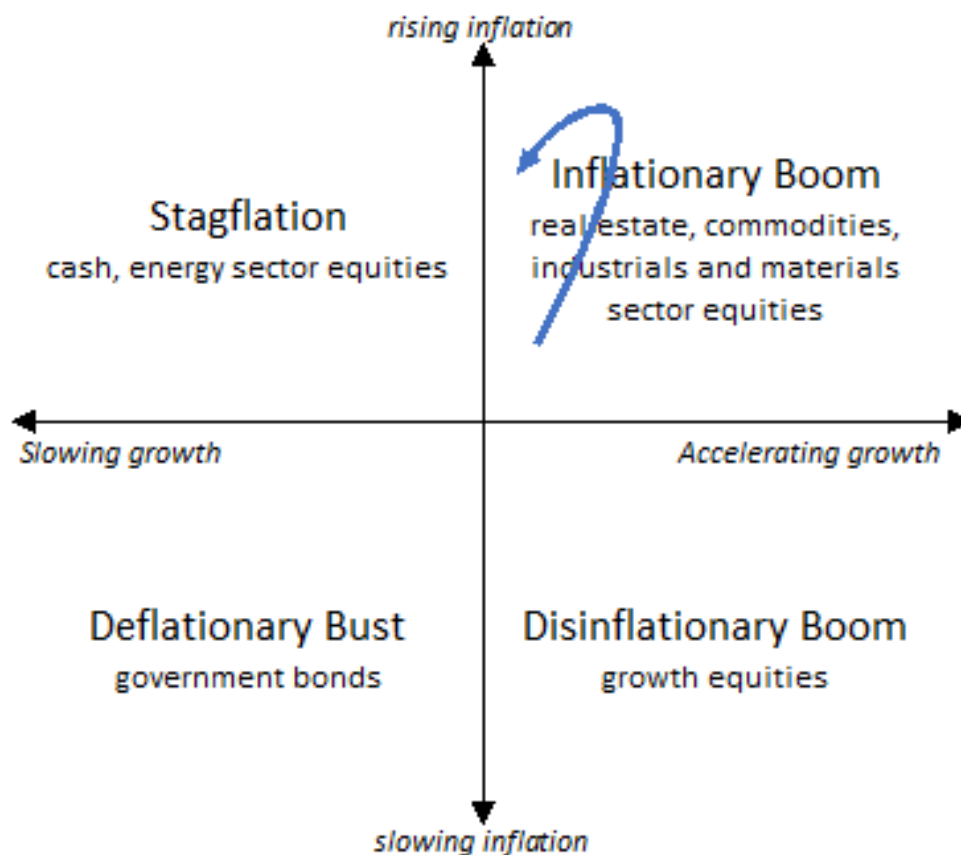
- Markets are focused on two paramount uncertainties – **inflation** and **growth**
- The comparative trajectory of both could determine the market regime over the next 18 months
- The below is the popular “**four quadrants framework**” with inflation on the y-axis and growth on the x-axis



Using the terminology of this framework, we have been moving from the **Inflationary Boom** quadrant towards the **Stagflation** quadrant over the past several months

COMPLEX SIGNALS / SIMPLE FRAMEWORK

- We now overlay traditional asset classes that, historically, have performed well in each regime.



However, **no cycle is the same** and this one clearly has unique features due to the pandemic. There are also alternative strategies to consider

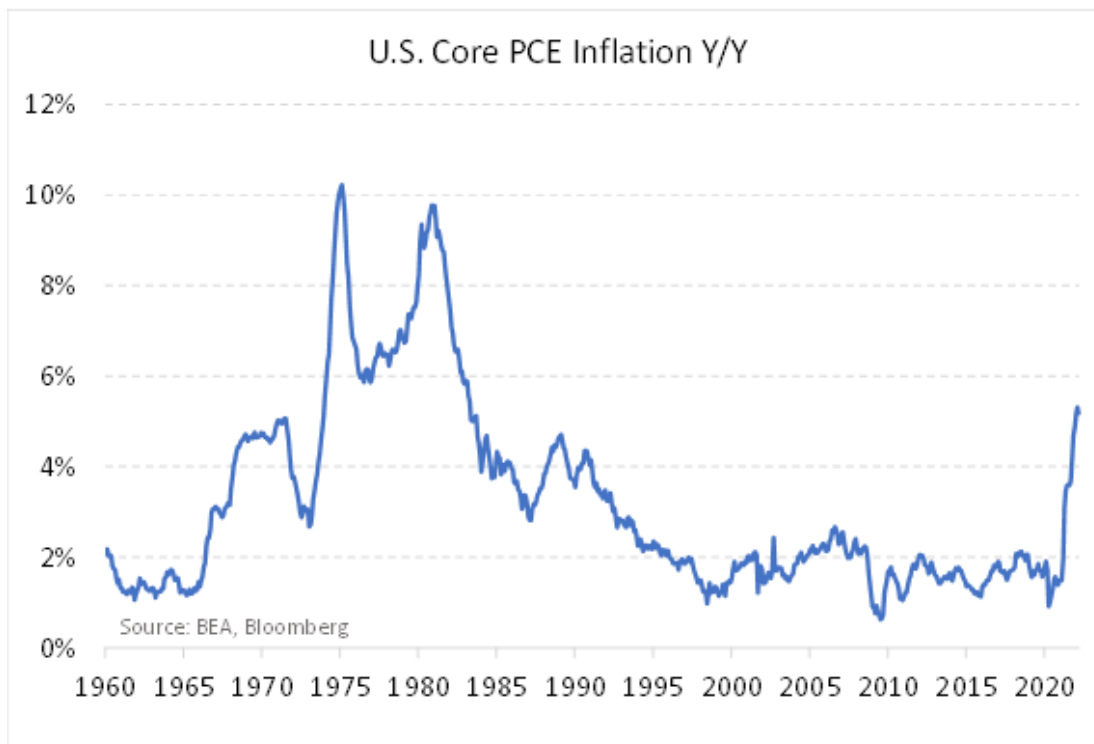
BACK TO THE TWO UNCERTAINTIES - INFLATION AND GROWTH

There are two major outcomes for **inflation** in the near term

1) Inflation is persistent – core PCE remains around 4.5% or higher into the fall months

2) Inflation declines steadily – core PCE drops below 4.5% by September and below 4.0% by January

- In a prior webinar, we shared the most important metrics relevant to today's inflation persistence – **rents** and **wages**. We outlined the early warning signals for rents and wages we believe are most important.
 - For **rents**: home prices, home sales inventory, mortgage rates, rental vacancy rates, and average hourly earnings.
 - For **wages**: job quits rate, job openings, unemployment rate, and employment to population ratio



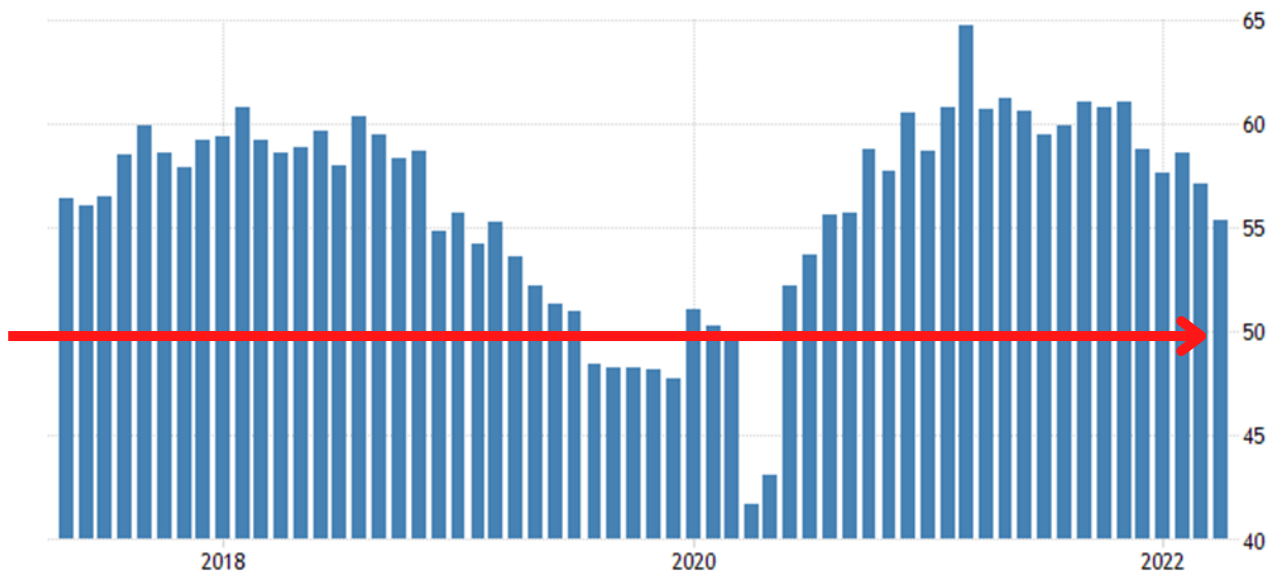
BACK TO THE TWO UNCERTAINTIES - INFLATION AND GROWTH

As for **growth**, the investment strategists at Blackstone have noted that, historically, three markers are instructive in predicting a near term recession (1)

- 1. U.S. ISM Manufacturing PMI declines below 50**
- 2. U.S. corporate profit growth turns negative**
- 3. U.S. unemployment rate increases vs. previous 12-month low**

US ISM Manufacturing PMI

(Measured 0-100
> 50 is expansion
<50 is contraction)



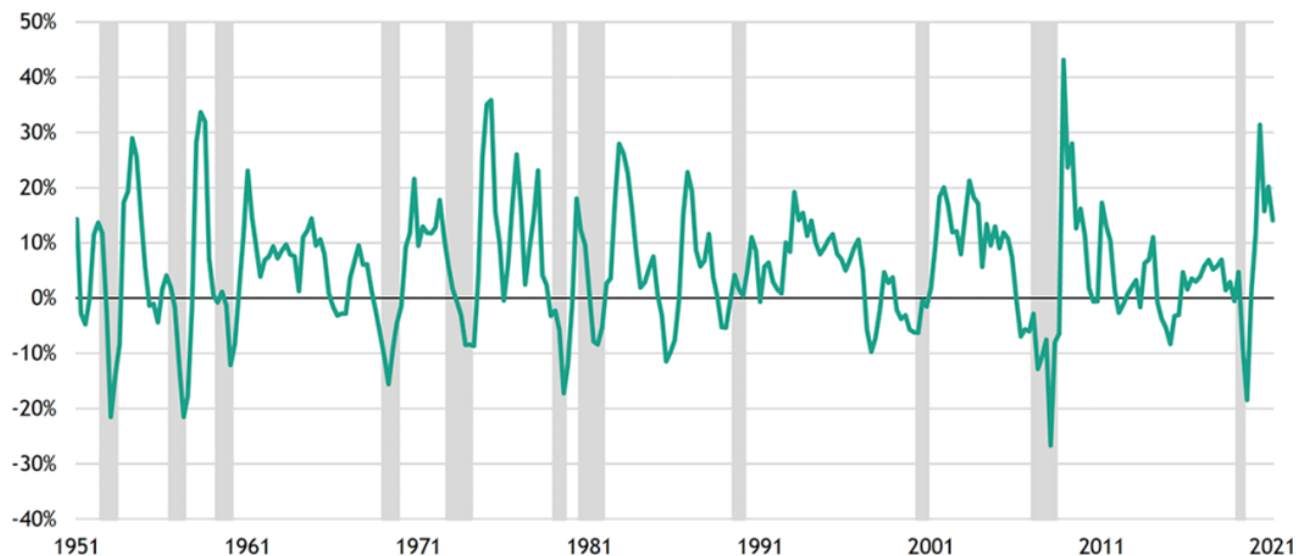
(1) <https://pws.blackstone.com/education-insights/article/joe-zidle-longer-runway-for-growth-and-inflation/>

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US Corporate Profit Growth
(YoY change)



Source: Blackstone Investment Strategy and Bureau of Economic Analysis, as of December 31, 2021. Represents corporate profits before tax with inventory valuation and capital consumption adjustments.

(1) <https://pws.blackstone.com/education-insights/article/joe-zidle-longer-runway-for-growth-and-inflation/>

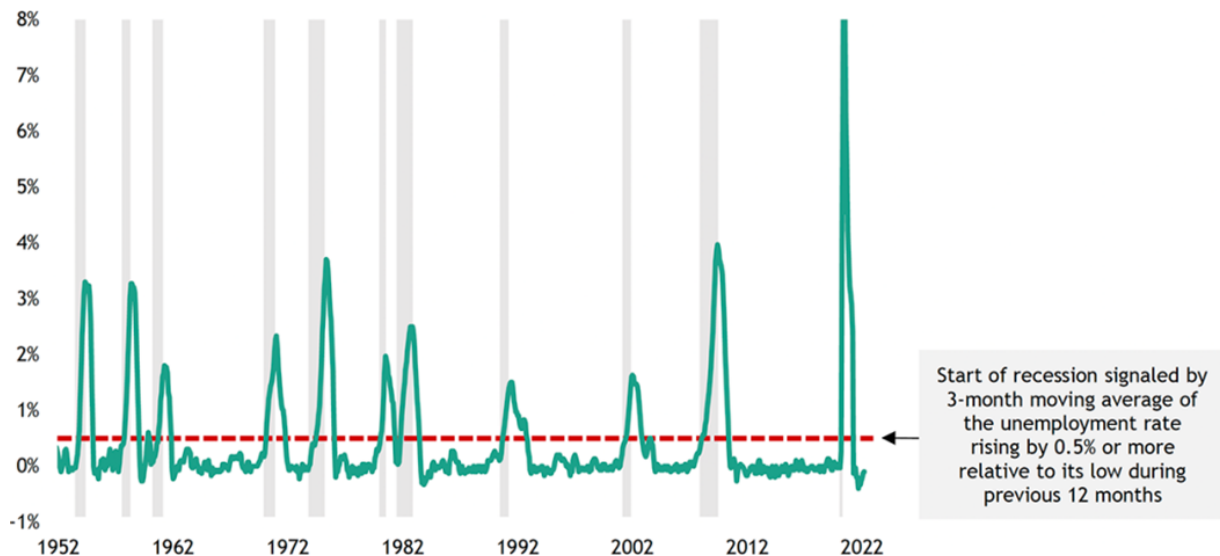
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Sahm Rule Recession Indicator

(3-month moving average of the unemployment rate, relative to its low during previous 12 months)



Source: Blackstone Investment Strategy, Bureau of Labor Statistics and Claudia Sahm, as of March 31, 2022.

(1) <https://pws.blackstone.com/education-insights/article/joe-zidle-longer-runway-for-growth-and-inflation/>

SCENARIO ANALYSIS

Our **baseline scenario** is as follows:

- 1)** The economy shows signs of strength with continued robust hiring, moderating inflation, and eventually a bump from China exiting COVID lockdowns

 - 2)** At some point later this year or early next year, the persistence of inflation becomes apparent even as we move past the peak year-over-year inflation readings. The Fed guides further interest rate increases to slow the economy even more

 - 3)** The Fed is successful. Inflation declines to a viable path back to the 2% target, and a soft landing for the economy is achieved
-
- **Risks to base case** include companies guiding down earnings expectations for 2Q more severely, a further decline in PMI surveys, a sharp slowing in the labor market or the housing market, or an escalation of the war in Ukraine

 - **Recession scenario:** diverges from the base case at point #3. The Fed is not successful in engineering a soft landing, and recession follows

 - **Bull scenario:** diverges from the base case at point #2. Instead of showing persistence in coming months, inflation declines steadily

SCENARIO ANALYSIS

Market strategies for **base** case scenario

Traditional assets:

- cash
- high grade corporate bonds
- energy sector equities
- when nearing point #3, shift into growth equities

Macro discretionary approach:

- **Bonds:**
 - short Eurodollars targeting Fed policy at end-2023
 - flatten position when nearing point #3
 - short 10Y bonds
 - flatten position at point #3
- **Equities:**
 - consider long equities at point #1
 - shift to neutral or short equities at point #2
 - shift to long equities at point #3
- **FX:**
 - long USD vs yen, euro
 - shift to short USD at point #3

SCENARIO ANALYSIS

Market strategies for **recession** case scenario

Traditional assets:

- cash
- government bonds
- defensive equities including healthcare, staples & utilities

Macro discretionary approach:

- **Bonds:** long 10Y bonds, flatten position when recession is fully evident
- **Equities:** short until recession is fully evident, then shift to long equities
- **FX:** neutral, then short USD vs yen, euro & emerging market currencies at start of recovery

Market strategies for **bull** case scenario

Traditional assets:

- growth equities

Macro discretionary approach:

- **Bonds:** short 10Y bonds, flatten position at point #2
- **Equities:** long equities
- **FX:** short USD vs yen, euro & emerging market currencies

SUMMARY TAKEAWAYS

- ➔ Evaluating uncertain times through a simple inflation/growth framework is helpful
- ➔ We believe inflation could persist longer than many think
- ➔ We do not yet see the markers of a recession in the near term
- ➔ Investors should prepare for a variety of scenarios in the event that their baseline projections do not play out

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THANK YOU

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