THE National Investor

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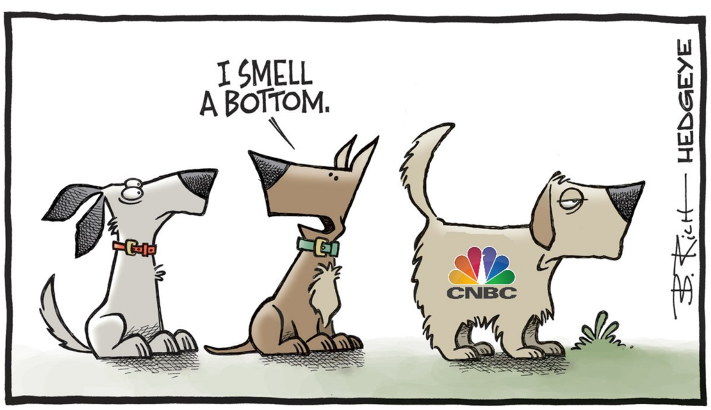
FROM OUR AUDIENCE

IS THE BEAR RALLY ALREADY OVER?

1. Chris, kudos for your near-perfect trading calls on the broad market, including seeing this latest rally coming. Question I have is whether this move is already over. Are markets waiting for the next inflation news? Any key technical levels on the S&P you have an eye on. . .?

2. Thanks for your SQQQ move last Friday (Aug. 5-Ed.) – *I was thinking you were falling in with that Cramer/CNBC crowd! Do you anticipate adding again sooner rather than later, as you kind of implied in your email?*

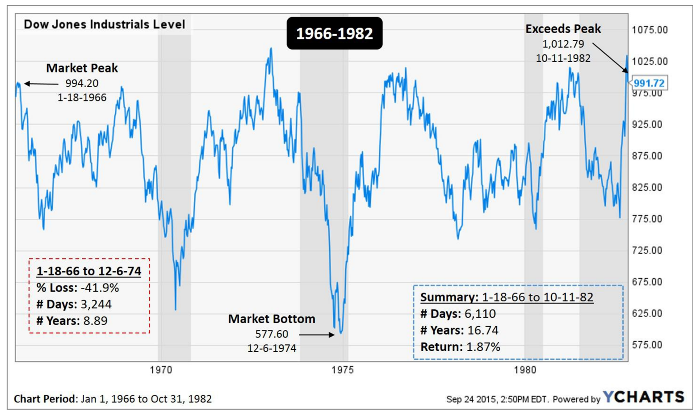


Lest anyone think otherwise—or *somehow* have the wrong impression from my prediction of the recent bounce for stocks—I by NO means think this bear market is over. I've commented a couple times of late that this bear market is going to potentially endure for *years*.

None the less, my (correct) view was that the markets would perceive/hope that at its last F.O.M.C. meeting, the Fed would at least hold out the *possibility* that it might dial back its tightening. "Fire Marshall Jay" Powell did not disappoint, even if the bulls stretched what they thought they heard/*wanted to hear* and dismissed anything contrary. By being somewhat noncommittal, Powell thus gave markets what they wanted: an excuse (no matter the odds of disappointment *later*) to rally further.

The markets *still*—even after the bloodletting of 2022 thus far *and* the Fed's overall insistence of its seriousness in "fighting inflation"—have that old "Fed put" muscle memory. Listening to most pundits as well as the average shills on *CNBC*, et al, it's near-unanimous that some signs of economic weakness as well as the perception that Y-O-Y inflation numbers perhaps *have* finally peaked, to them, means that Powell is soiling himself for fear of going too far. This, however, as Powell and most others at the Fed are warning repeatedly that they KNOW they might go "too far," but that such is the price to be paid to whip inflation. *I'll come back to the Fed a bit below.*

Ultimately, I think that most of the more outrageous/sensational predictions of *either* a bullish or bearish tilt will be disappointed. Still-huge amounts of liquidity will be supportive, even as the Fed tries to trim that for a fair bit longer. On the downside, corporate earnings and consumers' willingness to spend on all but necessities will pull in the other direction. *We may be in for many years' worth of the kind of stock market we had from the mid-1960's – early 1980's: a volatile ride to pretty much nowhere.*



***Unlike* back then, the downside risks are augmented by the obscene amounts of leverage; and all the ticking time bombs that has created.** So we need to continue to watch China…emerging markets generally…Europe and its already-rickety capital markets which will get worse…*and more*. But for present purposes, all we can attempt to do is divine what will bring about the next reversal downward (or not.)

In the proprietary information I get regularly from *Moody's*, they have gone to great pains to make the point that—while others quibble over whether we are *technically* in a recession now or not, by whoever's definition—**the credit cycle has already turned.** This underscores my point above: as opposed to watching the more obvious economic deterioration (not all at the same time, mind you, as I will also discuss a bit below), **we are best to watch what credits…corporate balance sheets…even countries/blocs…are fraying.** That die has already been cast.

Watch https://vimeo.com/729393720/c0a0650ddb for a brief synopsis of this.

Not necessarily in the order of most importance, here's what else I am continuing to watch:

*** The U.S. dollar and a potential *still* of a "dollar doom loop."**

If the allegedly "dovish" or even merely unequivocal Fed of recent days should have taken a fair bit of starch out of the greenback's upward trajectory…well…those "death of the dollar" shysters have still more 'splainin to do.

All the Fed got out of the same phenomenon that has goosed stocks and commodities anew has been the dollar giving back the few points since its breakout around July 1. It's *still* in a solid up trend. It's *still* above its 50-dma. And a renewed surge could *still* upend risk asset rallies as fast as they recently materialized.

We are *still* at grave risk I.M.O. of "…a 'dollar doom loop' like no other"; see this story/analysis: https://www.bloomberg.com/news/articles/2022-07-17/this-could-be-the-start-of-a-dollar-doom-loop-like-no-other?sref=AqatjHHy. **This potential issue remains of most concern to me.** We got but a taste of what some consequences of a renewed move higher would be via the markets' actions during the dollar's breakout in the first half of July.

The story is still the same and—if anything—moving *even more* in the favor of being *long* dollars right now. While some other central banks are themselves attempting to play catch-up, the Fed remains the most serious *relatively speaking* in tightening policy.

*** Europe's dark, cold and financially destabilizing winter ahead.** If any central bank now ostensibly tightening chickens out, the first will be the European Central Bank. It's hardly started yet; and I won't be surprised to see the dingbat Christine Lagarde declare that she must stop such efforts in order to "protect" the bloc from energy and other financial shocks; all a part of the assisted suicide Europe is succumbing to thanks to the U.S. and N.A.T.O. and *their* designs.

Added to all this is the still-minority (but growing) view among Europe's *people* in many countries that *they* are getting the short end as said pawns/cannon fodder in the proxy war against Russia. Italy is especially up in arms over this. Besides being browbeaten politically into simply shutting up, Lagarde has already seen her part in keeping this "union" together as coming up with any trickery imaginable to keep "peripheral" debt markets (remember the PIIGS crisis of a bit over a decade ago?) in line. So here, too, a BIG negative for the euro's exchange value.

Overall, I throw in with Brendan Brown's take in his article of a couple weeks ago on the Mises Institute's site; see https://mises.org/power-market/ecbs-long-journey-currency-collapse-just-got-lot-shorter.

* **China is STILL a ticking time bomb; and now, an angrier and more desperate one.**

Even with all the tricks (superior to the Fed, as I have pointed out numerous times in recent years) at its disposal, China is finding it more difficult to fight the laws of mathematics.

Early this year I authored a special four-part commentary for *The Epoch Times*; see https://www.theepochtimes.com/could-china-go-the-way-of-1980s-japan-part-one_4233153.html (this is the first; links to the subsequent three pieces of this are at the conclusion of this Part One.) **Much of what I was describing is coming about and will continue to**. Efforts to sell a broad restructuring of real estate giant Evergrande are fizzling; and what the government itself has called a "marketized default" now threatens to become just *default*.

Elsewhere, China is being revealed as every bit the debt-fueled paper tiger as the U.S. arguably is (but *without* the U.S. benefit of having—for now—the world's reserve currency.) Accordingly, with all else at play, many of China's would-be clients are starting to push back on all the debt and obligations foisted on them as would-be empire China seeks to extend its tentacles everywhere (see, for example, https://www.ft.com/content/eb2d89f6-afd1-491e-b753-863e9727f6de, where the *Financial Times'* editorial board recently described the disintegration of much of the Belt and Road initiative.)

We'll see what he thinks post-invasion?

It's interesting to ponder what measure(s) President *and would-be emperor* Xi Jinping has on the shelf to galvanize his support ahead of a potential ratification for an unprecedented (post-Mao) *third* five-year stint as head of the country and the CCP. Whatever they might be, the reckless hag Nancy Pelosi (herself needing diversions from a hugely unpopular job on domestic policy) just gave Xi another BIG one with her dopey trip to Taiwan to see if we can now goad China into a greater conflict, as she and her allies did with Russia.

Ironically, such a thing might well shore up Xi's support as well as take everyone's eyes of the world's most outrageous debt piles. *What all this would mean for markets remains to be seen, perhaps.* And it likely remains to be seen whether financially, China can keep its domestic economy/markets from imploding AND invade Taiwan.

* **Treasury yields.**

That the 10-year Treasury yield at one point last week was a full percentage point below its mid-June level even as Y-O-Y inflation remains at a high is remarkable in a way. But it goes to show what distortions come into markets when you have the kind of *real price suppression* Treasuries have been subjected to in a big way since 2008. In our part-Orwellian, part-Wonderland markets, to have such yields *barely a third* of the inflation rate is something nobody of my age ever thought we would see.

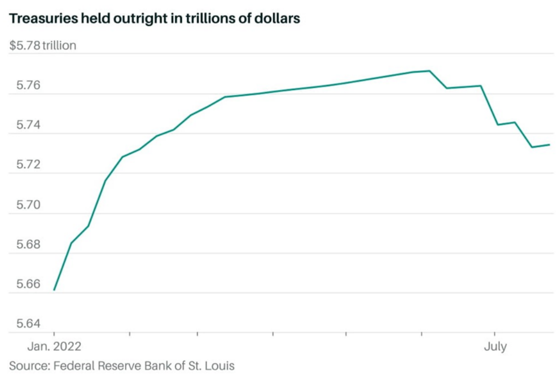
Treasuries' recent drop in yield owes to a number of factors; not the least of which is **that above-referenced renewed credulity of the markets**. But even that was second-guessed at week's end last week; see https://www.kitco.com/commentaries/2022-08-05/The-Metals-Money-and-Markets-Weekly-L-is-for-lunacy.html for--among many other market tidbits—our comments on the late week 30+ bps pop right back up for the 10-year.

At its low, that key yield had come down to very near a key technical area of 2.4-2.5%; one going back for *quite a few years*. **And those earlier interludes at that level were *without* inflation where it's been of late.** So—though I remain ambivalent about a trade into Treasuries long *or* short—kudos to those of you who shorted Treasuries mid-week last week.

It has become clear anew that very few on Wall Street believe that a much higher threshold of inflation will now be a fact of life. Most seem to believe that the "transitory" schtick will prove itself true in the end and that we'll all be back to a disinflationary rate of 2% or so singing *kumbaya* in front of our shrines to Powell.

Ironically—and underscoring investors' dyslexia—if folks really believed the Fed was going to chicken out before long, longer-term yields should be *rising*. That would suggest a still-liquid and at least somewhat healthy economy; not a recession everyone was scrambling to price in.

Also consider that Powell and Company's nascent QT (Quantitative Tightening) program—though



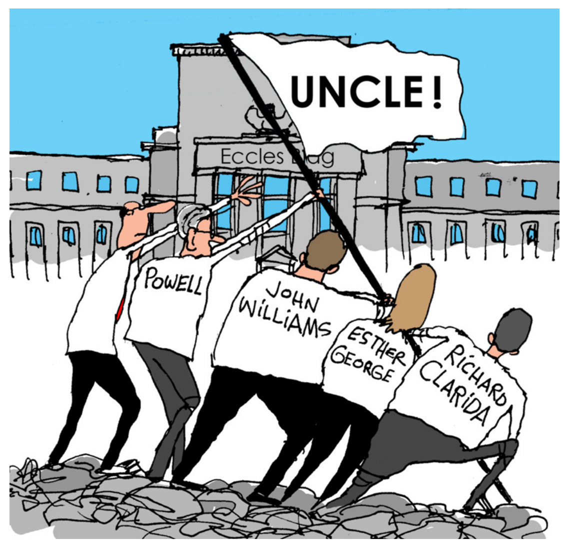
Much ado about nothing…so far, anyway.

off to a late start—is set to ramp up. Next month, the central bank intends to "unwind," net, $60 billion of Treasury paper and $35 billion of mortgage securities per month. And this will be as the official sector buying from overseas—save for Japan, modestly, as I discussed recently—has been shriveling up.

So all else being equal, if/when it dawns on the markets that they need to be repricing Treasuries in *their* world to reflect a potential years-long stagflation (not recession) ahead, the surge in yields could be abrupt to take us right back to those mid-June levels, *at least*.

* **The Fed's resolve.**

Not to be too redundant, but all of the above, good or bad, is going to depend most of all on whether Powell and his crew keep their resolve. As I sent out over the weekend via Wolf Richter's excellent piece (at https://wolfstreet.com/2022/08/03/markets-are-fighting-the-fed/ for those who still won't use social media) the current episode of the markets fighting the Fed is in that they refuse to take the central bank at its tough inflation-fighting word.



In one sense, it's hard to blame these folks, in light of Powell having been rolled by the markets back at the end of 2018. Some of you remember my spoof of the famous flag-raising on Iwo Jima at the end of World War 2; at right, the raising of a flag of surrender at the Fed after the markets rebelled at the prospect of further Powell "normalization." So as Sven Henrich (@NorthmanTrader on Twitter) said late this past week, "Nothing says no Fed credibility more than all Fed speakers desperate to stick to a hawkish message getting completely ignored by markets."

Again, the question is at what point the light bulb goes off over the market's head (or never really does, if I am all wet here.) Aside from this week's inflation prints and what chatter we get from Fed heads in that aftermath, I'll be especially interested to see how *the world's* central bankers behave at the Kansas City Fed-hosted summer-end picnic out in Wyoming in a couple weeks or so. "Reassessing Constraints on the Economy and Policy," is a sufficiently (and, I am sure, intentionally) vague theme for the August 25-27 confab that—like a lot of these central banker utterances—will be viewed as blots in a Rorschach test: however one *wants* to view them.

After the fact, we'll know (maybe) a couple important things:

1. How much everyone is still resolved to rein inflation back in, even at the expense of recession (provided *markets* don't blow a major gasket) and

2. To what extent the Fed particularly gets push-back on the dollar's choking out emerging markets, etc.

* **What will the nature of this unfolding recession be?**

I've described numerous times since the end of last year that the Fed's M.O. had changed. *Yes*, I realize that what has passed for tightening thus far seems puny in the grand scheme of things, as alluded to the still-low level of interest rates against consumer/producer prices, etc. But at the same time, it doesn't take a lot of tightening with all the overhang of debt/leverage to do some real damage.

And the Fed has made two things abundantly clear of late:

1. It is more concerned about bringing down inflation for the hoi polloi than keeping asset prices elevated; **this is the *political imperative* that many on Wall Street *still* don't get.** The Fed has made this fairly clear; indeed, insisting that putting a sufficient dent in that "wealth effect" will help reduce demand and, thus, some prices.

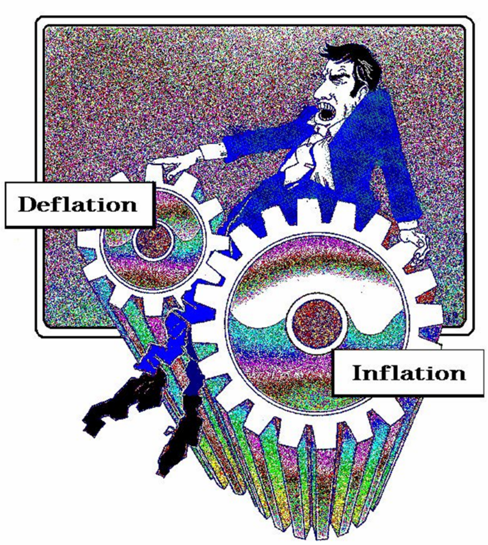
2. It acknowledges a goal of slowing demand and employment growth/wages to accomplish much the same thing.

Now here's the rub…two actually…

1. The Fed is betting that more people are happy with gas and some other prices coming down than those who are upset that they might lose their job and

2. It is likewise betting that the fall-off in spending/hiring overall is not *too* abrupt.

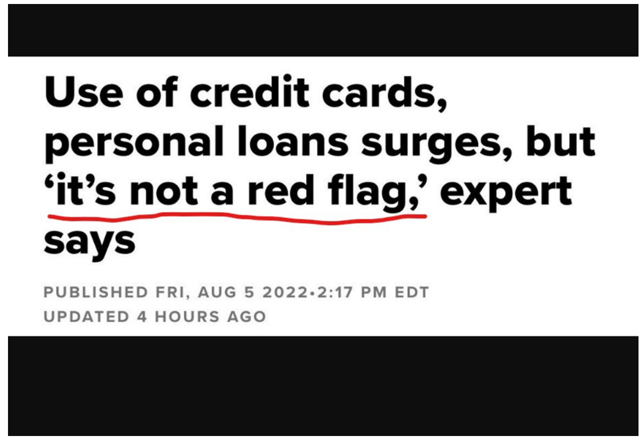
So far, things are going its way; and I daresay there are *not* legions of people who suddenly think we're in recession. **In my travels this summer I have thus far seen precious little "weakness" overall**. Vacation travel and such continues at a frantic pace: from most highways, to airports, to a report I just read of extremely heavy traffic at the major cruise ship port at Cape Canaveral, it sure doesn't *look* like much of a recession yet.



Elsewhere, though, there *are* signs of *some* things rolling over. Most real estate markets have peaked and—depending on the location—prices are 5 – 15% off their (absurd) peaks of this cycle. *That will dent the wealth effect and future spending, for sure.* And there are indications (that recent Walmart report being a major example) of consumer spending on non-essentials pretty much *crashing.*

Again—as alluded to earlier herein and as I have discussed *numerous* times this year in one forum or another—the question eventually will probably be, first, **what credit event, bankruptcy, or whatever torpedoes everything even if most consumers have learned to get along with less**. I suspect that long before consumers give up the ghost big time—squeezed as they inevitably will be by shrinking asset prices and still-higher inflation—we'll see an accident in the markets, payment systems, etc. causes a bust. In turn, *that* would lead to a deeper recession than we are already in. And in its wake, we'd see new Q.E. programs (with another zero added, perhaps,) more fiscal stimulus and the like.

One sign you have no doubt heard of that consumers may be hunkering down even more is that **much of their recent spending has been done on credit.** Though wage growth as reported last week is still running above 5% annually, that's still about half or so of the *admitted* rise in the C.P.I.


Use of credit cards, personal loans surges, but 'it's not a red flag,' expert says

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So it's no wonder consumer credit is in such energetic use; and as *CNN Business'* Matt Egan just wrote (https://www.cnn.com/2022/08/02/economy/consumer-credit-borrowing-surge/index.html) **U.S. household debt just hit $16 trillion for the first time.**

According as well to new New York Fed statistics covered by Egan, Americans are dipping into their savings also. The personal savings rate just reported of 5.1% is the lowest since August, 2009.

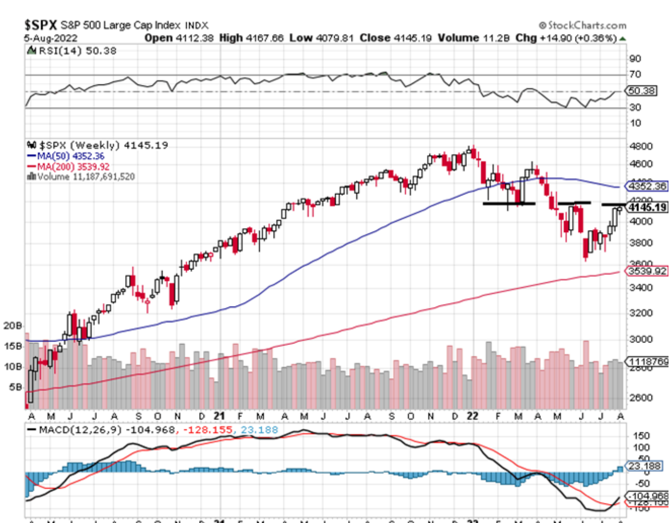
All this points to a fairly sharp hunkering down to come later in the year, once the vacations delayed for the last couple years have been enjoyed. Maybe it will be mitigated as Walmart and other retailers choking on excess inventories start slashing prices to move them. But still—while it's a mixed bag of statistics *right now* and we may see *positive* GDP for Q3—methinks a recession will be a more widely-acknowledge reality by the time we get into early 2023.

* **How quickly will corporate earnings tank?**

Last I read, with about half the S&P 500 companies having reported for Q2, earnings are up a mere 1.4% versus Q2 of 2021. *Ponder this:* such scant growth during a time when we were supposed to be having a "Biden Boom" as we recover from the Plannedemic. *What happens to corporate earnings next?*

Revenues were up 11% Y-O-Y. That number was somewhat juiced by the same inflation that decimated profits. Ditto, the strong U.S. dollar had an effect on bottom lines also.

So here, too, by the time we get just another quarter or two down the road, we are very likely—barring some major change in the equation we see before us now—to have earnings *declines* Y-O-Y for the broad markets. **Again, this factor of a *stagflation* that will endure for the foreseeable future is something yet to be priced in.**

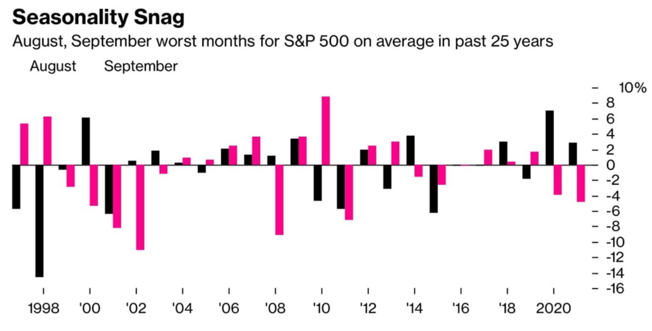


And this is but one of the reasons why I believe this bear market has not seen its end.

* **Technical, seasonal factors.**

I've discussed in recent days that the rally on Wall Street of the last several weeks has brought the stock market to a pivotal place. Though the Nasdaq overshot its own similar level, **the broad S&P 500 as you see at left is at "do or die" time *technically*.**

Taking all the factors into account that I have been discussing so far, it should be clear that the great weight of the evidence *fundamentally* argues against any sustained break higher. Whether a temporary one unfolds remains to be seen; a lower-than-expected inflation reading this week *could* briefly prompt that.



Source: Bloomberg
Footnote: S&P 500 Index percent change

Some are looking at a potential for the S&P to get to 4231; that would be a 50% retracement of the decline from stocks' high. We'll see. The fact that stocks have already rallied as much as they have on hopium…that most factors that would fundamentally be supportive are neutral-to-deteriorating…and the calendar…all this suggests we likely will be adding to last week's renewed SQQQ position, *even if we have to hold back until Jackson Hole*.

THE ABOVE SEGMENT IS EXCERPTED FROM THE MEMBERS ISSUE DATED AUGUST 8, 2022

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