

# ECONOMY

## Job Creation Trumps Inflation in Fed Realm

THINK STRATEGICALLY:

# The Powerful Force of Stock Rotation

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## Stock Rotation Analysis and Portfolio

One of the market constants is that as markets move up or down—particularly during times of an exogenous shock, such as from the pandemic—there is often a tidal wave that makes the markets change course. A stock rotation is a strategy used to capture returns from market cycles and improve the diversification of a portfolio over a defined time period.

While we continue to see the mostly positive returns from the Dow Jones Industrial Average, S&P 500, Nasdaq Composite and the Birling Puerto Rico stock index, we note that underneath the veneer, a large portion of stocks are experiencing one of the most comprehensive stock rotations since the pandemic took hold.

As we have discussed many times, Wall Street lives in the future, and it has long been preparing for a sustainable economic recovery that began in 2021 and will take us beyond 2023. Most investors are divesting from those stocks that primarily benefited from the pandemic and transitioning into those stocks most impacted by the pandemic.

For example, among the many cyclical sectors are banks, airlines and car rental companies. On May 14, 2020, we invested in 12 stocks that would

represent a reasonable basis for stock rotation. We want to discuss the performance and results of the individual stocks after reaching the first anniversary of our Stock Rotation Portfolio.

### Ranked by total return:

1. Avis Budget Group (CAR)
  - Stock Price on 5/14/20: \$11.90
  - Stock Price on 5/14/21: \$86.82
  - Price Increase/Decrease: \$74.92
  - Total Return: 629.7 percent
2. Tesla (TSLA)
  - Stock Price on 5/14/20: \$160.67
  - Stock Price on 5/14/21: \$589.74
  - Increase/Decrease: \$429.07
  - Total Return: 267.1 percent
3. Delta Airlines (DAL)
  - Stock Price on 5/14/20: \$19.38
  - Stock Price on 5/14/21: \$46.31
  - Increase/Decrease: \$26.51
  - Total Return: 139 percent
4. Morgan Stanley (MS)
  - Stock Price on 5/14/20: \$37.81
  - Stock Price on 5/14/21: \$87.35
  - Increase/Decrease: \$49.54
  - Total Return: 131 percent
5. Caterpillar (CAT)
  - Stock Price on 5/14/20: \$106.19
  - Stock Price on 5/14/21: \$242.23
  - Increase/Decrease: \$136.04
  - Total Return: 128.1 percent
6. Goldman Sachs (GS)
  - Stock Price on 5/14/20: \$174.45

- Stock Price on 5/14/21: \$368.77
  - Increase/Decrease: \$194.32
  - Total Return: 111.4 percent
7. JP Morgan Chase (JPM)
    - Stock Price on 5/14/20: \$87.52
    - Stock Price on 5/14/21: \$164.01
    - Increase/Decrease: \$76.49
    - Total Return: 87.4 percent
  8. Alphabet Inc. (GOOG)
    - Stock Price on 5/14/20: \$1,356.13
    - Stock Price on 5/14/21: \$2,316.16
    - Increase/Decrease: \$960.03
    - Total Return: 70.79 percent
  9. Apple Inc. (AAPL)
    - Stock Price on 5/14/20: \$77.39
    - Stock Price on 5/14/21: \$127.45
    - Increase/Decrease: \$50.06
    - Total Return: 64.7 percent
  10. Facebook (FB)
    - Stock Price on 5/14/20: \$206.81
    - Stock Price on 5/14/21: \$315.91
    - Increase/Decrease: \$109.10
    - Total Return: 52.73 percent
  11. Microsoft (MSFT)
    - Stock Price on 5/14/20: \$180.53
    - Stock Price on 5/14/21: \$248.15
    - Increase/Decrease: \$67.62
    - Total Return: 37.46 percent
  12. Amazon (AMZN)
    - Stock Price on 5/14/20: \$2,388.85
    - Stock Price on 5/14/21: \$3,222.90
    - Increase/Decrease: \$834.05
    - Total Return: 34.91 percent

As you can see from the overall results of the Stock Rotation Portfolio, the changes in value in some of the stocks were largely made up by others in the portfolio, which had a total return of 140.29 percent; these returns highlight the power of structuring a diverse portfolio of stocks in several market segments and industries.

### Week in Markets: Inflation Fears Drive Markets Down. What should we make of it?

After being on a decade-long holiday, inflation made its entrance, seen through one of the most significant increases in the consumer price index, which rose 4.2 percent compared with April 2020 and 0.8 percent more than in March this year. As inflation showed, the market reacted negatively, delivering three consecutive losing sessions and raising market

volatility significantly. While analysts and economists had projected price increases, how much they rose was a surprise. The core index rose 0.9 percent from March, which is the most significant month-to-month increase since 1981, or three times more than estimated. As big of a development as this rise may sound, we believe there are unique pandemic-related components that will further explain these price increases; at this time, we do not see inflation becoming an issue for the economy.

### What is driving prices up?

- As the economy reopens, there are widespread shortages that are driving prices higher. There are significant asymmetrical imbalances of supply and demand resulting from pandemic distortions, temporarily in our view.
- We are monitoring wage growth to determine if price disruptions will continue beyond the third quarter (3Q).
- While unlikely, should inflation rise over the next few months, there will be increased volatility, but the bull market will continue.
- We are monitoring wage growth to determine whether price disruptions will continue beyond 3Q.
- While unlikely, should inflation rise over the next few months, there will be increased volatility, but the bull market will continue.
- Rising shortages of supplies and manufacturing cannot keep up with pent-up demand. Many companies in the S&P 500 have reported a lack of manufacturing materials across many industries. This is limiting production and driving prices up for a vast amount of consumer goods. With most companies having reduced both capacity and inventories last year in anticipation of an extended recession that never occurred, the supply is only now catching up with demand.

Automobile manufacturers were forced to pare down production because of the widespread computer chip shortages. U.S. automobile manufacturing shipments dropped \$7.29 billion in December and \$5.94 billion in April, an 18.51 percent reduction. The result has

been that used-car prices rose 10 percent in April. This increase makes up 33 percent of the rise in the consumer price index. To make matters worse, demand for cars surged with the multiple rounds of stimulus checks.

We believe most of these bottlenecks can be resolved in the coming months, while others, like the chip shortage, could take some time but likely will not persist. Demand will eventually fall back, and supply will catch up.

The U.S. stock markets have grown significantly since the pandemic-induced shock. We recommend investors review their portfolios to make reallocations and invest selectively in those sectors that will benefit most from the current economic recovery.

### Final Word: What is the Roadmap the Federal Reserve Bank Will Take to Inflation Surprise?

Last week's sudden inflation rise came not only as a surprise but a nasty one for the Federal Reserve. While we do not foresee sudden changes in the Fed's policy and expect it will keep interest rates low until the United States reaches full employment, the elusive recovery of U.S. jobs is far from being achieved and will be the principal focus of the Fed's actions and will drive its policies.

However, if inflation rises further, the Fed may be forced to act. So far, we believe the Fed will continue its easing course of total support of the U.S. economy to aid the recovery.

The Fed stated it would continue to monitor the implications of incoming information for the economic outlook. The bank is prepared to adjust its monetary policy stance if risks emerge that could impede the Fed's goals, including assessments of information on public health, the labor market, inflation pressures and expectations, and financial and international developments.

Much more to come.

*Francisco Rodríguez-Castro is president and CEO of Birling Capital LLC. Think Strategically© is a publication by Birling Capital LLC that summarizes recent geopolitical, economic, market and other developments. This report is intended for general information purposes only and does not represent investment, legal, regulatory, or tax advice. Recipients are cautioned to seek appropriate professional counsel regarding any of the matters discussed.*

Weekly Market Close Comparison	5/14/21	5/7/21	Return	YTD
Dow Jones Industrial Average	34,382.13	34,777.76	-1.14%	12.34%
Standard & Poor's 500	4,173.85	4,232.60	-1.39%	11.20%
Nasdaq Composite	13,429.98	13,752.24	-2.34%	4.20%
Birling Puerto Rico Stock Index	2,659.59	2,626.76	1.25%	30.05%
U.S. Treasury 10-Year Note	1.63%	1.60%	1.87%	0.62%
U.S. Treasury 2-Year Note	0.16%	0.14%	14.29%	0.75%