TJT CAPITAL GROUP
REGISTERED INVESTMENT ADVISOR

On Our Radar March 2022

The S&P 500 index fell 3.1 percent in February as the Russian invasion of Ukraine added to the growing list of uncertainties affecting markets. Oil spiked to more than $105 a barrel, while wheat jumped to its highest level since 2008 as Russia and Ukraine account for roughly 30 percent of all wheat exports. Prices for corn, iron ore, sunflower seeds, barley, among others produced in Russia and Ukraine rose in tandem.

This is happening at a time when inflation has been increasing for more than a year while the Federal Reserve has failed to act. We consider this reckless behavior. As recently as January 26, 2022, Federal Reserve Chairman Jerome Powell referred to "the relatively high-class problems" that come with the economic recovery, including "high inflation." Inflation is running at a 40-year high, and real hourly earnings (meaning adjusted for inflation) have declined for 10 consecutive months.

The Fed has lost touch with reality. One day Fed Chairman Powell states inflation is a high-class problem, while another day he claims the Fed understands "that high inflation imposes significant hardship, especially on those least able to meet the higher costs of essentials like food."

TJT Capital Group's InVEST Risk Model ® has helped our clients participate in bull markets and protect capital from the devastation of bear markets by focusing on 5 indicators that really matter when it comes to determining the health and direction of markets. The following is the most recent update.

Interest Rates (Monetary Policy)

Inflation is running at a 40-year high and the Federal Reserve's official target rate for federal funds is zero to one-quarter percent. Moreover, the Federal Reserve continued to purchase bonds in February. Fed policy is unhinged from reality.

The issue is not that the Fed was wrong regarding inflation, it's that they stayed wrong based on theory. What's more, we believe the Fed was dishonest when they officially changed monetary policy in August 2020.

As we have previously pointed out, at that time Chair Powell said, "Of course, if excessive inflationary pressures were to rachet up above levels consistent with our goal, we would not hesitate to act." It seems as though the Fed had no intention of addressing higher inflation as a couple of months later Fed Governor Lael Brainard said the Federal Open Market Committee (FOMC) needed to "stay the course resolutely" regardless of higher inflation.

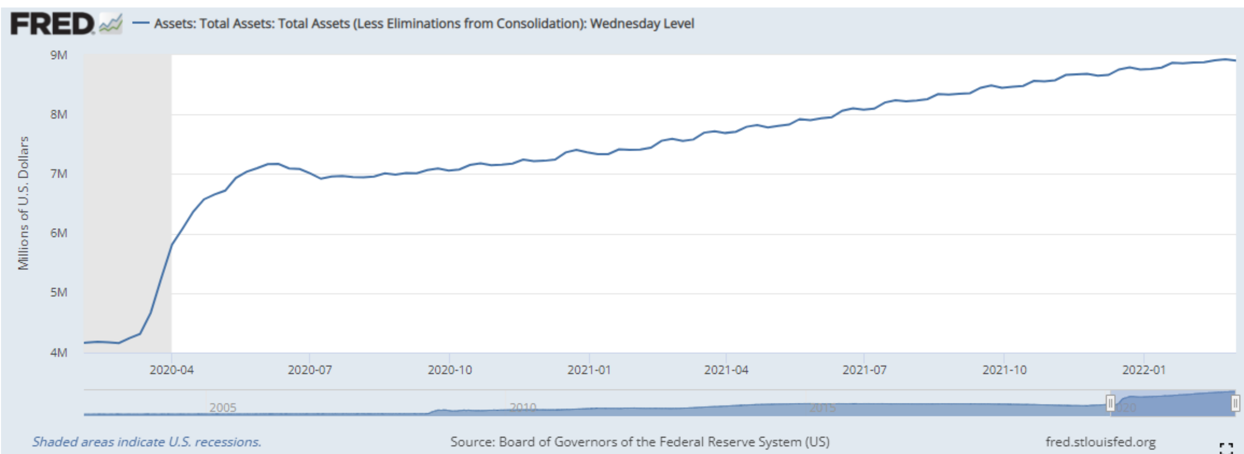
As if that was not bad enough, the Fed recently reaffirmed the August 2020 framework without any revisions. The Fed, along with the Biden administration, after dismissing the inflation problem are now attempting to cast the blame elsewhere. For example, they have been talking about supply chain problems causing price increases, but have not done anything significant to address those issues.

For example, the CEO of a billion dollar U.S. freight forwarding company recently said that "American ports operate at a lower throughput than Mombasa, Kenya." He went on to say that it is taking about 115 days to ship goods from China to the U.S. compared to an average of about 50 days pre-pandemic. Then, when goods arrive in the U.S., trucks are missing about 50 percent of their appointments because of a lack of chassis. What are the Fed and the administration doing to solve these problems?

It seems that we have people in positions of power for reasons other than their qualifications.

Regarding inflation, the Fed's staff expects Personal Consumption Expenditure (PCE) inflation to fall to 2.6 percent in 2022 due to "a decline in consumer energy prices." That is not comforting as this is the same staff that was not forecasting a recession in January 2008 when the recession had already begun.

As the Fed has more than doubled the size of its balance sheet to $8.9 trillion since the onset of the pandemic, we cannot afford more mistakes. The Fed's belief that the new policy - which was a grand experiment - would only produce positive results with no downside was naive at best. In reality, it turned out to be dangerously incorrect and we are all paying a price.



Valuation

S&P 500 operating profits for calendar year 2021 are expected to be around $205, putting the P/E (price/earnings) ratio at roughly 21.3-times earnings. While earnings estimates have been steadily rising, the rate of change has been slowing of late. Estimates for calendar year 2022 are roughly $223, thereby putting the forward P/E ratio at 19.6-times.

Unfortunately, higher interest rates and inflation have historically put downward pressure on P/E ratios as the discount rate applied to future cash flows rises.

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Economic Cycle

Gross Domestic Product (GDP) increased at a revised 7.0 percent in the fourth quarter, but that pace is unsustainable given the U.S. has curtailed its COVID stimulus. The U.S. economy will be lucky to grow at half that pace in 2022 given the reduction in fiscal support and a Federal Reserve that will eventually be forced to tighten monetary policy. The Consumer Price Index (CPI) increased 7.5 percent year-over-year in January, the highest since 1982, and consumer sentiment is plunging as it stands roughly 20 percentage points below levels from a year ago. The Leading Economic Index (LEI) decreased by 0.3 percent in January and Industrial Production declined 0.1 percent in December. On the bright side, the Institute for Supply Management manufacturing index increased to 58.6 percent from 57.6 in January, and the most recent unemployment rate was 4 percent.

Sentiment

Bullish investor sentiment has dropped dramatically - down roughly 18 percentage points since year-end - as inflation is running near a 40-year high. Moreover, there does not seem to be any short-term solutions coming from the Biden administration to address higher oil and commodity prices.

Since bullish sentiment seems to follow the market trends both up and down, any further market weakness could result in even lower bullish sentiment figures.

Technical Factors

From a technical viewpoint, the markets have been going through a correction with the number of new 52-week lows expanding over the past few months. Moreover, the number of stocks that were trading above their 50-day moving average fell below 19 percent on news of Russia invading Ukraine.

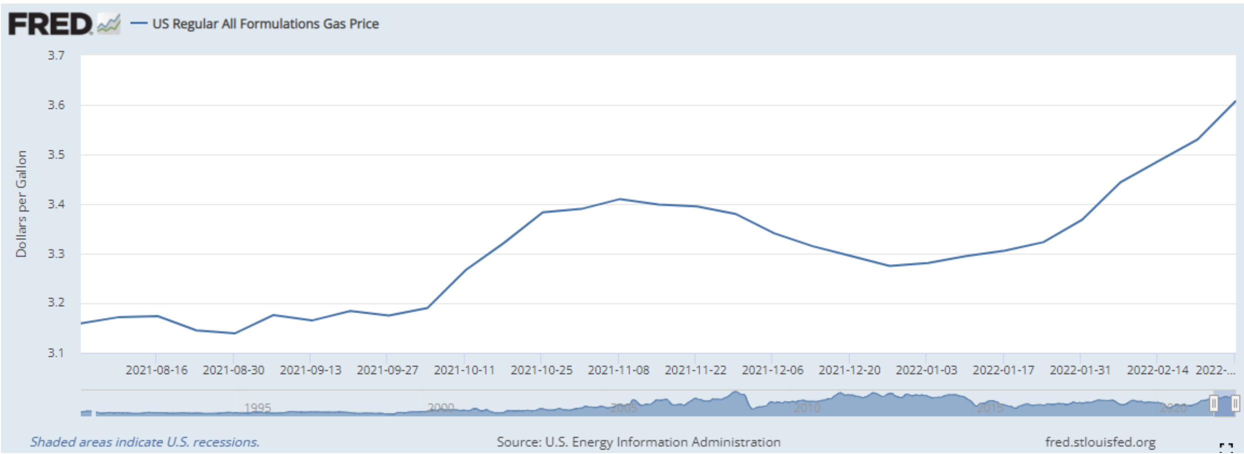
Historically, when the number of stocks trading above their 50-day moving average has dropped below 15 percent, it has generally been a good area to accumulate shares. That said, the Russia/Ukraine battle creates a level of risk and uncertainty that markets have not experienced in some time. As such, volatility is likely to remain high.

Outlook

To be polite, the Biden administration has totally mismanaged the transition away from oil. President Biden's misguided attacks on the oil and gas sector have put us in a position where the U.S. now imports roughly 1 million barrels of oil a day, with a good portion of that from Russia. Said another way, the U.S. is partially funding Russia's war on Ukraine.

As a reminder, one of the first things President Biden did was to cancel the permit for the Keystone pipeline, as well as permits in other oil and gas rich states. Moreover, the administration has issued veiled threats to cut off financing for energy producing companies. As a result of that - and COVID - the U.S. is producing roughly 1.2 million fewer barrels of oil a day than under the previous administration. It would appear that we have surrendered our energy independence.

As a result, gasoline prices that have been rising for more than a year are going higher.



As a reminder, when it comes to successful investing it is important to confront reality, focus on the facts, and weigh the evidence. Moreover, we consider money to be green; it's not "red" money or "blue" money depending on one's political leanings. As such, we call it as we see it and are equally critical of both sides when conditions warrant.

Russia invaded Ukraine and the President of the United States did not address the nation publicly for days. It matters not that he was preparing for the State of the Union address. President Biden's behavior has showed a stunning lack of leadership by the U.S. for the world to see. That was in addition to the catastrophic withdrawal from Afghanistan, which has caused an enormous humanitarian crisis with millions on the verge of starvation.

In a way the markets are experiencing a perfect storm where various issues are coming together at once. Geopolitical tensions are rising at a time of a leadership void from the U.S., while inflation is raging when the Fed appears to be asleep. The world is watching, and it has not gone unnoticed.

As a result of COVID, the Fed injected more money in three months than Ben Bernanke's Fed did in 5 years following the 2008 financial crisis. Accordingly, excesses developed in various markets including SPACs (Special Purpose Acquisition Company) and initial public offerings (IPOs).

For example, Rivian, an electric vehicle manufacturer, came public in November and hit a high of $179 a share, giving it a market capitalization of almost $160 billion. This was for a company that delivered 920 vehicles by the end of 2021. The stock recently fell to the mid-50s, but it still sports a market capitalization of nearly $50 billion for a company that is likely not to be profitable for years.

Correcting those excesses is not unusual, especially when interest rates are rising and inflation is running hot. More recently, however, the market has been coming after "good" companies with revenue growth, solid earnings and cash flow. Higher interest rates and inflation historically reduces the Price/Earnings (P/E) ratio on the equity market. As a result, the markets are becoming increasingly unstable.

The Biden administration has been hostile to the U.S. energy industry, and President Biden's pick to be the Fed's vice-chair for bank supervision, Sarah Bloom Raskin, has previously suggested that banks be penalized for lending to oil and gas companies. This type of behavior is not conducive to becoming energy independent.

While the long-term goal of "greener energy" makes perfect sense, cutting domestic supply and paying foreign countries upwards of $60 to $100 million a day to import oil when we have adequate supplies domestically seems absurd. It will take decades to get to the green energy goal.

Regarding the Federal Reserve, it is not the "cost" of money but the availability of money, and the Fed's bond purchases should end in March. While there seems to be a debate about the number of interest rate hikes on the way, we believe the collapse in confidence in the Fed has already had a greater impact. The Fed seems to be living in an alternate universe while everyone else experiences inflation first hand.

Not surprisingly, borrowing costs have risen on mortgages, auto loans, credit cards, among other things. Food and energy prices are likely to go higher in the months ahead.

Reality is setting in. Confidence in our leaders and our institutions is collapsing. Soundbites are no longer working as credibility is shot. Volatility is spiking across various markets and a lack of a clear strategy on several critical fronts is adding to uncertainty and instability. As such, investors should focus on exposure and expect a wider range of outcomes.

That said, a majority of companies have already experienced a correction and bullish sentiment is actually below the March 2020 COVID-lockdown low. Universal pessimism has historically represented attractive buying opportunities, especially when there are more "bears" than "bulls" as is the case today. While volatility is likely to remain high, a number of good companies are on sale. (3.1.22)