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"And so castles made of sand

Slips into the sea eventually"[1]

Predictions for 2022 - A cloudy vision of a volatile future.

January 21, 2022

The following are the Exclusive and Sole Opinions of the Author.

At the outset of 2022 the market tide is running out – fast. More of the beach has been exposed and the detritus is everywhere. What does the coming year hold? Is there any "normal"? Or even a new normal? Things seem to be falling into place – emphasis on falling.

The future: Real economic growth slows faster than expected, inflation is higher and more persistent than expected and popular discontent is expressed in an historic wave election.

2022 is the third year of the Covid Pandemic. The course of the disease and the effects on the world remain uncertain. Far beyond the scope of these predictions, except to note that is now obvious to all, the American economy is far less dominant and independent than before the ascendancy of China. Their economy is also weak, if not worse. So still number one.

2020 was a year of extreme fear and uncertainty. Confronted by a plague, the world went mad. Emotions were stoked to a fever pitch by sensationalist media and governments working hand in glove and exacerbated by an over-the-top presidential campaign. Covid response went from dealing with uncertainty to shutdowns and school closings. The economy stopped functioning for much of the country as freedom of movement and association were limited by government attempts to control the virus. Investors correctly realized sentiment could not get worse, that this was not an extinction event. After bottoming in March, the stock market soared as fear was replaced with confidence in the hereafter, we'll be here - after the plague and panic are gone.

[1] "Castles Made of Sand" is a song written by Jimi Hendrix and recorded by the Jimi Hendrix Experience for their 1967 second album, Axis: Bold as Love.   https://en.wikipedia.org/wiki/Castles_Made_of_Sand_(song)

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2021 began with a strong economic recovery and ended with roaring inflation and a peaking economy. Once again, an economic "emergency" resulted in enormous, excessive and wasteful government intervention. Massive borrowing and spending added fuel to the fire of the Covid recovery.

Government policies led to increased demand and reduced supplies, so inflation soared. The public attributes the inflation to failed government policy and no longer supported further intervention by the yearend.

The Year Ahead

As 2022 begins, growing evidence suggests that **Omicron is inescapable and generally mild**. (It is important to realize that the more dangerous Delta remains in circulation.[2]) This lucky turn of evolution becomes widely accepted, giving rise to an explosive market rally, sometime during the first quarter of 2022 - despite soaring inflation, rising interest rates and Permanent Covid Stress Disorder. **The effects of the economic and psychological harm from repeated waves of Covid is no more transitory than the soaring inflation.**

After new record highs, inflation eases slightly in late 2022 or early 2023 – possibly an exponential peak. The contribution from Homeowners' Equivalent Rent to the inflation index has lagged home prices and rents, substantially under reporting inflation. The catch up will support continued high inflation readings. Inflation expectations are now firmly embedded, as these and many other cost increases are discovered by experience. Consumers know prices have gone up and expect the prices to keep rising. Prices don't just rise, they leap, the changes are many percent at a time.

Stuck between a rock and a hard place, the **FED tries some of each to slow inflation** – ending monthly purchases (printing of money), open market operations, and shrinking the balance sheet at the FED.

Inflation and the accompanying economic "slow down" (stagflation) is once again understood to be the result of following Modern Monetary Theory. Debts never need to be paid, as long as they can be refinanced is a true statement. It does not follow that borrowing in ever larger amounts, without the apparent intention or possibility of paying down the debt is without malign consequences in the real world. The lower the chance of repayment, the higher the cost of the debt, once the government stops printing money to fill the gap. The FED needs to explicitly reject Modern Monetary Theory to restore their credibility.

As a result, Interest rates rise – although the hawkish tone of the FED minutes is likely to be muted soon by loss of economic momentum. Interest rate forecasts are like the weather, right more than wrong – sometimes. **1.25%, 2.5%, 3.5% - one year, ten year and thirty year look like maximums in 2022 to me** and assumes economic growth moderates – modestly. Beyond 2022 – rates could rise to levels that lead

[2] New data released on Tuesday shows that while omicron remains the dominant variant, delta — which is the more severe strain — is still a worrisome driving force behind the current surge. https://www.npr.org/2021/12/28/1068643344/cdc-omicron-covid-19-delta-revise-estimates

to a significant economic contraction. Thus far the equity markets are viewing the increases as necessary and limited, not much worried that the interim rise in rates will reduce economic growth significantly.

The economy is slowing, forecasters agree on the direction but not the pace of deceleration. The Omicron surge is confounding analysis. Each unexpectedly weak result is met with one or another explanation. Everything is transitory, until the evidence compels reappraisal and the paradigm shifts. The decline in growth has momentum – and a recession will soon be a real possibility early in 2023.

Going from 6% to 2% growth within 12 months ***is*** falling off a cliff, it will not feel like a soft landing. The stock market is unmoored from traditional analysis, but not the economy, and eventually moves lower as the economy slows. P.E. ratios contract as expected earnings growth falls or fails to materialize. **Lower ratios and lower earnings are a double whammy for equities**.

Many stock prices have dropped sharply, beyond the handful of market leaders. **Investors should not be shocked when the leadership joins the decline and valuations revert to "normal"**. A handful of these market leading companies are truly exceptional, almost all are overvalued, and many will never grow into the bubble-like valuations. Recall that successful businesses evolve. Disruptive becomes conventional, then mundane, going from an idea to a business generating free cash flows and returns to investors.

Specific throws of the dice:

Stocks end the year lower, despite a rally near year end as **the outcome of the 2022 midterms exceeds expectations**. The return of divided government is initially seen as beneficial.

Value outperforms growth. Dividends are once again important.

Interest rates go up, the course tempered by political considerations. The rapid rate of interest increases only slows the return to bond investing, as an alternative to stocks. **TINA[3] has left the building**.

Energy continues to attract investors. Making money is more important than ESG. Portfolio exposure doubles or even triples on the back of the strong performance in 2021. $100 oil and $4.00 Natural gas are baked in the cake, higher if the economy remains buoyant.

The bear market in some alternative energy sectors comes to an end. The cream floats to the top – **EVs take a back seat** to the "mundane" utility like companies.

Real estate holds its own in the rising rate environment – they aren't making any more of it – unlike crypto currencies or NFTs.

Gold dethrones cryptocurrencies as the faith investment of choice.

An Omicron relief rally in the first quarter and a Congressional Election/Year End rally are bookends to a difficult market in 2022.

[3] **T**here **I**s **N**o **A**lternative to stocks


$COMPQ Nasdaq Composite INDX
21-Jan-2022 12:15pm
Open 14046.22 High 14171.72 Low 13857.56 Last 14002.99 Volume 2.5M Chg -151.03 (-1.07%)
$COMPQ (Daily) 14002.99
MA(50) 15405.50
The deterioration in the second order indicators is far worse than the price action. Once again the declines have been rapid and widespread leading to an oversold readings.
$NAA200R 19.24 (20 Jan)
NASDAQ percentage over 200 day moving average
The current readings are approaching the March 2020 lows!
$NAAD -11473.00
NASDAQ Advance Decline Line
$NAHLW -877.00 (14 Jan)
NASDAQ High Low differential

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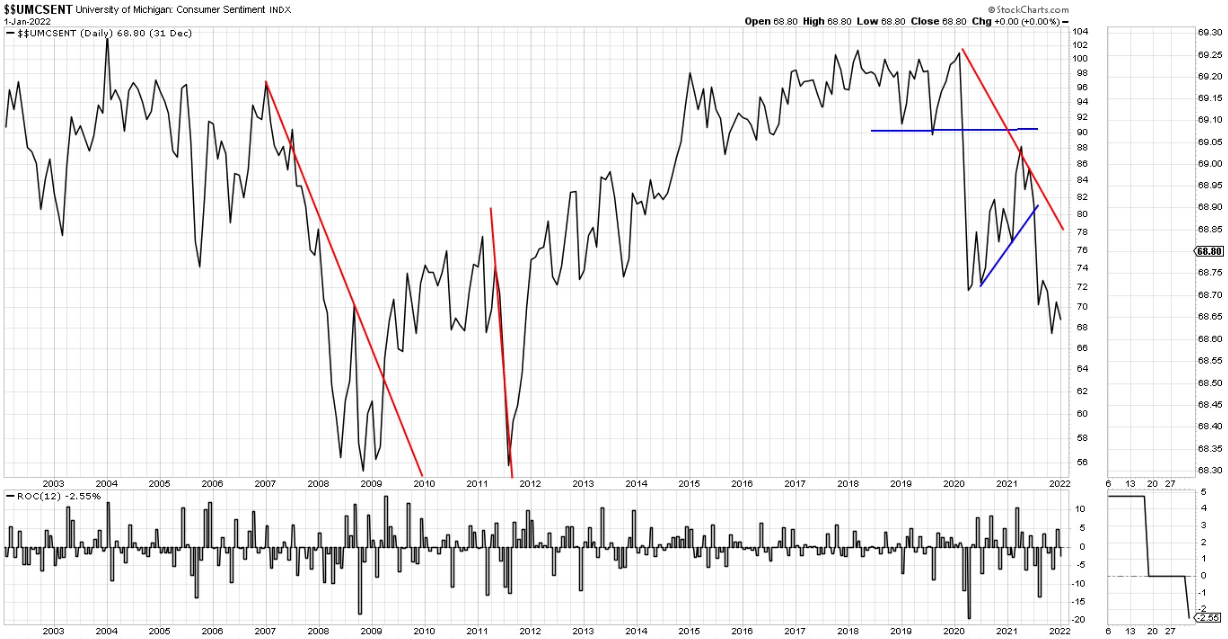

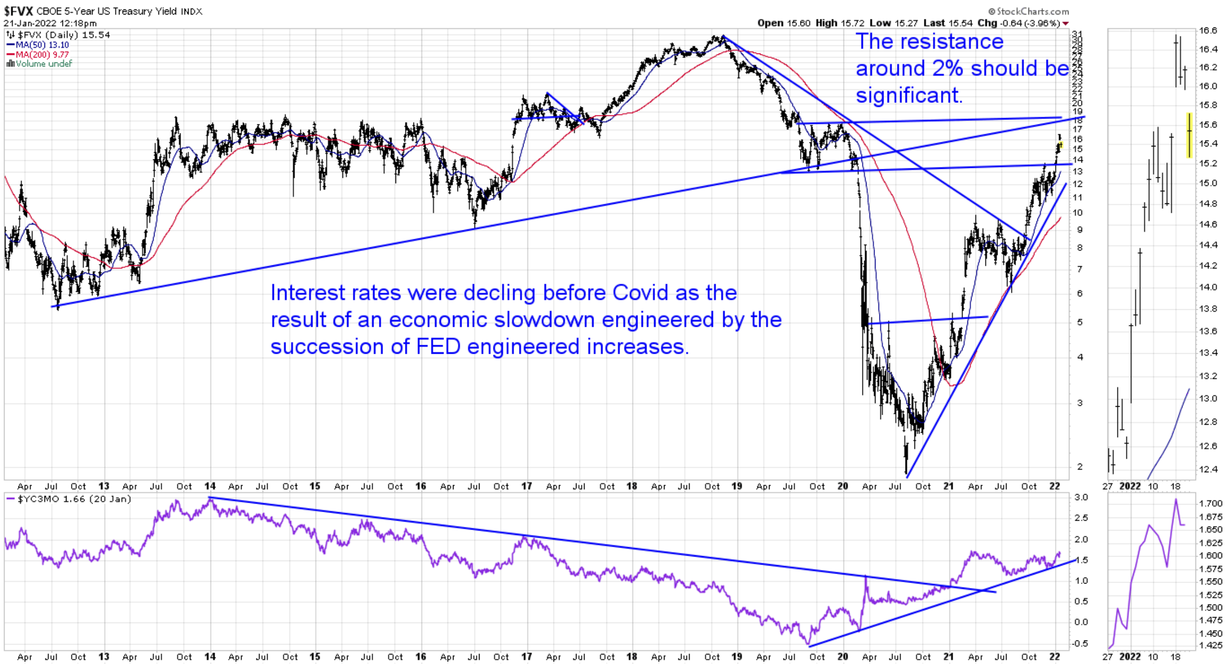

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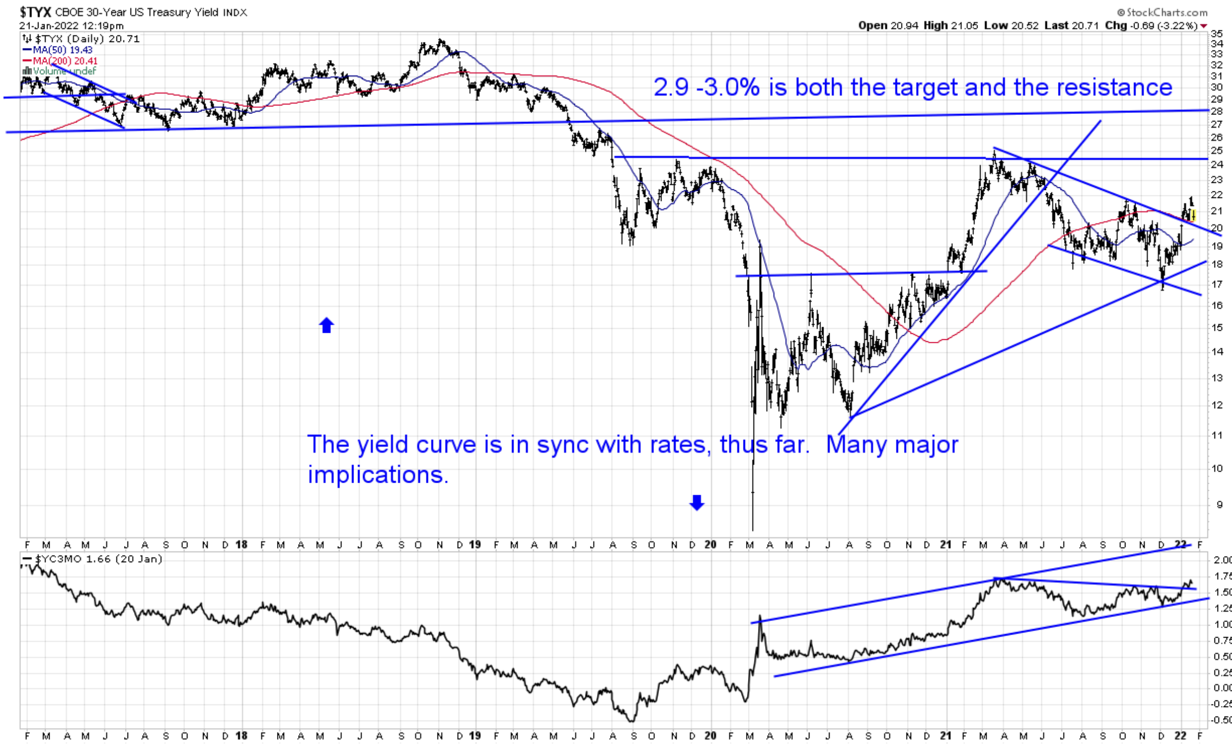

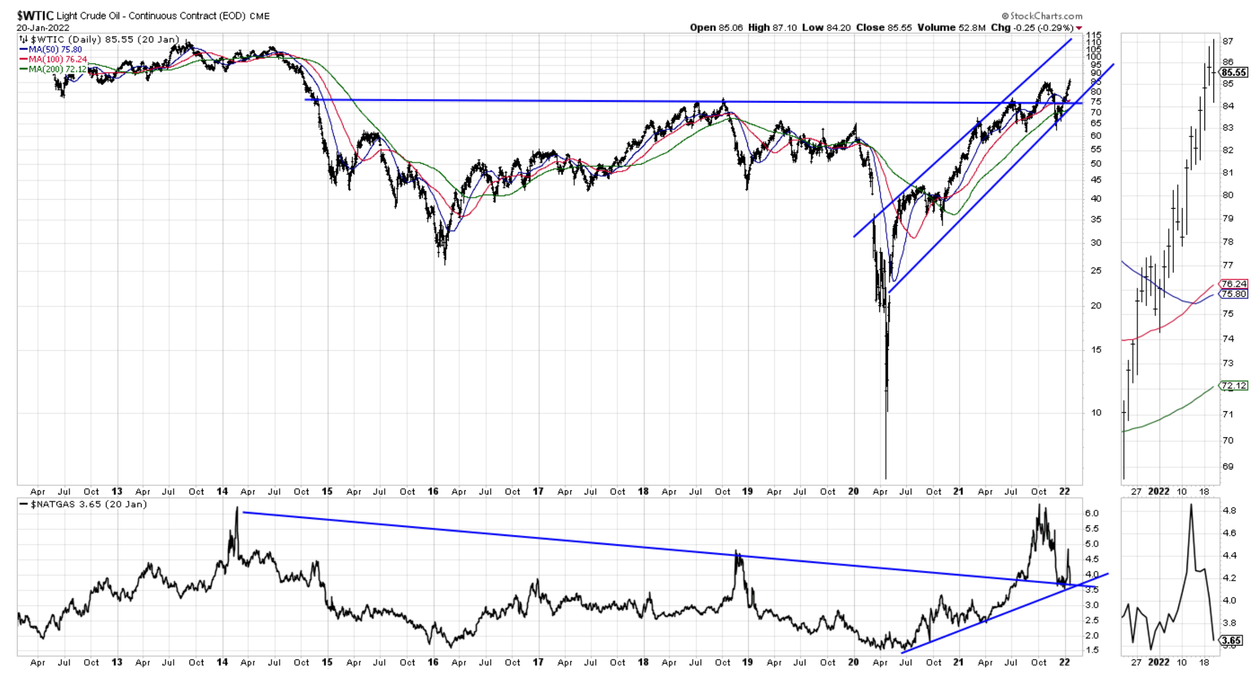

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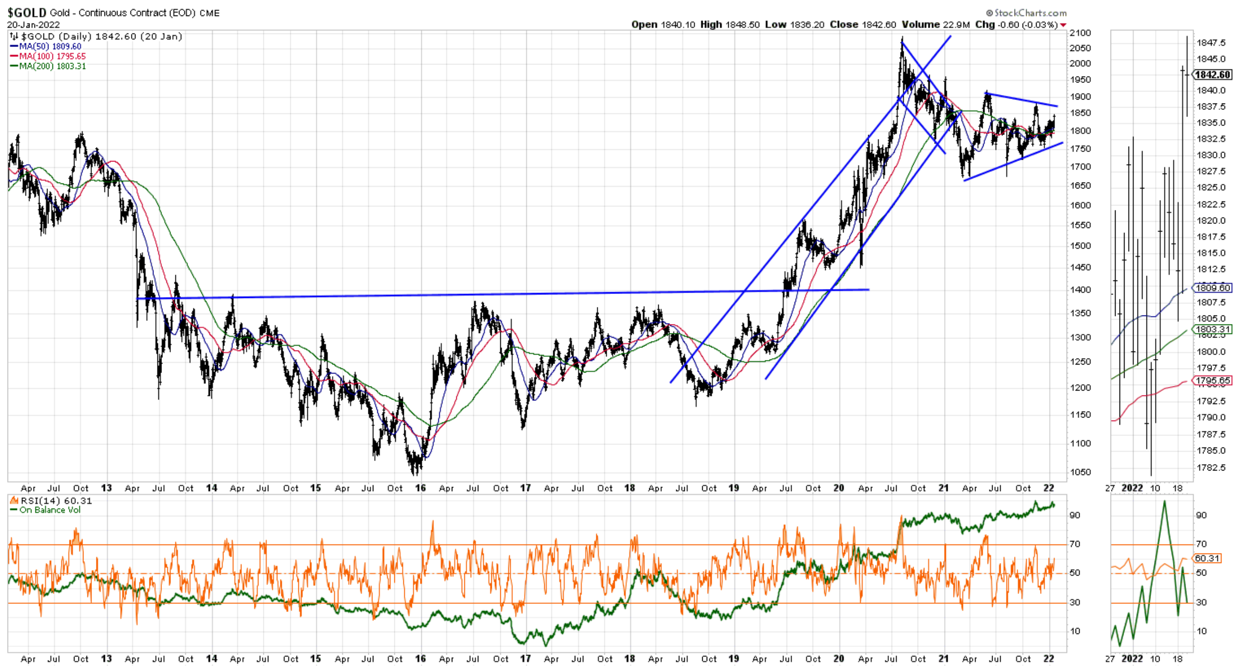

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