January 21, 2024

Dear Investor,

Those who cannot remember the past are condemned to repeat it.

- Santayana

Seems trite, on the one hand, yet screams loudly on the other. 2023 looks like it well may be a supreme re-run of 2021 … at least as measured by stock 'market' indices.

In 2021, stock markets floated up to all-time highs at year-end, Wall Street yammered about great days ahead, then handed off shares to ginned up retail investors in front of a historic beat-down. 2022 saw a relentless sell-off into late October, where 'markets' found their footing and have advanced steadily since.

Now, as then, the market advance powered upwards on the backs of central-planner manipulations. This time, however, the Treasury (not the Fed) is the source of the fiat debt-financed infusion of 'liquidity'. In 2021, it was the Fed relentlessly printing money and forcing down interest rates, with one after another Fed-head speakers jabbering about how they needed to boost inflation up to 2% 'for the good of all'.

In 2023, the Fed was in reverse gear almost the entire time. BUT, the Treasury, with former Fed chief Janet Yellen, goosed everything in sight, 'financing' today's profligate spending on everything in sight. With nary a hint of accountability (virtually no reliable tracking) she created ***trillions*** out of thin air, debt on the back of our kids' future.

With the public largely unversed in the history of fiat money and unable to fathom the scale of the activity money is printed ($80 billion here, $60 billion there), thrown overseas, laundered back locally, benefitting insiders who dominate business and government (sadly). The public gets inflation, insiders get filthy rich. The beast has likely grown too big to slay.

The **'LEVERS'** stocks we covered the past two quarters lifted market indices further, to deceptive levels (while the rest of the components of the indices advanced only modestly). They lifted into year-end, they were promptly dumped on January 2nd, once the Wall Street crowd could push capital gains taxes into 2025. We live in the financial Wild Wild West!

Yellen bailed out the banks in mid-March (or rather bank balance sheets which the Fed itself destroyed through its manipulations), then on Halloween she financed ***massive*** deficit spending, announcing her stunning 'Quarterly Refinancing Announcement' (QRA) of Treasury issuance (the country's debt). The Wall Street dog-whistle summoned the Q4 pump.

Since Halloween that same pattern of a broken US monetary system has reappeared: stock prices up *plus* bond prices up: ***both*** moving the same direction. The old concept of 'balanced' seems dead. Strike One was Q4 of 2018. Strike Two was calendar year 2022 (Nasdaq dropped **-34%**, the S&P 500 dove **-18%**, bonds crashing too: **-18%)**. Will Strike Three arrive in 2024? Either way, the Fed killed the natural order of markets. Killed it. It is Dead.

2024 is an election year. DC is a swamp. The Fed is anything but a-political. We can only imagine what can top lockdowns, masks, mostly peaceful protests and blatant media hysteria and nonsense like we saw in 2020. We will do our best to navigate it. Buckle your seatbelts.

Best Regards,

Mike Sullivan

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Detail

2023 Q4 resume the 'broken monetary system' pattern: prices of both bonds and stocks moving in the same direction ('un-balanced) Yellen loading up future debt to throw all over the planet did the trick. Here are the results (note that on October 17th, 9 of 17 indices we track were ***negative***!)

INDEX	TYPE	Q4	YTD
Standard & Poor's 500	US Based Large Stocks (500)	**11.7%**	**26.3%**
Dow Jones Industrials	US Based Large Stocks (30)	**13.1%**	**16.2%**
Nasdaq Composite	US Based Large Stocks	**13.6%**	**43.4%**
Standard & Poor's 400	US Based Mid-Cap Stocks (400)	**11.7%**	**16.4%**
Russell 2000	US Based Small-Cap Stocks (2000	**14.0%**	**16.9%**
Dow Jones Transports	US Based Transportation Stocks	**6.6%**	**20.6%**
Dow Jones Utilities	US Based Utility Stocks	**9.0%**	**-5.7%**
EAFE International Index	International Large Cap	**10.5%**	**18.8%**
MSCI Emerging Markets	Diversified Emerging Markets	**7.9%**	**9.8%**
Commodities	Bloomberg Commodity Index	**-4.6%**	**-7.9%**
10Y US Treasury Bonds	10 Y Us Treasury Bonds	**6.8%**	**3.5%**

Sources: *Bloomberg, vanguard.com, yahoo.com*

Here are your bullet-point market and economic highlights for Q4:

- Lever-Stock loaded Nasdaq led the way again up +13.6% in Q4
    - Everything else loved the new debt: Dow, Mid and Small indices climbed.
    - Even the Transports jumped, despite shipping volumes plummeting
- Interest rates plummeted. Part of Yellen's trick was she loaded the new debt to very short term maturities. That 'dog whistle' meant that new one and two year bonds dominated borrowing, which means she's betting interest rates will be lower then.
- The BRICS countries continued to align with each other … while dumping US debt.
- So who is buying this new US debt?
    - Government entities, pension funds, and money market funds buy up short term debt. Investors are happy to earn 4 to 5%+ without stock volatility.
    - Foreign banks are buying, despite foreign countries selling it.
- BRICS countries are escalating trading with each other, no longer using US dollars. The dollars will ultimately return to the US, keeping inflationary pressure up.
- Commodities dove, reflecting both the real economy slowing (see comment on Transports above). Even WW3 in the Middle East could not hold oil prices aloft.
- The 10 Year Treasury yield (which drives home & car loans, etc.) dropped over Q4.
- Housing is holding up in fewer regions now, but supply is still tight.
    - Many homeowners are trapped in their homes holding low mortgage rates.
- Inflation continues to subside, although not as much as markets hoped; December import prices were flat at 0.0% vs a -0.6% decline. CPI, Consumer Price Index *increased* but at a lower pace, prompting media false narratives it is 'falling'.
- Shipping in the Red Sea has essentially shut down with vessels being attacked by (Iran-backed) Houthi drones. Supply chain price pressures are about to re-appear, similar to during the Covid hysteria, again putting upward pressure on inflation.
- The bond market has priced in ***seven*** rate cuts for 2024 as a result of Yellen's dog whistle. The resulting 'stock prices up / bond prices up' move in markets will almost surely be in heavy reversal if the Fed cannot cut those rates as hoped.
- Economic/business indices in New York and Philadelphia show stark slow-downs. NY's Empire index dropped the most in 60 years last month, and Philly disappointed.

- Retail sales continue to show strength, but fewer units are being sold at higher prices.
- Yellen's March 2023 $800 billion back-door-bank-bailout is due to expire in March.
  - The banks continue to hold $700 billion in losses on their books, do we think she can shut down the program? No … the banks would resume their failures.
  - Embedded bank losses can be seen on the chart that follows.
- Yellen will announce her next QRA (Quarterly Refunding Announcement) in late January. This announcement of new 'borrowings' will indicate the new money the US has to borrow to keep everybody buying everything.
  - In our view, Yellen is a complete political hack. It is she, speaking for all Americans, that is funding via the debt-based money taken from the future, all of war efforts of the US and other countries, all of the border chaos, all of the social activities, and every resultant monetary expenditures that has to occur.
- But … at the surface, things continue to look ok, and are framed as 'good'
  - Asset prices remain at high levels (asset *owners* are happy for that)
  - Incomes are increasing (but lower income *people* struggle more and more)
  - People continue to be busy, consuming goods and services
- Wall Street firms like Goldman Sachs pumped 'buy' signals while actually selling equities itself[i] (see endnote article)
- Company Insiders have been selling stocks hand over fist (see chart below)
- Fundamentally, earnings expectations have continued to decrease steadily as seen in the table below. Although we see a recent uptick this first week of January, thus far 71 of the S&P 500 component companies have reported, cutting expectations by -2.2%, more than expected.

S&P 500 EPS growth expectations have fallen at an increasing rate this earnings season

Date	4Q23E EPS Growth	1Q24E EPS Growth	2Q24E EPS Growth	3Q24E EPS Growth
7/1/2023	1.32%	2.27%	-	-
8/1/2023	0.78%	1.41%	-	-
9/1/2023	0.64%	1.74%	6.76%	-
10/1/2023	**0.63%**	**1.63%**	**6.73%**	**10.21%**
11/1/2023	-1.22%	0.95%	6.19%	4.74%
12/1/2023	-3.60%	0.17%	5.94%	1.47%
1/1/2024	-3.32%	-0.04%	6.11%	0.92%
1/8/2024	**-3.35%**	**-0.11%**	**6.15%**	**0.99%**

Start of 3Q23 earnings season

Start of 4Q23 earnings season

Near term, technically, a stock market bounce can be expected.

Since the Halloween goosing, market breadth has improved. The notion of lower interest rates in 2024 sparked an initial rally, then under-invested advisors and retail investors alike began to chase. The many companies that lingered through the first ten months of 2023 joined in too.

Beyond that psychological rally, we await Yellen's late January QRA announcement. Yellen will again declare what level of pillaging of the future will be decided on our behalf.

With the knowledge that the 2023 bank bail-out program is scheduled to end in March, but the banks remain essentially insolvent without the bail-out, we expect she will extend that too.

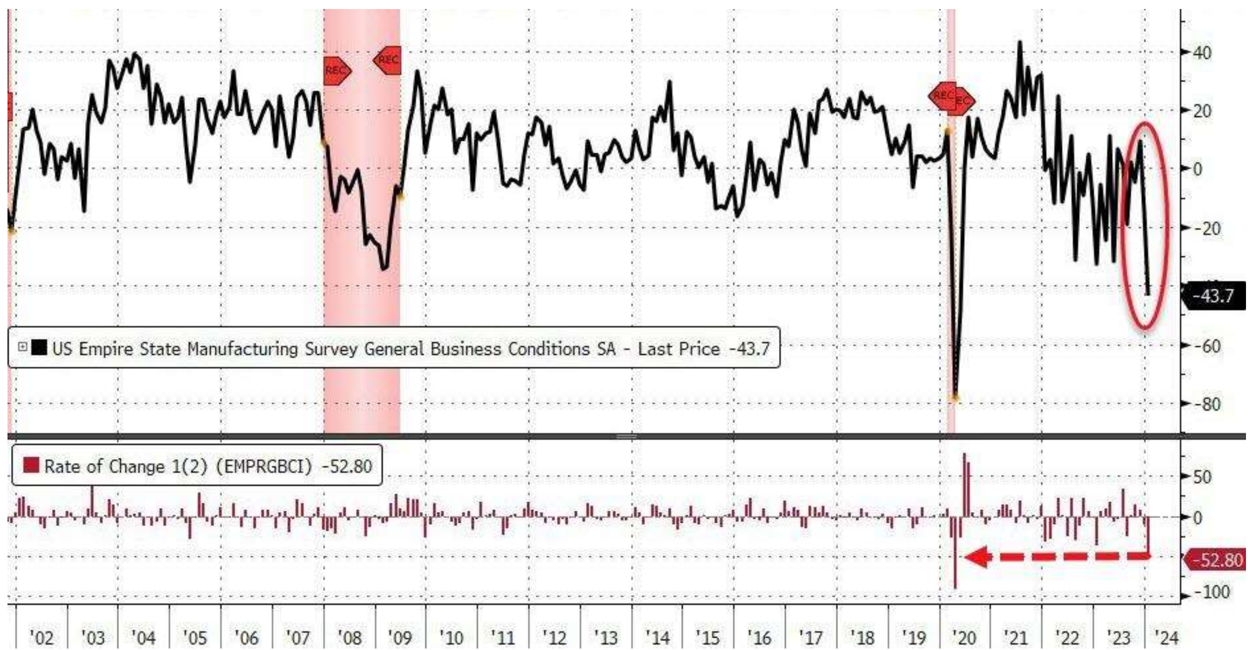
Both QRA and extension of bank bail-outs are supportive of asset prices.

You can see how the Treasury and Fed have turned markets into a debt-fueled game. We expect the US episode to end like every other fiat-money mis-adventure, there is no way for

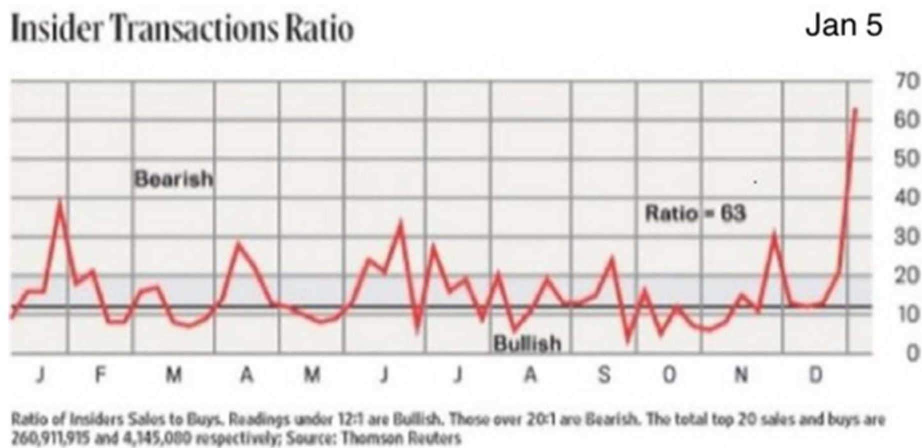
them to de-escalate the creation of new monetary units without collapsing everything. So … they won't … until it ends of its own accord.

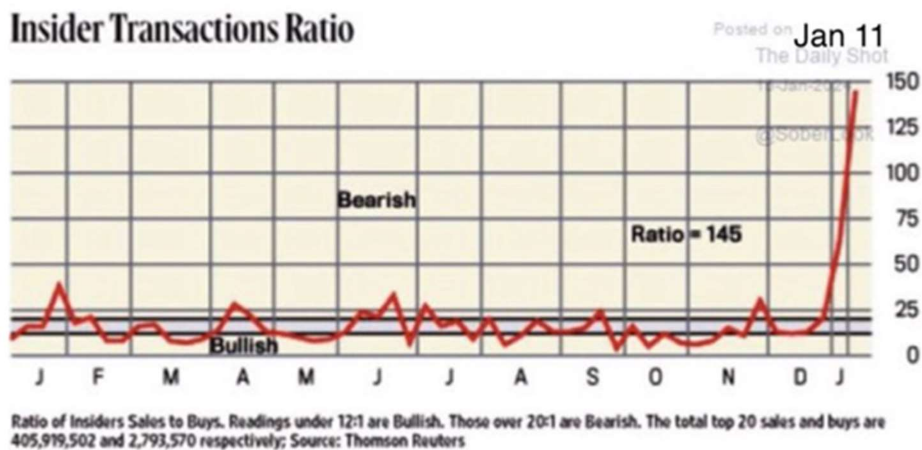
Should we choose to look for 'red-flags' past the year-end rally, we can find plenty:

Here is the Empire Index (NY Economic Activity) which dove the most on record for a month:



Company insiders are selling their shares of stock:





The banks are ***still*** essentially bankrupt (caused by the Fed's money printing and interest rate manipulations), and their bail-out from March 2023 will have to be extended (meaning more debt-based money will need to support them).

Said differently, as equity investors we are going to have to be betting on more of the same. We know with reasonably high probability that the situation will end, and end with a very unpleasant impact on asset prices, but we do not know when. Anyone that does not directly participate in central planning meetings, but states they know when it will happen is not being honest. We certainly do not know 'when', we simply measure the stakes and position accordingly.

Here are the losses on the banks' books, in just as bad shape as they were when Yellen stepped in to rescue the problem that she and the Fed created, and their only hope of delaying or avoiding a massively negative outcome is extension of the bail-out:

Unrealized Gains (Losses) on Investment Securities

Source: FDIC.
Note: Insured Call Report filers only. Unrealized losses on securities solely reflect the difference between the market value as of quarter end and the book value of non-equity securities.

Here is a quick recap, or for new readers an explanation: the losses are on long term bonds held as assets by the banks. (They are required to hold high quality bonds as assets.) As interest rates rise, say for example 1%, bond prices can be expected to drop by roughly 1% for each year left of life on each individual bond. So, when the Fed jacks interest rates up by 4% as they did this past cycle, bond prices can lose roughly 4% per year of life on the bond.

Remember, it was the Fed's printing of new money during Covid that caused deposits to fly into banks. The banks were then required to buy bonds. 2-year US Treasuries yielded a paltry 0.2% when the fiasco started, and 10-year Treasuries yielded as low as 0.7% per year. So … banks that wanted that extra yield, piled into 10-years for that extra little bit of yield. When the inflation resulted from all the new currency units flying around, and the Fed embarked on 4%+ of rate hikes, it decimated the asset portfolios of the banks.

Logically, the banks did not pay 'savers' any more interest … because they had very little coming in … only that 0.7% from long term Treasuries! So all the deposits left, moving to money market investments that were earning the higher and higher rates.

Thus, to pay the 'savers' who were leaving, the banks could only sell their bonds, which were at staggering losses. Enter Yellen, see her volunteering more debt for the US, and watch her fix the same problem she and the Fed created … with the same solution.

This is how centrally planned monetary regimes end.

Note the losses continue to be substantial. Also note that the FDIC insurance fund has roughly only 1%+ of the money needed to bail out bank deposits. And note that the logical implication is that the Treasury will have to bail out the banks because FDIC cannot.

Hence, our preference for treasury money market instruments over bank assets. The FDIC insurance is dependent on the treasury, so why not go direct to the treasury for better yield?

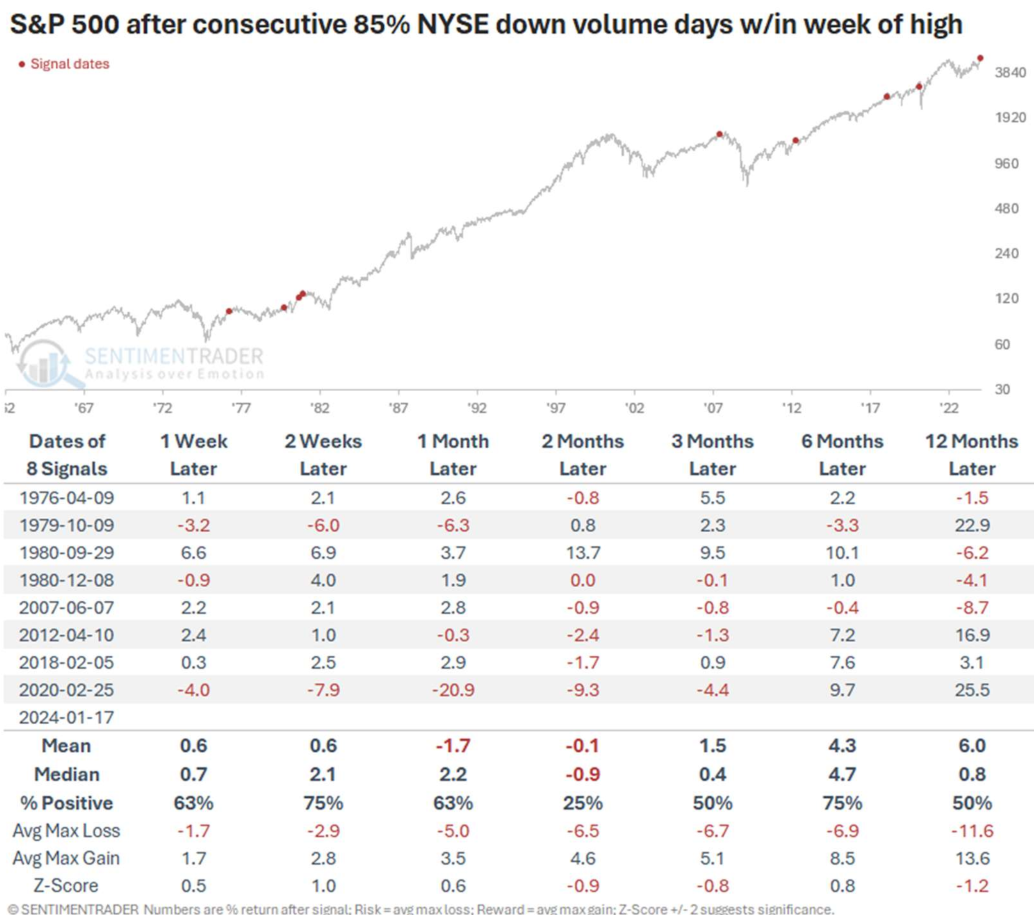
You can throw away the gobblety gook words the Fed and Treasury use to explain their activities, they're a one-trick pony.

Precisely when this fact matters, we do not know, but matter it will. And Yellen really has no choice but to extend the bail-out again.

Once more, that is supportive of asset prices, but it is also a visible malignancy. One day it will matter.

For equity investors, the question is: 'do you want to chase it'?

If the Red Sea supply chain pressures continue, or economic activity continues to be strong, inflation pressures will stay elevated, rates will stay elevated, the bond losses on the banks books will remain substantial.



Dates of 8 Signals	1 Week Later	2 Weeks Later	1 Month Later	2 Months Later	3 Months Later	6 Months Later	12 Months Later
1976-04-09	1.1	2.1	2.6	-0.8	5.5	2.2	-1.5
1979-10-09	-3.2	-6.0	-6.3	0.8	2.3	-3.3	22.9
1980-09-29	6.6	6.9	3.7	13.7	9.5	10.1	-6.2
1980-12-08	-0.9	4.0	1.9	0.0	-0.1	1.0	-4.1
2007-06-07	2.2	2.1	2.8	-0.9	-0.8	-0.4	-8.7
2012-04-10	2.4	1.0	-0.3	-2.4	-1.3	7.2	16.9
2018-02-05	0.3	2.5	2.9	-1.7	0.9	7.6	3.1
2020-02-25	-4.0	-7.9	-20.9	-9.3	-4.4	9.7	25.5
2024-01-17							
Mean	**0.6**	**0.6**	**-1.7**	**-0.1**	**1.5**	**4.3**	**6.0**
Median	**0.7**	**2.1**	**2.2**	**-0.9**	**0.4**	**4.7**	**0.8**
% Positive	**63%**	**75%**	**63%**	**25%**	**50%**	**75%**	**50%**
Avg Max Loss	-1.7	-2.9	-5.0	-6.5	-6.7	-6.9	-11.6
Avg Max Gain	1.7	2.8	3.5	4.6	5.1	8.5	13.6
Z-Score	0.5	1.0	0.6	-0.9	-0.8	0.8	-1.2

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The table above comes from Jason Goepfert of Sentiment Trader.

Of note, in 1979 after struggling through a rough month, the S&P 500 ended the year strong. Could that await during the 2024 election year? Or, is that asking too much of our deliberately fractured country? Compromised central planners finance exploding national debt, have eviscerated free markets, and funded a thoroughly corrupt government. Medical institutions financed by big-pharma are thoroughly discredited. Trust in institutions is justifiably at all-time lows … a hallmarks of failed nation-states.

In contrast to 1979 when the era of exponential money printing was young and the nation was principled and rightfully proud, today we are essentially bankrupt, deliberately divided, and have a destroyed middle class. Consumers continue to do what they do best: consume. Credit card debt and their corresponding interest rates have not stopped the train … yet.

In the face of the meddling of central planning, there is no precise way to determine when the system will reach its limitations. 2023 proved that American investors were willing to chase price, ignore geopolitical messes and political corruption, accept inflationary repression of a wide swath of America and border invasions, and just about every other red flag there is.

So we will continue to assist clients with their assets, seeking prudent moves in the paper-wealth markets, and consulting on the role of real and other assets in financial plans.

Call us if we can be of assistance at (614) 734-WLTH (9584).

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[i] https://www.zerohedge.com/markets/goldman-was-dumping-billions-stocks-and-other-assets-it-told-clients-buy