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THE FED AND YOUR PORTFOLIO AS WE MAKE THE TURN INTO FALL

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WOW, has the summer flown by! My stay up at my "northern digs" is winding down. At least up here in northwest Wisconsin, the first signs of fall after a hot summer (even here!) are developing. And in the financial world, we were treated just over a week ago to the Federal Reserve's summer-end "picnic," albeit a *virtual* Jackson Hole one again this year.

Many had expected to hear from Fed Chairman Jerome Powell that the central bank's "Wonderland" I have spoken of might become a little more *real* sooner rather than later. Specifically—*especially* following the latest Fed minutes release (from the late July F.O.M.C. meeting) *and* given that pretty much every Fed head that spoke in the few days prior to Powell supported this—the expectation was that Powell himself would signal an *imminent* reversal of the Fed's current Q.E. policy: $120 billion monthly of *acknowledged* purchases of Treasury and mortgage debt.

But a "defiantly dovish" Powell, as one pundit aptly described him, did not deliver that in his speech Friday morning. **Indeed—while suggesting that the widely-expected "tapering" could still commence while the calendar says 2021—he even hedged on *that*.** Much as Joliet Jake Blues in the iconic movie "The Blues Brothers" did (in the scene where Carrie Fisher's character has him cornered at gunpoint in the underground culvert, wanting an explanation for why Jake stood her up at the altar) Powell continued to offer reasons real and imagined why he was in utterly no hurry to stop printing money.

In her commentary on Powell's Friday screed, ("Taper Time is on the way, Maybe. Powell sets the stage with Plenty of Caveats") *Barron's* Lisa Bielfuss wrote in that paper's new issue, "…every statement that could be interpreted as a sign that withdrawal of extraordinary monetary-policy accommodation is imminent *was caveated by a reminder of why it isn't*. At least for now…" (*Emphasis* added.)

"Powell was very articulate and emphatic. He did say that there have been times when the Fed had prematurely hiked interest rates and that had pushed inflation below the Fed's target in the past," pointed out another who was seemingly more in agreement with the implications of Powell further dragging his feet. **Yet the chorus—both within the Eccles Building and without—is beginning to get a bit louder that Powell is making a mistake**. To a great many Fed-watchers and economists—even normal Fed/bubble cheerleaders such as the Wharton School's Jeremy Siegel—Powell is borderline delusional in his "transitory" schtick on a wave of consumer/producer price inflation likely to be anything *but* that.

Then again, the Siegels of the word don't say that's *all* bad, since stickier inflation, they think, will keep the bull market in equities going. Fair enough, *at least to some extent*. But as I will argue below, this is one way of many that this current epoch is NOT the 1970's. With the Fed having *already* goosed things in an historically unprecedented fashion (as witnessed by the *doubling* of its balance sheet in less than a year and a half's time)…with Washington's fiscal policy adding more trillions to that…and with rapidly-growing signs that the "sugar high" of the recent past due to all this is wearing off…one can legitimately question just how much longer Powell's various bubble parties can last.

WATCH and LISTEN! *--In the recent past, Yours truly has added a LOT to this discussion of just how far the Fed can go before "breaking" something…lessons from history combined with modern "facts of life" and SIMPLE MATHEMATICS.*

*At right, I discussed a lot of these things with a few dozen of our folks at a dinner gathering in the Chicagoland area; that is available HERE. And not many days ago I updated a lot of this—**and especially discussed my RAPIDLY-increasing bullishness for gold again**—HERE with Trevor Hall at Mining Stock Daily.*

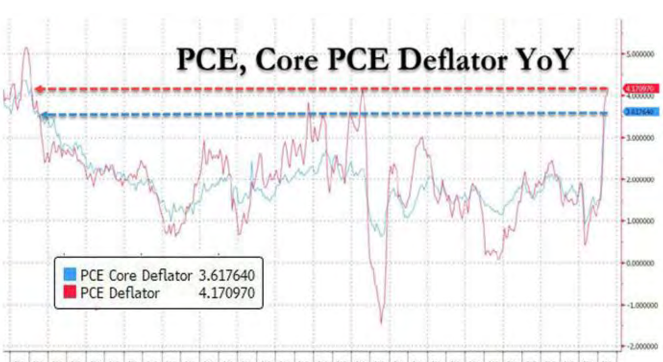
THE "TRANSITORY" INFLATION SCHTICK

In each of those above-referenced discussions (but especially as I discussed "The Flation Debate" for our folks in Lincolnshire back in the late spring time frame on my way north for the summer) I threw in *a little bit* with Chairman Powell and his dilemma. Eventually (as I describe farther along) **high prices *will* cure high prices *somewhat***. Yet this process will hardly be seamless; nor will it return America to the long, largely positive "disinflationary" trend that punctuated much of the last 40 or so years.

As I commented in one of my commentaries earlier this summer, the late Milton Friedman was correct when he once pointed out that "Inflation is always and everywhere a monetary phenomenon." What changed since the 1970's was not that there was *less* money printing. There has been progressively more…LOTS MORE; and especially since the onset of the Plannedemic, which in about 18 months' time now has seen the broad M-2 Money stock increase by about *one-third*.

What DID change over these years is the way in which the Fed figured out *how to drive this ever-increasing monetary inflation into asset prices as a first matter.* For the great majority of the disinflation trends of the last four decades, rising asset prices sopped up the monetary inflation. Further, they bolstered the "wealth effect" leading to ever more consumption.

But more so than at any time in the "Disinflation Era," the dam seems to be breaking that has kept all the money printing, etc. of recent years largely *out of* producer and consumer prices. Even the most understated (i.e.-manipulated) of the official inflation numbers—the Fed's favored PCE deflator—is at its highest level since 2008 (*right before*, I remind you, the deflationary crash that followed the Fed goosing markets too much back then.) The rate of change of the PCE recently has been the highest since 1983.



And, of course, the garden variety producer and consumer price rises that matter most to hoi polloi like you and I are likewise at *their* worst in a few decades.

Without a doubt, the supply chain issues which Chairman Powell inordinately focuses on *are* cause for *a portion* of this. But that is certainly not true with it all. *Powell himself knows this very well*, having once eloquently articulated the folly and ultimate damage done by the very policies he now is embracing more than any of his predecessors to date (for a recap of Powell's transformation as Fed chair, check out THIS ARCHIVED PIECE entitled "A Year in the Life of Fed Chair Jerome Powell.")

Dr.StrangePowell (Or, How I learned to stop worrying and Love the Bubbles)

Powell is getting by with all this for a few reasons, not the least of which is that **the great majority of economists and investment managers alive and active today have NO experience with or memory of a protracted period of inflation or stagflation**. Thus, markets are happy to ride ever higher among the bubbles a man who once eschewed them is happily blowing. They are—for now—willing to embrace Powell's Wonderland partner, Treasury Secretary Janet Yellen, who notably insisted a while back that we will never again see a debilitating market bust in our lifetimes.

So the average money manager—and the great majority of investors—have been all too happy to IGNORE what Powell himself once pointed out: **that DEFLATIONARY busts follow periods of too much monetary inflation and the resulting market speculation/bubbles *as a matter of simple mathematics* (and gravity!)**

Yours truly, for one, believes that enough of the price inflation pressures of recent times will *persist* to give us **an increasingly ugly, modern-day version of the STAGFLATION of the 1970's**. But unlike was the case in the 1970's, as I explained in my comments at our Chicagoland gathering back in May, the average American business and household will be MUCH less equipped and able to navigate this.

The undercurrent of the inflationary (money and prices) part of that equation will be bolstered if/as the government is able to continue adding zillions to the federal budget and debt. **The stagnation part of it will be when more and more businesses and consumers hunker down and are unwilling/unable to spend as they have been.** That latter is already occurring; and as the latest plunging consumer confidence figures show, the average *consumer* doesn't see inflation as transitory even if the average money manager and central bank-fawning pundit continues gulping Powell's Kool-aid.

As I quipped earlier, consumer spending coming off the boil somewhat will likewise take the edge off prices for *some* things. **But as I see things, the cat is already out of the bag**; and in SO many ways, we are going to see a period of rising prices for businesses and consumers persist for FAR longer than "Cargo Plane Jay" suggests.

One of the biggest reasons for this—and perhaps THE biggest change from the Disinflation Era—is WAGES. In case you don't remember, one of the biggest reasons for the push for globalization over the last generation was that it served to keep wage costs down for big corporations. That disproportionately hurt Americans, as millions of jobs were "shipped" to various foreign lands where wage levels were a fraction of ours.

But—in part, because of the push back from the 2008 crisis aftermath when Wall Street, the big banks and Corporate America *again* got all the bailouts while Joe Sixpack merited hardly a crumb—things have changed politically and economically enough to make a difference. The most sustained rise in wages in years as a result—a good and proper cause *morally*, although a debilitating "cost" in the banker-centric system in which we live—promises to strengthen the case *against* Powell's "transitory" narrative. Maybe we won't have quite the wage-price spiral we did for several years back in the 70's. *But neither will this go away quickly.*

Of everything I see in front of us, though, the most onerous is going to be the way in which Americans' energy costs move inexorably higher in the coming years. I explained this in considerable detail in my previously-linked discussion from a few weeks back with Trevor Hall.

And I will be speaking to this separately in the weeks ahead, together with providing some new/renewed recommendations to my Members on this most counter-intuitive (but viable, thanks to the double-minded Biden Administration) theme.

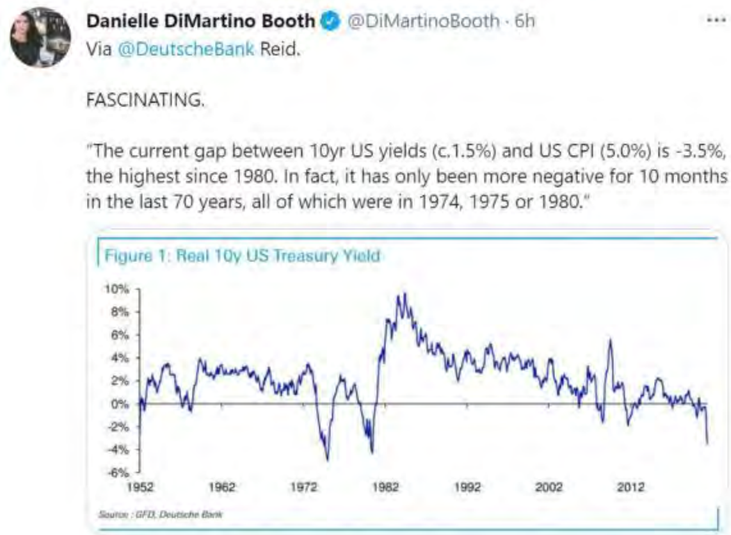
THE BOND MARKET: FROM VIGILANTE TO CONTROLLED ENABLER

When I first got into this industry back in those late 1970's, a species of being known as **the bond market vigilante** was at its peak influence. Those who owned Treasury bonds—the direct "I.O.U.'s" of a government increasingly debauching its currency and running higher deficits, as well as pushing up costs in those days for energy and everything else—demanded more of a "premium" for the risk they were taking. The then Arthur Burns-led Fed could not debauch the dollar with impunity. Nor could the national government run $40 billion or so annual deficits without being punished by the bond vigilantes, who brutally sold off Treasuries and caused market interest rates to spike.

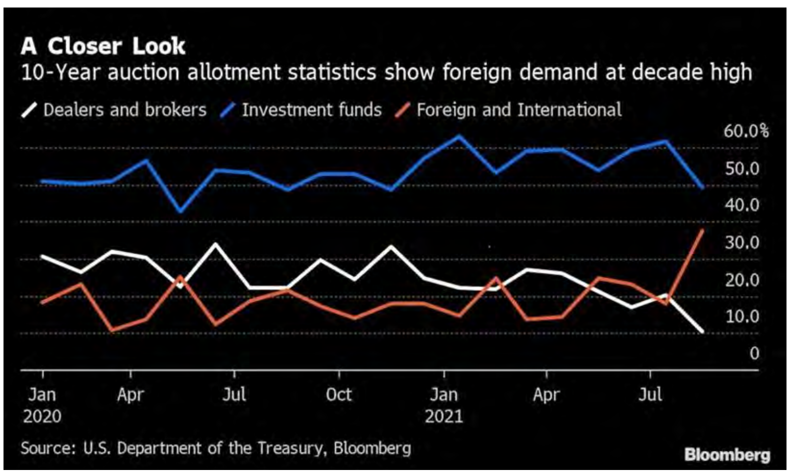
For a brief time earlier this year, as you remember, it seemed as if a few of these sorts had pretty much come back from the dead. It didn't take long for the yield on the modern-day bellwether 10-year Treasury not to jump from below 0.5% to threaten the 2% level, as price inflation accelerated and the worst effects of last year's self-imposed recession and market crash were overcome.

Yet, it seems as if the Fed has not yet run out of tricks to keep interest rates suppressed (this, I must remind *some of you* again IS the story of "price suppression" in markets today.) **Since peaking**

back in the spring, market interest rates have been FALLING progressively *even as price inflation has continued to worsen*. So in the Fed's modern Wonderland, this has led to the most negative level of *real* yields since that episode of over four decades ago. But very much unlike those days, markets generally are cheering this; and those few bond vigilantes who dared show their faces several months ago have gone back into hiding.



Now certainly, it's hard to be one of those today in a world where the Fed—demonstrably *unlike* the 70's—has the game rigged against you. Back then, of course, the central bank had not yet come up with so-called *quantitative easing*, or "Q.E." When for present purposes Powell and Company are themselves buying $80 billion per month worth of Treasuries that they tell us about—and are CLEARLY of a mind to keep interest rate levels low—it's tough to bet against that.



Also delivering a major "assist" to both the Fed and the U.S. Treasury this summer has been the dramatic escalation in purchases of Uncle Sam's IOU's by foreign entities; see https://finance.yahoo.com/news/treasury-sales-under-scrutiny-foreign-080549878.html. (I guess some of these folks didn't get the memo that the dollar and U.S. debt were being "dumped" by foreigners in favor of Chinese yuan, some "new" I.M.F. currencies, cryptos, or *whatever*.) This foreign demand is due to the recent strength in the dollar, the still-significant spread in yields versus most anyplace else, the greenback's continuing role (like it or not and, again, contrary to the carnival hucksters out there regularly suggesting otherwise), etc.

And—it bears repeating—Treasury prices are also being kept aloft (and yields artificially low) as markets continue to place a blind, largely unquestioning and child-like faith in Powell and his Wonderland.

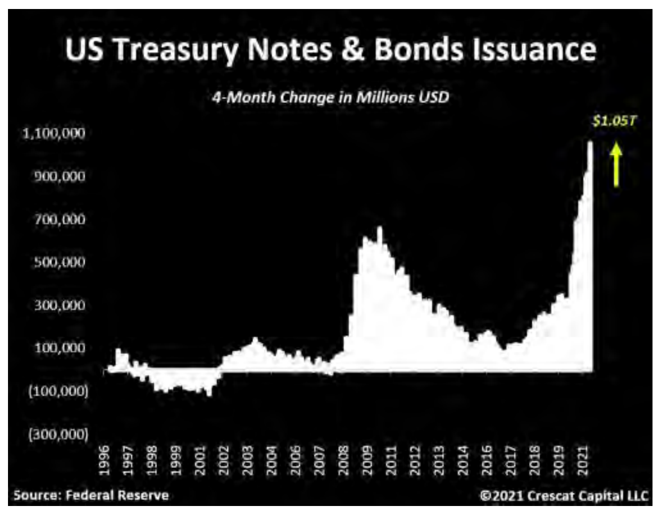
The $64,000 question, though (or, pick your own number allowing for the higher inflation these days, ha ha!) is how long this VERY aberrant situation can/will continue before *at least trying* again to "right" itself. By all appearances, Powell continues—deserving or not—to hold pretty much all of the propaganda cards, together with that most important asset of pretty much everyone in the market giving him the benefit of the doubt. Even if, for discussion's sake, we have a few more months' worth of worrisome price pressures and *that* finally causes Powell to relent and agree to a "taper" starting, markets would probably be mollified buy that for a bit longer *still*. So here again, nothing is likely to cause an *abrupt* rise in market interest rates—and all that would cause—right away.

Those who look farther out *and are worried* chiefly are those (like Yours truly) who believe that the recent spate of higher producer and consumer prices will be anything but "transitory" *even if the Y-O-Y level might be peaking at the recent 4 – 5% area*. Though WAY more diplomatic about how he chooses to put things than I am, well-respected economist and Fed watcher Mohamed El-Erian wrote immediately after Powell's Jackson Hole speech how WRONG he fears Powell is; see his remarks at https://www.bloomberg.com/opinion/articles/2021-08-29/federal-reserve-chair-jerome-powell-s-dovish-tilt-risks-a-mistake. I believe El-Erian is correct; and will stress a few other things also here he does *not* spend as much time on:

* **A LOT of the price pressures for Americans are being self-imposed and will endure, *if not worsen*.** As alluded to earlier, the Biden Administration is setting us up for onerous increases in energy costs in the years ahead, alternately hamstringing the very projects (in some respects) needed to provide domestic sources for some battery metals while also pushing the starving of the traditional fossil fuel industries. The result(s) will be that we won't remotely make the Administration's own purportedly desired climate, E.V. rollout and related targets…*and* will have rendered "traditional" energy scarcer and more expensive.

Also—as alluded to earlier—the unfolding wage-price spiral is going to be more than expected as well.

* **Treasury issuance continues to SOAR**. Though certainly goosed by the "needs" following the onset of the Plannedemic, the sheer volume of debt to be issued going forward is going to remain historically high. That will be even more so if the Democrat Party and the Biden Administration succeed in their multi-trillion dollar planned spending spree (though as I write this, West Virginia's Sen. Joe Manchin has again cast some doubt on these schemes.)



Inevitably, we will again see *at least some period of time* where the market clearly is unable or unwilling (or both) to do "its part" in keeping demand for all this debt in tact. As I argued earlier in the year, the Fed is taking *some* gamble in believing that any further "rebellions" by the bond vigilantes will be contained; see https://www.nationalinvestor.com/2590/the-feds-calculated-risk-but-just-how-high-will-they-let-rates-go/.

What Powell and his crew *don't* want to be *forced* into right away is becoming an even more prominent "buyer of last resort" of Treasuries. Yet this mess is one of the Fed's—and specifically, Powell's—own creation. They are also loathe to admit *outright* that they have now waited *so long* to remove all these "emergency measures" that they are pretty much now at a place where they *can't,* with the economy *already* slowing back down, etc. (*thus, Powell's channeling of Jake Blues*.)

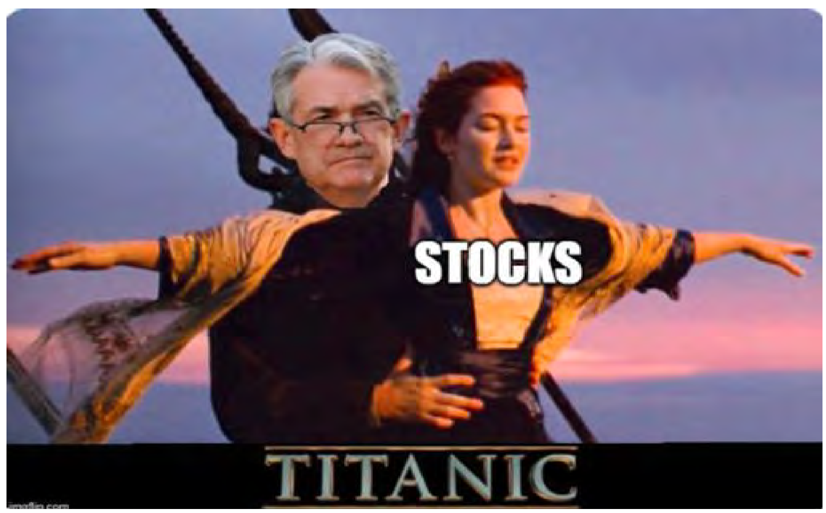
To me, one of the ways in which the Fed has had most bamboozled is in the idea that they have the will or ability, either one, to EVER "normalize" policy again. As Daniel Lacalle writes in his recent VERY sobering piece on this subject, the truth of the matter is that central banks really cannot “taper” *even if they wanted to* (see https://www.zerohedge.com/markets/central-banks-cannot-really-taper-slowdown.) He concludes:

> *“Central banks are faced with the devil’s dilemma created by their own policy. Either let inflation run and create a stagflation problem or scare the markets by reducing purchases. They will choose the first, without a doubt.”*

Or, as the late dean of investment newsletter publishers, Richard Russell, famously and succinctly sums things up as, **INFLATE OR DIE.**

To date, the attitude of the markets has overwhelmingly been “Oh, goodie--more free money!” But as *enormous* Treasury supply…inflation less transitory and far more sticky…and a spendthrift government all endure, at some point I still suspect a light bulb will go off over at least some traders’ heads. ***Then*, the thought will start turning toward, “Oh my God…*more* free money?”**

A FALL CORRECTION—AT LEAST AND AT LAST—FOR STOCKS?



Perma-bears have chronically underestimated the Fed’s ability and <u>resolve to keep markets aloft</u>.

As many of you know already, I am typically a sponge absorbing all manner of information; including oftentimes stuff I do *not* necessarily agree with, but want/feel the need to consider. Along the way as you have heard me quip numerous times, **I am neither a perma-bear nor a perma-bull.** And I am certainly not of the former of those camps, given that it has become more evident over the years that the Fed has its own thumb so heavily on the scales that anyone wishing to bet in a major way against stocks’ going ever higher *starts out at an immediate deficit*.

And that has become ever more so of late, when the Fed has SO juiced everything that stocks (I speak of the major indices here, and not the *somewhat* weaker, recently, broad market) can't even muster a 5% pullback, let alone an old-fashioned 10% correction *or more*.

Market Periods	5-Year Cyclically Adjusted Earnings Yield	Subsequent S&P 500 Performance 1-Year	2-Year	3-Year	5-Year
1929 Peak	3.8%	-30%	-59%	-84%	-74%
1937 Peak	3.5%	-37%	-29%	-33%	-51%
Tech Bubble	2.8%	-17%	-26%	-43%	-21%
Average at Peak	3.4%	-28%	-38%	-53%	-49%
Today	2.8%	?	?	?	?

Data from 1/1980-6/2021 | Source: GMO, Compustat

Of course, this does not mean the bears are wrong in many of their assertions:

* Cyclically-adjusted corporate earnings are again at an historic low compared to valuations (above left.)

* Stocks generally are trading near their dot-com era high price-sales ratio (above right).

* The famous "Buffet Indicator" (measuring stocks against overall economic output) has just *exceeded* its dot-com era peak, with stocks now at 205% of growth.

* The Shiller P.E. ratio is double its historic mean of 16.84, standing now just shy of 39.

* *As for sentiment*, not even during the 90's has there been the overwhelming propensity for investors to throw piles of money at S**T as they have been doing since the Fed *really* cranked up the printing presses early last year.

* Given the liquidity and investors' carefree attitudes, I.P.O.'s have SOARED.

* Corporate debt is priced at nosebleed levels, *with even the market yields on so-called "junk" below inflation!*

Yet all of the above and about $8 will get you an overpriced foo-foo "coffee" at Starbucks.

As long-time newsletter writer (even a little longer than me, at *his* 41 years) and Freedom Fest founder/proprietor Mark Skousen recently quipped, "Bears might make the headlines, but bulls make the money." In the Fed's Wonderland, fundamentals generally matter for little. And still, trying to bet against this in most *any* way—let alone take the "stand" that the perma-bears do—is a fool's errand, when you look at the bond market and more undergirding the Fed in its efforts to keep *all its bubbles* inflated.

Back in my comments in Lincolnshire referred to a couple times earlier (AGAIN, archived on my YouTube channel) I expressed what I believe to be the most reasonable "forecast" as to how a lot of this plays out *in years to come.* Essentially, I think the big picture might prove to be a lot less dramatic than most think it will.

But that does NOT mean that the near-term situation is without *any* risk. Quite the contrary, in fact, as I will explain in the Members-only issue following this one, in regards to what I propose we *do* about those risks.

There are a good many who continue to view this unfolding new wave of inflation as more positive than negative for the stock market. *On the surface*, they have some history on their side. Yes, it is true that the 1970s wave of inflation and all pushed most everything higher also, including the stock market. As it went on, of course, there were a number of reasons why commodities of most kinds eventually outdid the gains of the general stock market.

But one must remember that this only happened *after* stocks had already been cut in half from there cyclical bull market peak in 1972. **I do *not* see the same setup today; at least from where we are starting *this* discussion, with the broad stock market already at historic/nosebleed levels as the modern wave of higher producer/consumer price rises is arguably only beginning again.**

As I'll be discussing, again, just following this issue, I do believe still in the scenario I laid out for our audience this spring in Lincolnshire *long-term*. **But especially *for present purposes*, I think the "fun" for stocks *generally* is pretty much over with for a while.** Gains going forward are going to be a lot harder to come by, as the sugar highs for both economic recovery and earnings for Corporate America dissipate.

Also—as I have said elsewhere recently—I believe that **policy decisions in Washington** will increasingly be a *net negative* for the markets. President Biden and his allies on Capitol Hill will probably get *at least some* of the tax increases they desire. There are also unfolding efforts for more specific taxes and controls on Wall Street, stock trading and such. Again, I do not expect anything *major*: yet the tone and potential effects will be negative, especially as all these various other reasons assert themselves more for at least a pause in the bullishness and exuberance of the recent past.

Finally, what most troubles me about the near-term prospects for the stock market generally—*and even for some fundamentally good themes and sectors*—is the ineptitude of, frankly, *both* Establishment parties in Washington when it comes to infrastructure and the dawning of the desired "Green Economy" of the future. I have spoken to this many times in recent months and will further still in the near future separately.

In short, nobody seems to even understand the massive policy and financial/economic changes that MUST come about to make these various goals *even work*. Partisan silliness is already dooming America to falling even further behind the rest of the world; *even Europe now*, as I have recently lamented. Republicans who never worry about debt when it comes to military spending and conquering/occupying the world are suddenly worried about it now that a Democrat is in the White House. For their part, the Democrats cannot effectively articulate and attempt to legislate the various infrastructure and green energy needs that *do* legitimately exist. So as usual, they are of simply a single-minded purpose to try and push through anything and *call it* "infrastructure."

IN SUMMATION, with no legitimate policy "help" coming…with STAGFLATION emerging more…and with little in the way of continued, *organic* economic growth on tap…the "Goldilocks" environment WILL be changing.

GOLD WILL BE A STANDOUT AGAIN; BUT CHIEFLY AT THE EXPENSE OF MOST EVERYTHING ELSE

Two pairs of policy makers who were more social and financial engineers. Different time. Same pattern. But same outcomes?

In a sense, it is fitting that we marked mere days ago the 50th anniversary of former President Richard Nixon forever breaking the last link (meaningless as it was for the average *citizen* even then) between the US dollar and gold. When Tricky Dick did that in the summer of 1971, gold was unleashed and eventually soared well more than 20-fold from its previous "fix" at $35/ounce.

Part and parcel of what enabled/justified such a surge for the yellow metal was that Nixon's Federal Reserve Chairman Arthur Burns became an enabler of his "boss's" political aims. First, it was Nixon's demands for easy money to bolster his reelection chances in 1972. Later, it was a more willing

Burns that kept interest rates low and the dollar week ostensibly to help mitigate the deleterious effects on the economy of the Arab oil embargo. *As critics warned—and as history shows—all Burns' inflationary monetary policy served to do was to make the price increases for energy (and most everything else) that much worse*.

Today, an arguably **even more politically craven Fed Chairman Jay Powell** is following a similar and even less contentious approach to merging what is supposed to be an "independent" Fed monetary policy with 1. The desires of the current president/administration and 2. Frankly, the laws of mathematics in NEEDING to keep the accelerator to the floor in any event.

I explained in some detail in my recent conversation with Trevor Hall the reasons why gold—which has been somewhat of a laggard in the last year since peaking at over $2,000/ounce last August—is set to reverse those fortunes *for the better*. Indeed, as indicated by my recommendation to our Members the day of Powell's recent "defiantly dovish" speech, that process seems now underway.

I'll add some more "meat" to the whys and wherefores of this in the Members issue immediately following this one. *Additionally*, you'll shortly see the latest iteration of one of my Special Reports, *"This is NOT Your Father's Gold Market!"* where I will again go into considerable detail as to why gold stands to be the biggest beneficiary of the unfolding STAGFLATION environment.

For now—besides to my own conversation with Trevor—I'll refer you to well-known hedge fund manager and gold bug John Paulson as to why he sees gold going "parabolic" from here: it's at https://www.bloomberg.com/news/videos/2021-08-29/john-paulson-on-why-gold-goes-parabolic-video?sref=AqatjHHy.

***Unlike* was the case back in the 1970's, though, this is not going to be quite the "rising tide lifts all boats" situation where *all* commodities are concerned; at least, not yet.** I've explained that as well in those above-referenced discussions (and elsewhere for some time now) and will be again separately as well in short order.

Don't forget that those of you so inclined can follow my thoughts, focus and all pretty much *daily* ! ! !

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