JULY 2021

INFLATION AND CONSUMER SPENDING

KNOCKOUT CAPITAL

PREPARED BY:

Kiyoko Osone

WHERE WE ARE NOW

DOVISH MONETARY POLICY

While we currently experience a dovish monetary policy contributing to risks of high inflation, there is little to no overheating risk with ample economic slack and a fading fiscal impulse. Concomitantly, there is little to no zombification risk from increase in interest rates as size of said companies are much smaller than crisis of 1990.

While there have been major concerns whether the economy will essentially overheat as that the stimulus is much greater than what is actually necessary, these concerns are unwarranted as there is much greater economic slack than accounted for. Thus there is only slight inflation and not an offshoot off of the Fed's target. The Fed will start tapering asset purchases in 4Q21, with progress towards a steeper hike in 1Q23 (Jan Hatzius, Goldman Sachs).

The most recent hike in bond yields is due to economic recovery from the pandemic in contrast to the 2013 Taper Tantrum shock from Fed policy which is yet to occur when hikes announce.

Future economic outlooks must balance the crucible of veering towards negative interest rates if pandemic conditions exacerbate and the tightening of monetary policy.

During periods of economic recovery, value stocks do well within the circular business cycle as the intrinsic underlying will rebound as the economy improves. A meaningful rise in inflation expectations therefore typically triggers a reasonable degree of rotation in leadership towards more Cyclical and Value-oriented companies (Peter Oppenheimer, Goldman Sachs). Technology and materials will experience a sharp upturn due to exposure in economic growth. Due to the low interest rates, buoyed consumer behavior lends to more purchasing power Figure (1). Lastly, in periods of excess reflationary backdrops, commodities and non-U.S. securities may be a means of hedging against risk. On average, reflation favors equity exposure as companies expand.

As aforementioned, Hatzius's sentiments indicate the current 6% unemployment contributed to a greater drop than the 3% GDP the Congressional Budget Office (CBO) estimates.

GDP FORECASTS

CONSUMER BEHAVIOR

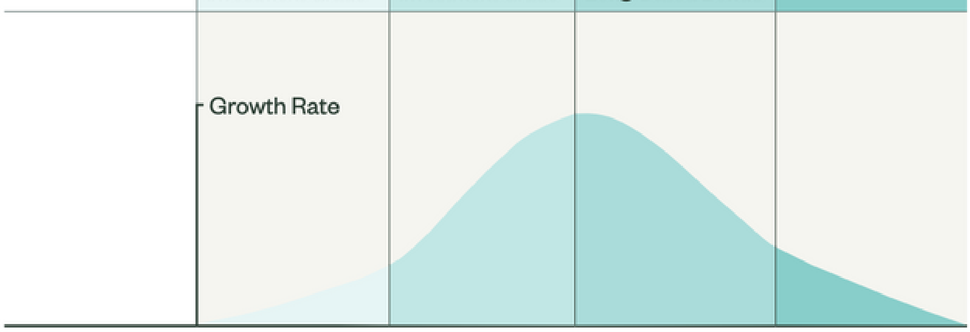
By Okun's law, swings in output gaps tend to exceed unemployment gaps by a factor of two, so it should be 12% drop, but this is offset by the weakness concentration in labor intensive sectors. Healthcare industries in public markets will continually perform strongly in the near future while in the long term view consumer discretionary will revive.

Due to the larger than expected spending of stimulus provisions, U.S. consumer markets project strong recovery. Morningstar reports reflect Goldman Sachs sentiment that Feds will have no issues taming inflation rates if subject to off-shooting. We forecast consumer behavior to evolve from consumption of nondurable and durable goods to services and media. The growth of in person services will lag in comparison to media, as openings of travel and restaurants will be contingent on COVID-related tailwinds.

An exemplification is Morgan Stanley analyst ratings of Zendesk (NYSE: ZEN) as overweight. Due to projected recovery in travel, growth in partnerships, and positional displacement of competition via legacy enterprises and green field technologies, Zendesk is positioned for steady growth. An example of an undervalued company is Roku Inc. (NASDAQ:ROKU). Market sentiment underestimates Roku's capaciousness to scale, as Over the Top (OTT) is a novel space as consumers navigate to long-tail publishers of niche and targeted content.

Figure (1)
Best performing asset classes in business cycles

	Recovery	Expansion	Slowdown	Contraction
Sectors	**Materials** Real Estate Technology	Consumer Discretionary Industrials Technology	Utilities Real Estate	**Consumer Staples** **Heathcare** Utilities
Smart Beta	Small Cap Value Large Cap Value	Small Cap Small Cap Value	Low Volatility Quality Dividend	Low Volatility Quality Dividend
Fixed Income	High Yield Investment Grade	**High Yield** Investment Grade	**High Yield** **Long-Dated Bonds**	Treasuries



Source: State Street Global Advisors, Bloomberg Finance L.P. The above diagram is for illustrative purposes only. Assets in bold represent those that scored well across *all* evaluation criteria, whereas assets in normal typeface represent those that scored well on the majority of the evaluation criteria.

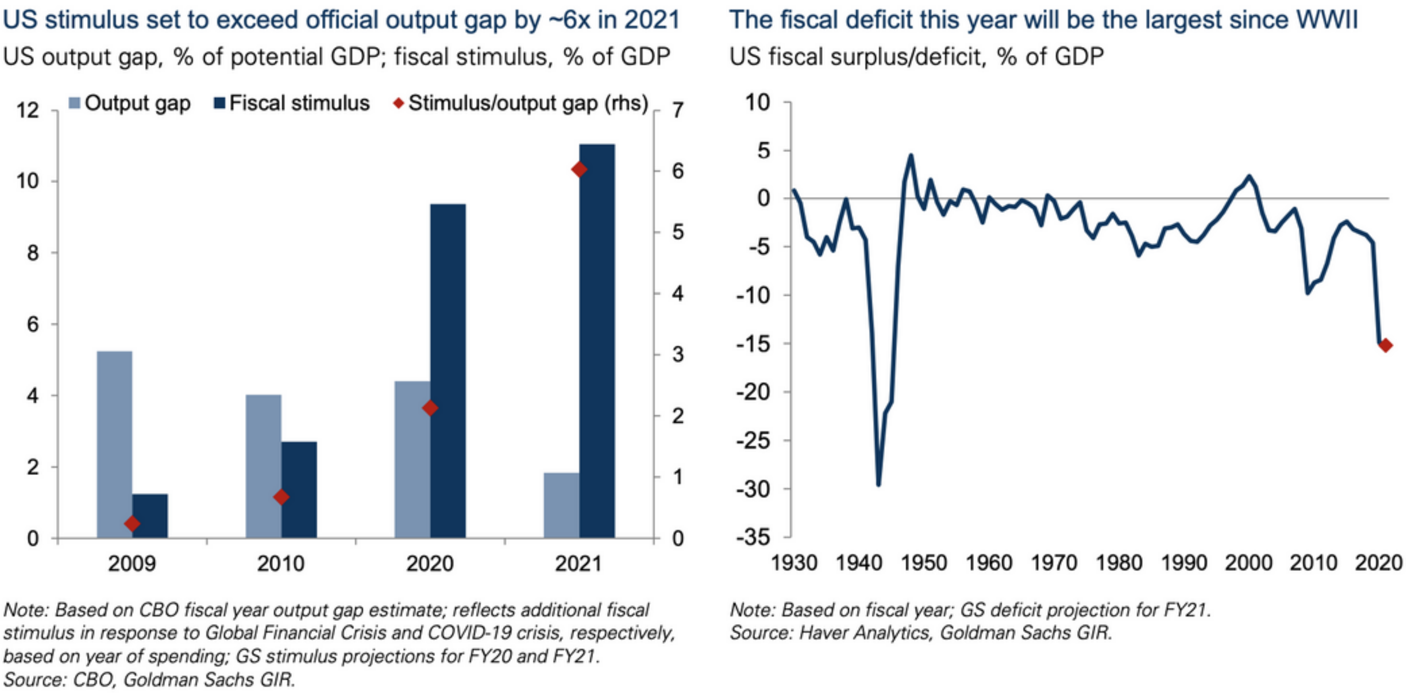


Figure (2)

Upshoot in Fiscal policy, exceeding GDP and deficit since WWII

HEDGES AGAINST INFLATION AND THE WEAK DOLLAR

Gold and rare metals are seen as hedges against the increasingly weak dollar due to fiscal spending Figure (2) and Figure (3). The largesse of this rationalization is the utility value of said commodities, such as gold in electronic chips. Other hedges are luxury goods, art, and bitcoin as a store of value as perceived value does not diminish in climes of inflation.

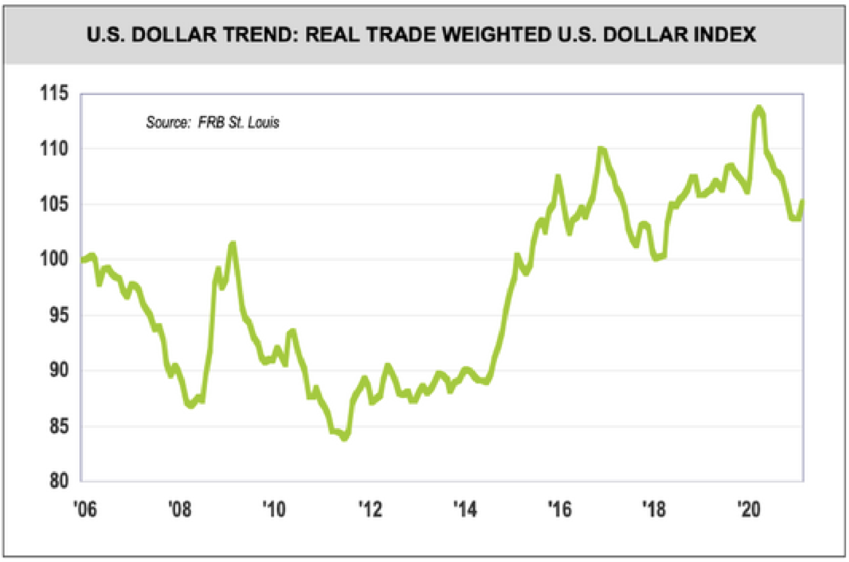


Figure (3)

Weakening sentiment in U.S. dollar

MCDONALDS: SLOW, STEADY GROWTH WITH INNOVATION AND GOLDEN ARCHES

What redefines brand value is association, as Mcdonald's (NYSE:MCD) scores rollout with Famous Orders and partnership Kanye, Keith Urban, and BTS. McDonald's blurs the line of private and public markets with curation of its own innovation hub, McD Tech labs in Silicon Valley. McD invests in AI to optimize recommendations via its drive-throughs menus, and recently acquired Apprente, a voice recognition platform to more accurately serve customers with capaciousness to detect accents and goal of replacing human workers. CFRA maintains an annually projection as overweight from 235 to 250 on annual earnings, Morgan Stanley at 259. Defensive stocks tend to perform regardless of market conditions.