Global Market Comments
January 5, 2022
Fiat Lux

2022 Annual Asset Class Review
A Global Vision

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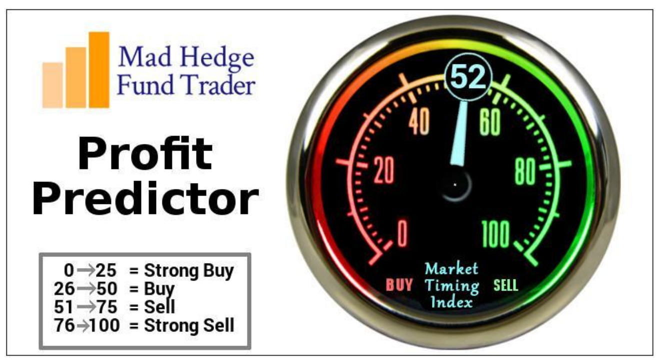
Featured Trades:
(SPX), (QQQ), (XLF), (XLE), (XLY),
(TLT), (TBT), (JNK), (PHB), (HYG), (PCY), (MUB), (HCP)
(FXE), (EUO), (FXC), (FXA), (YCS), (FXY), (CYB)
(BHP), (FCX), (VALE), (AMLP), (USO), (UNG),
(GLD), (GDX), (SLV), (ITB), (LEN), (KBH), (PHM)



1) **2022 Annual Asset Class Review**

I am once again writing this report from a first-class sleeping cabin on Amtrak's legendary ***California Zephyr***.

By day, I have two comfortable seats facing each other next to a panoramic window. At night, they fold into two bunk beds, a single and a double. There is a shower, but only Houdini could navigate it.
I am anything but Houdini, so I go downstairs to use the larger public hot showers. They are divine.

We are now pulling away from Chicago's Union Station, leaving its hurried commuters, buskers, panhandlers, and majestic great halls behind. I love this building as a monument to American exceptionalism.

I am headed for Emeryville, California, just across the bay from San Francisco, some 2,121.6 miles away. That gives me only 56 hours to complete this report.

I tip my porter, Raymond, $100 in advance to make sure everything goes well during the long adventure, and to keep me up to date with the onboard gossip.

The rolling and pitching of the car is causing my fingers to dance all over the keyboard. Microsoft's Spellchecker can catch most of the mistakes, but not all of them.

As both broadband and cell phone coverage are unavailable along most of the route, I have to rely on frenzied Internet searches during stops at major stations along the way to Google obscure data points and download the latest charts.

You know those cool maps in the Verizon stores that show the vast coverage of their cell phone networks? They are complete BS.

Who knew that 95% of America is off the grid? That explains so much about our country today.

I have posted many of my better photos from the trip below, although there is only so much you can do from a moving train and an iPhone 12X pro.

Here is the bottom line which I have been warning you about for months. In 2022 you are going to have to work twice as hard to earn half as much money with double the volatility.

It’s not that I’ve turned bearish. The causes of the next bear market, a recession, is at best years off. However, we are entering the third year of the greatest bull market of all time. Expectations have to be toned down and brought back to earth. Markets will no longer be so strong that they forgive all mistakes, even mine.

2022 will be a trading year. Play it right, and you will make a fortune. Get lazy and complacent and you’ll be lucky to get out with your skin still attached.

If you think I spend too much time absorbing conspiracy theories or fake news from the Internet, let me give you a list of the challenges I see financial markets facing in the coming year:

The Ten Key Variables for 2022

1) How soon will the Omicron wave peak?
2) Will the end of the Fed's quantitative easing knock the wind out of the bond market?
3) Will the Russians invade the Ukraine, or just bluster as usual?
4) How much of a market diversion will the US midterm elections present?
5) Will technology stocks continue to dominate, or will domestic recovery, and value stocks take over for good?
6) Can the commodities boom get a second wind?
7) How long will the bull market for the US dollar continue?
8) Will the real estate boom continue, or are we headed for a crash?
9) Has international trade been permanently impaired or will it recover?
10) Is oil seeing a dead cat bounce or is this a sustainable recovery?


DANGER
THIN
ICE

The Thumbnail Portfolio

Equities – buy dips
Bonds – sell rallies
Foreign Currencies – stand aside
Commodities – buy dips
Precious Metals – stand aside
Energy – stand aside
Real Estate – buy dips
Bitcoin – Buy dips

1) ***The Economy –***

What happens after a surprise variant takes covid cases to new all time highs, the Fed tightens, and inflation soars?

Covid cases go to zero, the Fed flip flops to an ease, and inflation moderates to its historical norm of 3% annually.

It all adds up to a 5% US GDP growth in 2022, less than last year's ballistic 7% rate, but still one of the hottest growth rates in history.

If Joe Biden's build back batter plan passes, even in diminished form, that could add another 1%.

Once the supply chain chaos resolves inflation will cool. But after everyone takes delivery of their over orders conditions could cool.

This sets up a Goldilocks economy that could go on for years: high growth, low inflation, and full employment. Help wanted signs will slowly start to disappear. A 3% handle on Headline Unemployment is withing easy reach.

A Rocky Mountain Moose Family

2) ***Equities* (SPX), (QQQ), (IWM) (AAPL), (XLF), (BAC)**

The weak of heart may want to just index and take a oneyear cruise around the world instead of in 2022 (here is the link for Cunard at https://www.cunard.com/en-us/cruise-destinations/world-voyage).

So here is the perfect 2022 for stocks. A 10% dive in the first half, followed by a rip roaring 20% rally in the second half. This will be the year when a big rainy-day fund, i.e., a mountain of cash to spend at market bottoms, will be worth its weight in gold.

That will enable us to load up with LEAPS at the bottom and go 100% invested in every month in H2.

That should net us a 50% profit or better in 2022, or about half of what we made last year.

Why am I so cautious?

Because for the first time in seven years we are going to have to trade with a headwind of rising interest rates. However, I don't think rates will rise enough to kill off the bull market, just give traders a serious scare.

The barbell strategy will keep working. When rates rise, financials, the cheapest sector in the market will prosper. When they fall, Big Tech will take over, but not as much as last year.

The main support for the market right now is very simple. The investors who fell victim to capitulation selling that took place at the end of November never got back in. Shrinking volume figures prove that. Their efforts to get back in during the new year could take the S&P 500 as high as $5,000 in January.

After that the trading becomes treacherous. Patience is a virtue, and you should only continue new longs when the Volatility Index (VIX) tops $30. If that means doing nothing for months so be it.

We had four 10% corrections in 2021. 2022 will be the year of the 10% correction.

Energy, Big Tech, and financials will be the top performing sectors of 2022. Big Tech saw a 20% decline in multiples in 2022 and will deliver another 30% rise in earnings in 2022, so they should remain at the core of any portfolio.

It will be a stock pickers market. But so was 2021, with 51% of S&P 500 performance coming from just two stocks, Tesla (TSLA) and Alphabet (GOOGL).

However, they are already so over owned that they are prone to dead periods as long as eight months, as we saw last year. That makes a multipronged strategy essential.

Frozen Headwaters of the Colorado River

3) *Bonds* (TLT), (TBT), (JNK), (PHB), (HYG), (MUB), (LQD)

Amtrak needs to fill every seat in the dining car to get everyone fed on time, so you never know who you will share a table with for breakfast, lunch, and dinner.

There was the Vietnam Vet Phantom Jet Pilot who now refused to fly because he was treated so badly at airports. A young couple desperately eloping from Omaha could only afford seats as far as Salt Lake City. After they sat up all night, I paid for their breakfast.

A retired British couple was circumnavigating the entire US in a month on a "See America Pass." Mennonites returning home by train because their religion forbade automobiles or airplanes.

The national debt ballooned to an eye popping $30 trillion in 2021, a gain of an incredible $3 trillion and a post-World War II record. Yet, as long as global central banks are still flooding the money supply with trillions of dollars in liquidity, bonds will not fall in value too dramatically. I'm expecting a slow grind down in prices and up in yields.

The great bond short of 2021 never happened. Even though bonds delivered their worst returns in 19 years, they still remained nearly unchanged. That wasn't good enough for the many hedge funds, which had to cover massive money losing shorts into yearend.

Instead, the Great Bond Crash will become 2022 business. This time, bonds face the gale force headwinds of three promised interest rates hikes. The yearend government bond auctions were a complete disaster.

Fed borrowing continues to balloon out of control. It's just a matter of time before the last billion dollars in government borrowing breaks the camel's back.

That makes a bond short a core position in any balanced portfolio. Don't get lazy. Make sure you only sell a rally lest we get trapped in a range, as we did for most of 2021.

A Visit to the 19th Century

4) Foreign Currencies (FXE), (EUO), (FXC), (FXA), (YCS), (FXY), (CYB)

For the first time in ages, I did no foreign exchange trades last year. That is a good thing because I was wrong about the direction of the dollar for the entire year.

Sometimes, passing on bad trades is more important than finding good ones.

I focused on exploding US debt and trade deficits undermining the greenback and igniting inflation. The market focused on a delta and omicron variants heralding new recessions. The market won.

The market won't stay wrong forever. Just as the bond crash is temporarily in a holding pattern, so is a dollar collapse. When it does occur, it will happen in a hurry.

5) **Commodities (FCX), (VALE), (DBA)**

The global synchronized economic recovery now in play can mean only one thing, and that is sustainably higher commodity prices.

The twin covid variants put commodities on hold in 2021 because of recession fears. So did the Chinese real estate slowdown, the world's largest consumer of hard commodities.

The heady days of the 2011 commodity bubble top are now in play. Investors are already front running that move, loading the boat with Freeport McMoRan (FCX), US Steel (X), and BHP Group (BHP).

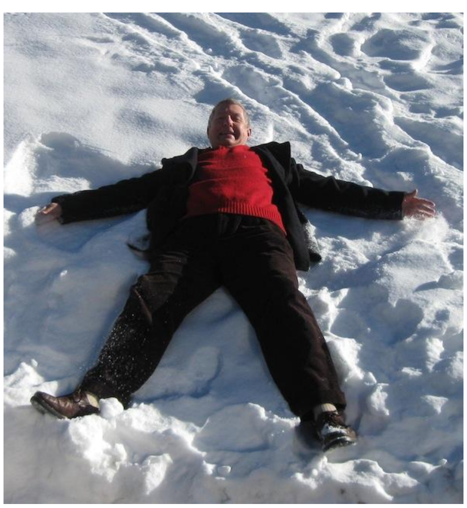
Now that this sector is convinced of an eventual weak US dollar and higher inflation, it is once more the apple of traders' eyes.

China will still demand prodigious amounts of imported commodities once again, but not as much as in the past. Much of the country has seen its infrastructure build out, and it is turning from a heavy industrial, to a service-based economy, like the US. Investors are keeping a sharp eye on India as the next major commodity consumer.

And here's another big new driver. Each electric vehicle requires 200 pounds of copper and production is expected to rise from 1 million units a year to 25 million by 2030. Annual copper production will have to increase 11-fold in a decade to accommodate this increase, no easy task, or prices will have to ride.

The great thing about commodities is that it takes a decade to bring new supply online, unlike stocks and bonds, which can merely be created by an entry in an excel spreadsheet. As a result, they always run far higher than you can imagine.

Accumulate commodities on dips.



Snow Angel on the Continental Divide

6) **Energy (DIG), (RIG), (USO), (DUG), (UNG), (USO), (XLE), (AMLP)**

Energy may be the top performing sector of 2022. But remember, you will be trading an asset class that is eventually on its way to zero.

However, you could have several doublings on the way to zero. This is one of those times.

The real tell here is that energy companies are drinking their own Kool-Aide. Instead of reinvesting profits back into their new exploration and development, as they have for the last century, they are paying out more in dividends.

There is the additional challenge in that the bulk of US investors, especially environmentally friendly ESG funds, are now banned from investing in legacy carbon-based stocks. That means permanently cheap valuations and shares prices for the energy industry.

Energy stocks are also massively under-owned, making them prone to rip-you-face-off short squeezes. Energy now counts for only 3% of the S&P 500. Twenty years ago it boasted a 15% weighting.

The gradual shut down of the industry makes the supply/demand situation more volatile. Therefore, we could top $100 a barrel for oil in 2022, dragging the stocks up kicking and screaming all the way.

Unless you are a seasoned, peripatetic, sleep-deprived trader, there are better fish to fry.

7) **Precious Metals (GLD), (DGP), (SLV), (PPTL), (PALL)**

The train has added extra engines at Denver, so now we may begin the long laboring climb up the Eastern slope of the Rocky Mountains.

On a steep curve, we pass along an antiquated freight train of hopper cars filled with large boulders.

The porter tells me this train is welded to the tracks to create a windbreak. Once, a gust howled out of the pass so swiftly, that it blew a passenger train over on to its side.

In the snow filled canyons, we sight a family of three moose, a huge herd of elk, and another group of wild mustangs. The engineer informs us that a rare bald eagle is flying along the left side of the train. It's a good omen for the coming year.

We also see countless abandoned 19th century gold mines and the broken-down wooden trestles leading to them, relics of previous precious metals booms. So, it is timely here to speak about the future of precious metals.

Fortunately, when a trade isn't working, I avoid it. That certainly was the case with gold last year.

2021 was a terrible year for precious metals. With inflation soaring, stocks volatile, and interest rates going nowhere, gold had every reason to rise. Instead, it fell for almost all of the entire year.

Bitcoin stole gold's thunder, sucking in all of the speculative interest in the financial system. Jewelry and industrial demand alone was just not enough to keep gold afloat.

This will not be a permanent thing. Chart formations are starting to look encouraging, and they certainly win the price for a big laggard rotation. So, buy gold on dips if you have a stick of courage on you.

Would You Believe This is a Blue State?

8) **Real Estate (ITB), (LEN),**

The majestic snow-covered Rocky Mountains are behind me. There is now a paucity of scenery, with the endless ocean of sagebrush and salt flats of Northern Nevada outside my window, so there is nothing else to do but write.

My apologies in advance to readers in Wells, Elko, Battle Mountain, and Winnemucca, Nevada.

It is a route long traversed by roving banks of Indians, itinerant fur traders, the Pony Express, my own immigrant forebearers in wagon trains, the transcontinental railroad, the Lincoln Highway, and finally US Interstate 80, which was built for the 1960 Winter Olympics at Squaw Valley.

Passing by shantytowns and the forlorn communities of the high desert, I am prompted to comment on the state of the US real estate market.

There is no doubt a long-term bull market in real estate will continue for another decade, although from here prices will appreciate at a 5%-10% slower rate.

There is a generational structural shortage of supply with housing which won't come back into balance until the 2030's.

There are only three numbers you need to know in the housing market for the next 20 years: there are 80 million baby boomers, 65 million Generation Xer's who follow them, and 86 million in the generation after that, the Millennials.

The boomers have been unloading dwellings to the Gen Xer's since prices peaked in 2007. But there are not enough of the latter, and three decades of falling real incomes mean that they only earn a fraction of what their parents made. That's what caused the financial crisis.

If they have prospered, banks won't lend to them. Brokers used to say that their market was all about "location, location, location." Now it is "financing, financing, financing." Imminent deregulation is about to deep six that problem.

There is a happy ending to this story.

Millennials now aged 26-44 are now the dominant buyers in the market. They are transitioning from 30% to 70% of all new buyers of homes.

The Great Millennial Migration to the suburbs and Middle America has just begun. Thanks to Zoom, many are never returning to the cities. So has the migration from the coast to the American heartland.

That's why Boise, Idaho was the top performing real estate market in 2021, followed by Phoenix, Arizona. Personally, I like Reno, Nevada, where Apple, Google, Amazon, and Tesla are building factories as fast as they can.

As a result, the price of single-family homes should rocket during the 2020's, as they did during the 1970's and the 1990's, when similar demographic forces were at play.

This will happen in the context of a coming labor shortfall, soaring wages, and rising standards of living.

Rising rents are accelerating this trend. Renters now pay 35% of their gross income, compared to only 18% for owners, and less, when multiple deductions and tax subsidies are taken into account. Rents are now rising faster than home prices.

Remember, too, that the US will not have built any new houses in large numbers in 13 years. The 50% of small homebuilders that went under during the crash aren't building new homes today.

We are still operating at only a half of the peak rate. Thanks to the Great Recession, the construction of five million new homes has gone missing in action.

That makes a home purchase now particularly attractive for the long term, to live in, and not to speculate with.

You will boast to your grandchildren how little you paid for your house, as my grandparents once did to me ($3,000 for a four-bedroom brownstone in Brooklyn in 1922), or I do to my kids ($180,000 for a two bedroom Upper East Side Manhattan high rise with a great view of the Empire State Building in 1983).

That means the major homebuilders like Lenar (LEN), Pulte Homes (PHM), and KB Homes (KBH) are a buy on the dip.

Quite honestly, of all the asset classes mentioned in this report, purchasing your abode is probably the single best investment you can make now. It' also a great inflation play.

If you borrow at a 3.0% 30-year fixed rate, and the long-term inflation rate is 3%, then, over time, you will get your house for free.

How hard is that to figure out? That math degree from UCLA is certainly earning its keep.

Crossing the Bridge to Home Sweet Home

9) Bitcoin

It’s not often that new asset classes are made out of whole cloth. That is what happened with Bitcoin, which in 2021 became a core holding of many big institutional investors.

But get used to the volatility. After doubling in three months, Bitcoin gave up all its gains by yearend. You have to either trade Bitcoin like a demon or keep your positions so small you can sleep at night.

By the way, right now is a good place to establish a new position in Bitcoin.

10) Postscript

We have pulled into the station at Truckee in the midst of a howling blizzard.

My loyal staff have made the ten mile treck from my beachfront estate at Incline Village to welcome me to California with a couple of hot breakfast burritos and a chilled bottle of Dom Perignon Champagne, which has been resting in a nearby snowbank. I am thankfully spared from taking my last meal with Amtrak.

After that, it was over legendary Donner Pass, and then all downhill from the Sierras, across the Central Valley, and into the Sacramento River Delta.

Well, that's all for now. We've just passed what left of the Pacific mothball fleet moored near the Benicia Bridge (2,000 ships down to six in 50 years). The pressure increase caused by a 7,200 foot descent from Donner Pass has crushed my plastic water bottle. Nice science experiment!

The Golden Gate Bridge and the soaring spire of Salesforce Tower are just around the next bend across San Francisco Bay.

A storm has blown through, leaving the air crystal clear and the bay as flat as glass. It is time for me to unplug my Macbook Pro and iPhone X, pick up my various adapters, and pack up.

We arrive in Emeryville 45 minutes early. With any luck, I can squeeze in a ten mile night hike up Grizzly Peak and still get home in time to watch the ball drop in New York's Times Square on TV.

I reach the ridge just in time to catch a spectacular pastel sunset over the Pacific Ocean. The omens are there. It is going to be another good year.

I'll shoot you a ***Trade Alert*** whenever I see a window open at a sweet spot on any of the dozens of trades described above.

Good luck and good trading in 2022!

John Thomas
The Mad Hedge Fund Trader

The Omens Are Good for 2022!