Talbot Asset Management Random Report

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Hello It's Me

"Hello it's me. I've thought about us for a long long time. Maybe I think too much but something's wrong." These are the first three lines of a classic 1972 song by Todd Rundgren. I was graduating junior high school in Urbana, Illinois at the time. Although the song was about breaking up with a girlfriend, the initial three lines have been constantly running through my head recently. I have tried to get a newsletter out to give you my thoughts. I have written about six newsletters and things are changing so rapidly that new items develop before I can get timely information out. "Maybe I think too much but somethings wrong." It seems that every week brings new developments that have some degree of investment implications. It is tough to have a high degree of conviction when the cross currents are changing so rapidly. Usually in that environment, my motto of "when in doubt, raise cash" kicks in. Therefore, I'm going to give you a variety of current thoughts. These are my observations of a variety of scenarios that have investment implications.

The X's and O's

As you know, I base a lot of my investment decisions off of technical analysis which uses various charts. Most of my risk analysis revolves around point and figure charting which uses X's and O's to determine whether demand is in control (the X's) or supply is in control (the O's). This strategy can be used in almost every investment asset class from stocks, bonds, commodities, cryptocurrencies, etc. Simply put, it monitors supply and demand and allows me to monitor risk levels in all different asset classes. It is a tactical approach to investing which dynamically changes all of the time. Since February of 2021, those X's and O's have been sitting around the 50% level. This means 50% of the stocks on the New York Stock Exchange are on buy signals and 50% are on sell signals. This means things have been neutral and/or been very rotational in nature. I have mentioned multiple times in the past that I let the markets dictate my strategy, rather than trying to dictate a strategy to the market. Since February, my stance has been fairly neutral….until recently.
In the last few weeks, demand has moved higher and the X's started to turn more positive. That was making sense at it would coincide with the seasonality of the markets. November through April usually are the best time of the year for stock investing due to end of year bonuses, pension plan payments and then next year IRA contributions. The odds of this cash going towards money market funds or bonds is probably pretty slim, thus creating more demand. However, a potential new Covid variant came out of left field right before Thanksgiving prompting a market sell off that moved the indicators back to neutral. Although the initial reports of the "Omicron" variant doesn't appear to be as severe, it prompted a sell first, ask questions later scenario. Thus, right now the X's and O's are back to a neutral position.

Inflation...

Inflation is the elephant in the room. Today's inflation is the result of fiscal and monetary policies. For inflation to roll over we would need to see a shift in the fiscal/monetary policies in the world's major economies. Odds of that happening right now: zero. No government anywhere is going to step on monetary and fiscal brakes to the degree necessary to curb inflation right now because of the shock it could send to the economic system. Milton Friedman once said, "Inflation is always and everywhere a monetary phenomenon in the sense that it is and can be produced only by a more rapid increase in the money than in output." In my last newsletter, I pointed out the rocket launch of the money supply. Right now, Milton Friedman's analysis has proved correct and the current inflationary trends are probably here to stay for awhile and in fact could increase.

In fact, the inflation numbers are currently WORSE than the 1973-1975 inflation numbers (source: The Federal Reserve Bank of St. Louis). The Federal Reserve has publicly declared the inflation is "transitory". In my opinion, that is gobblygook. If inflation is staying for a while, the investment implications are completely different than what we have seen over the last several years. Value stocks will probably do better than growth stocks. Companies that can raise prices to compensate for higher costs (including labor costs) should perform better than companies that can not raise prices to offset that. Inflation sensitive stocks, including commodities, should outperform.

The types of companies that would do better are not the ones you get excited to talk about at cocktail parties. Instead of software companies, think fertilizer. Instead of cell phones, think soybeans. And think oil…….

Oil...

Unfortunately, the Biden Administration has done everything in their power to make oil prices go up. On their first day, they cancelled the Keystone Pipeline (thus making existing pipelines more valuable). They then banned new leases on federal lands including Alaska. Just last week, they proposed a 20-year ban on any new drilling in New Mexico. They rejoined the Paris climate accord which outlines that oil companies need to be carbon neutral by 2050. To accomplish this, most oil companies would have to have a NEGATIVE growth in the number of wells drilled. This means no new drilling of wells and probably results in their excess cash being returned to shareholders. Then in May, in a very quiet move, they added the Lesser Prairie Chicken to the Endangered Species list. Even though a court order in 2015 noted the species was not endangered, the Administration put it back on the table for addition to the list and invited public comment. Where does the Lesser Prairie Chicken live you ask? In the Permian Basin of Texas where a good amount of US oil is drilled. Adding this to the Endangered Species list will prevent new drilling for probably years as environmental studies would have to be undertaken.

There is currently a big supply disruption at the same time demand is accelerating. Oil at $100 a barrel is not unrealistic (currently at $80 a barrel) or higher. Natural gas prices have also skyrocketed. Some economists are saying it could cost you 50% more in heating costs this winter.

Wages and the Work Force

Everywhere you look you see help wanted signs. You don't see anybody talking about raising the minimum wage to $15 anymore. Covid changed the workforce. The widely known federal jobless benefits played a big part in keeping workers out of the workforce. Some economists calculated that federal benefits combined with rent relief equated to almost $100,000 in compensation. It's an interesting economic quirk -if you pay people not to work….they usual don't work.

However, other factors are in play. Covid pulled the curtain back on the education industry. According to Barron's Magazine, almost <u>two million</u> mothers have dropped out of the workforce to home school their kids. According to First Trust, almost 4 million people have taken early retirement and another 2 million retirees who took part time jobs to stay active have opted not to return to work due to Covid. The remaining workers will be demanding increasing wages to meet rising costs of shelter, groceries, and other household expenses. According to Geoffrey Sanzenbacher, an economics professor at Boston College, Covid caused at least 15% of those over the age of 62 to retire compared to a normal environment of 10%-12%.

The investment implications of this are numerous. Labor costs will lower profit margins of companies unable to pass through prices increases. Automation will advance quickly, especially with robotics. Companies have also discovered interesting benefits of Covid…..McDonald's has discovered it is much more profitable to not have indoor dining so don't be surprised if newer McDonald's locations are redesigned without indoor dining.

Supply Chain Disruptions

Is the breakdown in global supply chains due to Covid? Probably not….it has more to do with more regulations in the shipping industry requiring ships to cut sulfur dioxide emissions in 2020 along with new permit rules for long haul truckers. Los Angeles has labor issues as well as they have various union rules that don't allow owner operator truckers to pickup loads from the various ports.

Is the semiconductor shortage caused by Covid? Probably not….the semiconductor issue has more to due with the US-China trade war than Covid. And unfortunately, China is winning this war. Since most semiconductors have been made in China or Taiwan, the trade disputes with China have prompted a slowdown in supply to the U.S of semiconductors. You will eventually see more semiconductor factories built in the US but that's a 2–3-year process. In fact, yesterday Ford just announced a major deal with a semiconductor manufacturer to build a plant as soon as possible to exclusively supply semiconductors in the US for Ford. Until then, don't expect anything that has a semiconductor in it to be readily available (or at a price you like) anytime soon.

Follow the Yellow Brick Road

You're off to see the Wizard, the Wonderful Wizard of Oz. You'll find he is a Whiz of a Wiz if ever a Wiz there was. If ever, oh ever, a Wiz there was the Wizard of Oz is one because, because, because, because, because, because. Because of the wonderful things he does. You're off to see the wizard, the Wonderful Wizard of Oz. The recently passed "Infrastructure Bill" in Congress reminds me of the song "Follow the Yellow Brick Road" from the 1939 classic movie "The Wizard of Oz."

The Interstate Highway System was first mentioned in a Bureau of Public Roads to Congress in 1939. <u>SEVENTEEN YEARS</u> later President Dwight Eisenhower signed the Federal Aid Highway Act of 1956 to create the Interstate Highway System we know today. Historians consider it his most important accomplishment of his two terms in office. This infrastructure project had SPECIFIC goals and objectives and was widely supported by the American people.

Congress recently passed and the President signed a $1.2 trillion infrastructure bill. Of the 1.2 trillion, only $550 Billion appears to go towards infrastructure. The money will be allocated to various government agencies to be distributed to various entities. No one knows what projects will get done. Transportation Secretary Pete Buttigieg in a news conference basically said they are still trying to figure out where to spend the money. In the 2008-2009 infrastructure bill passed by President Obama, it was widely known the jobs were not "shovel ready."

I have a friend who does business with a large American steel company who would be a major supplier of steel for anything infrastructure. He told me his client has orders to run their facilities 24 hours a day, seven days a week. Sounds great!

However, they only have enough workers to run one eight-hour shift, five days a week.

The moral of this story….just because you have a yellow brick road of money doesn't mean the Wizard of Oz can make it happen.

Interest Rates…

Five minus 1.5 equals 3.5. If inflation is five percent and interest rates are 1.5 percent, your purchasing power loses 3.5 percent a year. For long time readers of my random reports, you know I haven't been a fan of bonds for quite some time. It doesn't take a PhD in mathematics to understand the numbers behind this. John Templeton told me years ago, when you have inflation, you would rather own the grocery store than the mortgage on the grocery store. In a higher inflation environment, you will either lose purchasing power or your principal, or both in the bond market. In the past, advisors suggested a 60% stock and 40% bond portfolio to have a balanced portfolio. This rule of thumb is probably dead. As I have mentioned in the past, the biggest risk is probably in bonds as the 40-year bull market in bonds is over. In all likelihood, interest rates should gradually rise over the next few years to compensate for the higher inflationary forces and increased government spending. Federal Reserve Chairman Powell is up for reelection in February. Any meaningful rise in interest rates will probably occur after that.

What keeps me up at night?

There is an old saying on Wall Street that says, "Don't confuse a bull market with brains". This was so obvious in the 1980's when people got hooked on trading penny stocks (as shown in the movie "The Wolf of Wall Street") or in the 1990's with the dot.com era. The thing that makes me nervous is not my indicators but the bullishness and/or complacency that is prevalent right now with people that have very little clue in what they are doing. With online apps that almost create an online casino for small and unsophisticated investors to use….it usually works…until it doesn't. Some of the online groups that promote risky stocks and cryptocurrencies are almost cult like. When I talk to individuals, I know who are buying some of these, I usually ask, "Why do you own it"? And the answer almost always is, "Because everyone else is buying it". If you ever play craps in Vegas, everyone usually plays the Pass Line and then they keep pressing their bets until eventually the shooter craps out. It's the most entertaining game in the casino as long as the shooter keeps avoiding the 7. Usually when you see so much bullishness in the stock market with unsophisticated investors, I just have a gut feeling that someone is going to roll a 7 at some point.

Annual Reviews...

As more regulations continue to trickle down from the "never worked in finance" regulators in Washington, D.C, they are requiring annual reviews on all of our managed accounts. I manage close to 250 managed accounts all over the United States and a few foreign countries. We have already begun having these discussions as we talk to clients on a normal basis. However, we are starting to put together a schedule for these annual reviews. Nancy and/or Sam will be reaching out over the next few months to schedule a time for us to chat about your accounts. If we have had recent conversations and/or met in person, then we are good for a while.

During our discussion, we will need to update your accounts if there has been any change in your objectives. As a refresher, I manage funds with the following investment objectives: Wealth Preservation, Growth with Income, Medium Growth, or Aggressive Growth. We will discuss whether your risk tolerances fall into the following categories: Conservative, Moderately Conservative, Medium Growth, Moderately Aggressive or Aggressive.

I will also need to know any income needs or other changes. Any life changing events, such as a new grandchild, retirement, etc. will also be on the agenda. These reviews can be done by phone or via zoom (preferably zoom so I can share my screen for illustrations). I would also hope that local clients can come by the Talbot Asset Management World Headquarters.

Health Plan One-Medicare

If you are one of the fortunate ones that are providing job security to your local postal carrier by having your mail box stuffed with daily mailers to sign up for Medicare, then you may want to think about calling Health Plan One. The transition to Medicare from an individual or group health insurance plan is a very confusing task. The choices are numerous and are driven by many factors from your personal health, choice of doctors, financial considerations, and even zip code.

Raymond James has partnered with HPOne to help you navigate this maze of confusion. They are not part of Raymond James. They have been around since 2006 and have agents licensed in every state and have access to over 8000 different plans. They are committed to helping you find the most affordable coverage that fits your needs. They have a DEDICATED Raymond James Phone Number: 844-269-2346. It could save you a lot of time.

Big Ideas for 2022...

As we get closer to the end of the year, I will start getting tons of investment research ideas from various sources outlining their "Best Picks" for 2022. Some of the big investment opportunities in the future could come from what is called "Disruptive Innovation." I am seeing emerging opportunities developing in the following areas:

Deep Learning: Humans have historically programmed all software. Deep learning uses artificial intelligence to write software. By "automating" the creation on the software, this could turbocharge every industry.

Virtual worlds: You probably heard Facebook is changing their name to Meta. Meta is a virtual world. Besides interactions with each other through a virtual world including gaming, the ability to train people virtually could save billions of dollars.

Digital Wallets: Traditional banking is starting to get upended by virtual banking. They are penetrating everything from payments to lending.

Electric Vehicles and Autonomous Driving. As battery costs decline, electric vehicles will eventually approach sticker price parity with gas powered cars. According to ARK Investments, EV sales could rise from 2.2 million in 2020 to 40 million units in 2025. Autonomous ride sharing could also drop the cost of taking a taxi by 90% by 2030, spurring widespread adoption.

Automation: Covid has exposed a huge worker shortage… robots are coming. And quickly.

Drone Delivery: Lower battery cost and autonomous technology will deliver our packages, food and even people. This could transform shopping behavior.

Orbital Aerospace: I find this area one of the more exciting. Rocket and satellite cost declines are upending a bureaucratic industry that used to be concentrated in government projects. This will enhance global connectivity through expanded internet connections via satellites. Hypersonic point to point travel will be available. I have mentioned in past newsletters how Space X is working on hypersonic flights to go from New York City to China in 23 minutes. And lastly, rocket capabilities are evolving to where humans could go back to the moon and/or Mars and INHABIT it within 10 years.

3D Printing: This is a very exciting area as you can manufacture objects layer-by-layer and collapses the time between design and production. You can even build houses now using 3D technology.

These are just some on the interesting areas I'm coming across…..I'm looking forward to seeing what some of these analyst "Best Picks" are for 2022.

Late Night Revelations and Other Useless Information...

- The original six members of the Commodores were thrown together for a hazing ritual tradition at Tuskegee Institute (now Tuskegee University). They performed as freshmen in a talent show for upper classmen. The crowd went wild and they decided to continue as a group and became so popular around the Tuskegee bar circuit that they were asked to open for the Jackson 5 in 1971. The following year they signed with Motown and the rest is history.

- In the Barbara Streisand/Neil Diamond duet, You Don't Bring Me Flowers, Neil Diamond originally wrote the song as a 45 second song for a TV show that never was aired. He liked the 45 second version and added some instrumentals and performed it on tour. A year later, Barbara Streisand liked the song so much she performed it on one of her albums. A radio producer for @AKY-AM in Louisville, Gary Guthrie, was going through a divorce with his wife Becky. He noticed how Becky would cry when she heard Neil's song. When he heard Barbara's version, he decided to splice the versions together and play them on the radio as a duet. After he started playing it, it exploded in popularity and Neil and Barbara figured they needed to record it together and they did, which become one of the more popular songs all of time. As a side note: Neil Diamond and Barbara Streisand went to high school together where they were in the school choir together.

- If you want an interesting and unusual gift for Christmas or a birthday….try going to Cameo.com. You can get a personalized video just for you by your favorite stars. One of my favorite musicians is Meatloaf (it's a 70's thing) and my wife got me a video for my birthday last year of him singing me "Paradise by the Dashboard Lights" and for her birthday I got her cooking tips from Paula Deen (she doesn't need cooking tips….Paula is one of her cooking heroes). My buddy's daughter in law had Brett Favre of the Green Bay Packers announce to their son that they were expecting a baby…..How cool is that???

- As we get close to Christmas and you start dusting off that annual Christmas card list….the first Christmas card was sent in 1843 in London, England and was printed for a civil servant named Sir Henry Cole.

- Christmas wasn't actually a federal holiday until 1870. However, several states recognized it earlier with Alabama starting the tradition in 1836.

- Norwegian scientists (remember to always trust the science) have hypothesized that Rudolph's red nose is probably the result of a parasitic infection of his respiratory system (probably from Covid 7).

- According to data analyzed by Facebook (now Meta), the most popular time to break up for couples is two weeks before Christmas.

- Although Santa had Blitzen and Comet, male reindeers shed their antlers around Christmas, so the reindeers pulling Santa's sleigh are most likely females.

- President Teddy Roosevelt, who was an environmentalist, banned Christmas trees from the White House in 1901.

Notes from Nancy (Office Manager, RJFS):

We would like to take this time to thank you for choosing Talbot Asset Management to help you reach your financial goals. We appreciate each and every one of our clients and wish you and your families a wonderful holiday season and a Happy New Year!