January 14, 2022

Dear Investor,

First, a thank you to all of our clients who moved along with us to our new home. Most of you have arrived safely and securely as expected and are getting acclimated to the new system and statements. An addendum is included with this letter that describes the various entities involved in our service to you, and a look at what you can expect as we roll through 2022.

Regarding 2021, 'markets' wrapped up 2021 on an absurdly strong note, pushed by the Federal Reserve's relentless destruction of U.S. dollars. The Fed printed $120 Billion per month almost every month of 2021, and the flood of new dollars continued to pile into assets, making most assets require more and more dollars to purchase them. Major stock market indices finished the year in positive territory with many ranging from low teens to twenties, while bonds dragged against them exemplified by the 10 year US Treasury bond's -3.5% drag. Cash again earned zero.

For years, really since the Housing Bubble bust of 2009, we have written about the state of the monetary system and markets, and overlaid it with some lessons from history. History lessons have been little more than that to date, but that may be about to change as we will discuss here.

We are often asked what we do. The answer is relatively simple: we look to grow and protect assets for people we care about, which is everyone who entrusts their assets to us.

A sub-plot to that is: ***we search for truth***.

In an honest world, truth would govern the direction of asset prices. In fact, it used to be that way. Unfortunately, today's world is highly devoid of truth. Therein lies the challenge.

It has been fascinating to note that two driving forces of asset prices are 1) manipulation of markets by central banks and their constituents, and 2) acceptance and embrace of it by investors.

An inflection point in this condition is capable of changing market direction quickly and powerfully. There are many hints that we may be at that inflection point, 2022 may be pivotal.

As we have said numerous times, the Fed has turned markets into a game. The Vice Chairman of the Federal Reserve, Richard Clarida just announced his resignation … on the heels of two other Fed presidents, all of whom were trading their personal portfolios at the same time they were making decisions about how much of the country's money they should print out of thin air.

Anyone who has ever made the statement 'and they're using our *tax dollars*' to voice displeasure with some decision coming out of Washington DC, has missed the point entirely about how the monetary system and markets work. For Fiscal 2021, the US government collected $3.9 Trillion in taxes.[i] The Covid response since April 2020 has seen **$15** to **$18** Trillion in money printed.

We explain all of that further in the update that follows as we consider whether we may or may not be near a market top. Call us at 614-698-0333 if we can review your strategy and allocations with you!

Best Regards,

Mike Sullivan, President, Certified Financial Planning Professional ®

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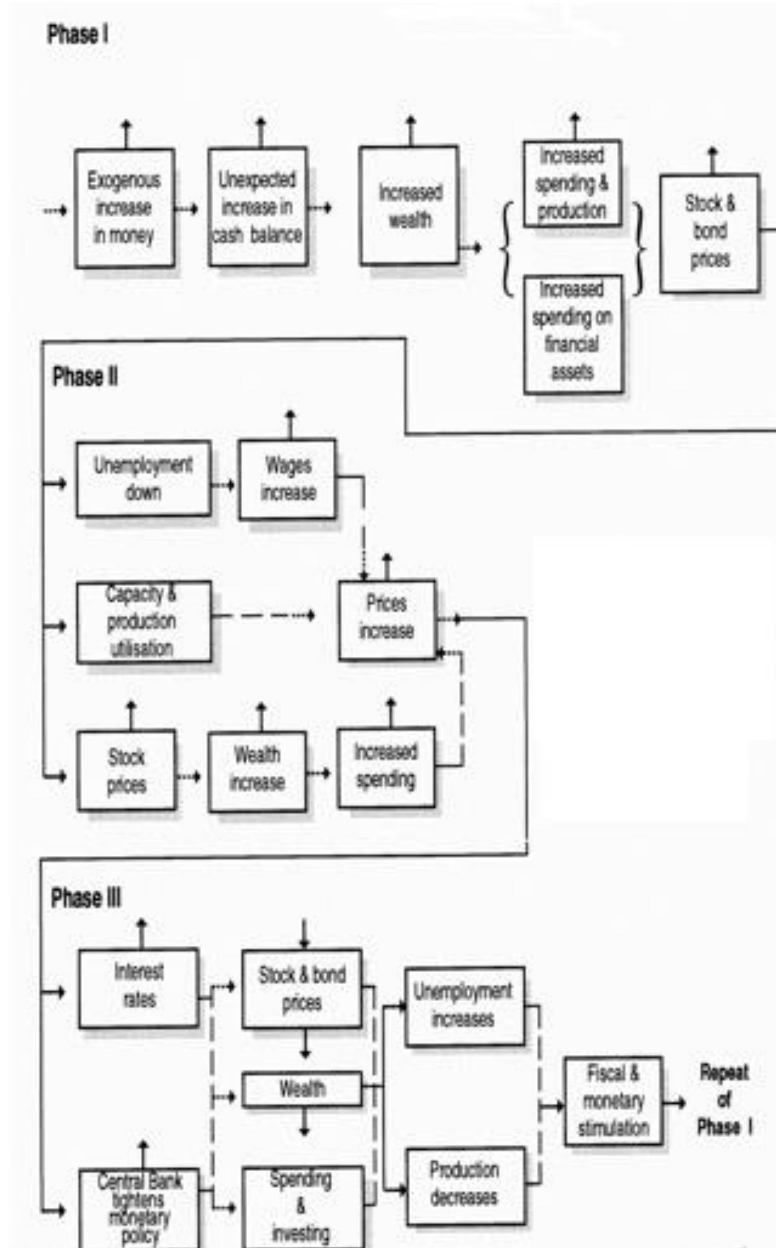
Perspective & Outlook:

Before we get into the 2021 results, let's take a look at the Economic Cycle, illustrated below.

The resulting Bail-Out from the 'Greatest Crisis Since the Great Depression' in 2009 prevented companies from defaulting on loans, and the unprecedented new supply of dollars since then motivated market participants to pile them into asset prices, buying those assets back up and propelling them to current levels. We see that sequence of events represented in Phase I:



The cycle looked like it may have ended as Covid arrived in Q1 of 2020, but the invention of the $15 - $18 Trillion referenced previously served to goose us for another two years.

Most investors ***see*** wild disconnects between real economic activity and surging asset prices (#1 manipulation of asset prices), but rather accept it for what it is (#2 acceptance/embrace).

While monetary manipulations have played out in history books numerous times before in many locations, that lesson has been ignored and a lot of money has been 'made' since, by all who obliged the Fed's actions. Nonetheless, we seem to now find ourselves near or at the end of Phase 2 in the Economic Cycle above: unemployment is down (3.9% reported Friday)[ii], wages have increased, prices have increased, and most certainly stock prices, wealth and spending have all increased. This is clearly Phase 2, as you can see.

The Fed has stated it will stop the 2021 manipulations of printing $120 Billion every month. They do this not at all because they want to, but rather because they have to at least pretend temporarily that they are responsible stewards of the country's currency, the US dollar.

In noting Phase 3, we can see that as the Fed is forced to tighten monetary policy, interest rates should rise, asset prices and wealth should decline, and unemployment should reverse course and then begin to rise once again.

If the Fed does not tighten, its credibility as a 'central bank' will be shot.

Truthfully, the Fed's credibility is already long past 'shot'. An increasing number of highly informed professional advisors ***know*** the Fed has been derelict in its duties, although some empathize that perhaps there is some good intent in that they naturally just do not want to be responsible for deflating the asset bubbles they have created. However, Fed members are also guilty of what is highly unethical (and even criminal) behavior for others in the financial industry. The resignations of the Fed officials that were trading their own accounts while making decisions about how much of the country's money to print, essentially raiding the (empty) US Treasury is Banana Republic type behavior. Too bad, they'll get to just quietly exit stage right and bear zero consequence, while anyone else might end up in jail.

The Fed has de-valued the dollar to such an extent that their activity can no longer be hidden by deceptive measures, like their 'Inflation' metrics. They further try to hide truth, however, as evidenced by the fact they are changing the Inflation calculation for 2022. Seem innocent?

The Fed's deceptive numbers matter primarily only to Wall Street traders' short-term trading activity, and the segment of the investing public that goes along for the ride. But those disingenuous numbers do not matter *at all* to people who do not hold investment assets. Rather what matters to them, is using their devalued dollars to buy fewer groceries, pay higher rent, buy more expensive cars, houses and everything else. That group of people is not impacted by false numbers the Fed's bureaucrats' report, but rather by real inflation. Truth.

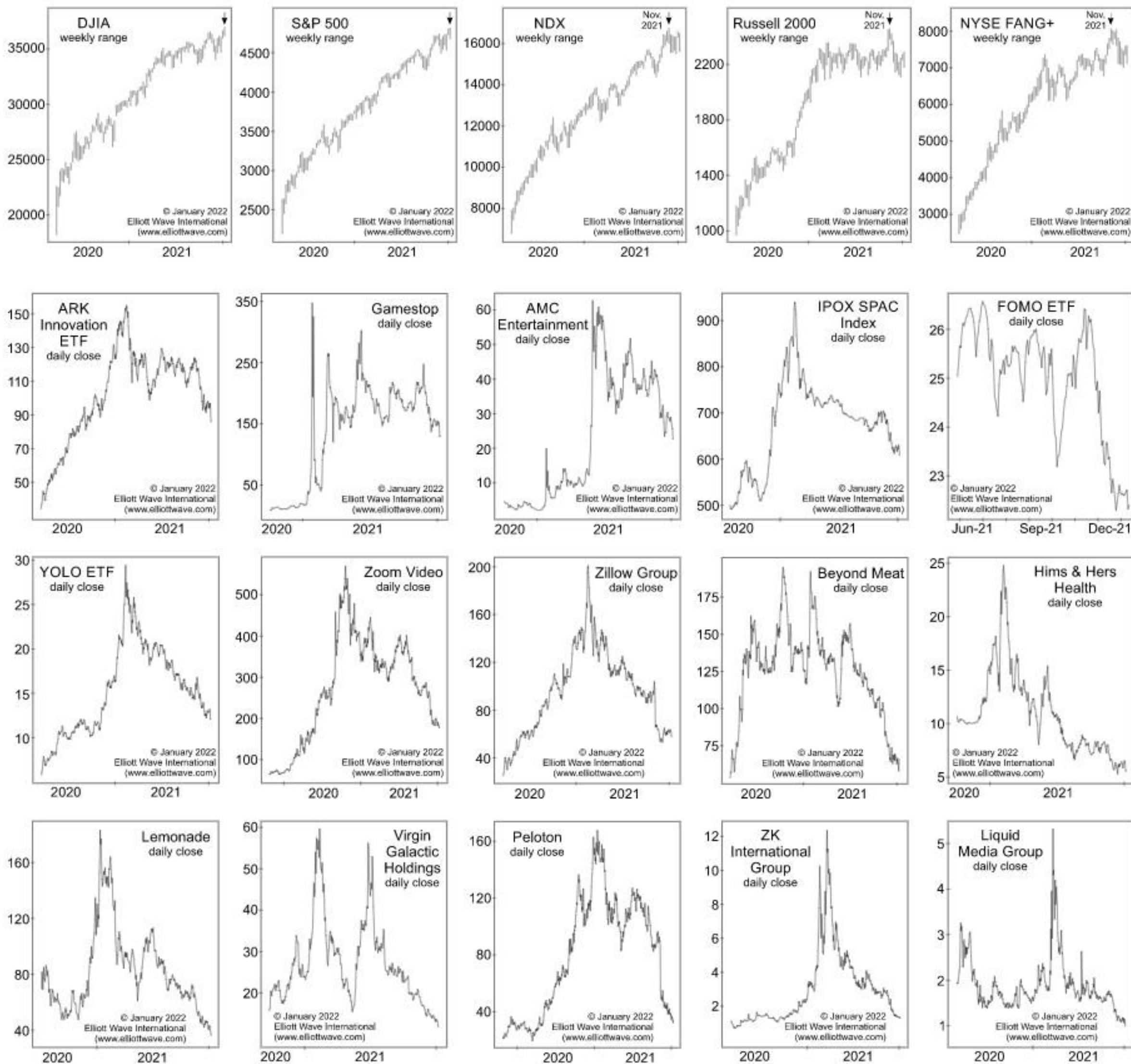
So, as we look at the Economic Cycle, we note that if in fact the Fed is going to be forced to reduce the pace of their money printing and to actually allow interest rates to rise, we should be entering Phase 3 … if we are not already in it. That suggests the long market rally since 2009 may be near or at an end.

Importantly, in rare examples of honesty, the Fed has stated numerous times that asset prices have been the primary target of their Fed policy. So, for them to have to release control of asset prices, and stop inflating them, it suggests a pivot in economy and markets may have arrived.

Let's get back to the two driving forces (truths) that have determined the trajectory of the markets since 2009: 1) manipulation, and 2) investor acceptance.

Manipulations can be easily seen in stocks of Zombie companies, IPOs (Initial Public Offering) companies that sell themselves to investors by issuing new stock, and stocks of other companies that are perhaps profitable, but very highly priced. The charts that follow show us the major market indices (top row), followed by many companies in the categories just mentioned. Note that while indices have reached their highs just recently, many of the over-valued speculative stocks began declining heavily months prior, many in October or November of 2021:

THE STOCK MARKET



The Fed knows that prices must continuously rise and any interruption in that trajectory will have a cascading effect. Wall Street knows that ***if*** the Fed is going to be forced to reduce its money-printing activities, and let interest rates rise, there will be less money in their hands to pump up stock prices of unprofitable companies. Moreover, if those companies have to pay even more dollars in interest to pay their debt, they will become even less profitable.

The Fed has trained Wall Street to pump asset prices, and to then beat those prices down to force the Fed (or give it cover) to resume printing money. 2022 has had a wild start, with the market expecting 4 rate hikes now in 2022, declining strongly, then rallying when JP Morgan's

Jamie Dimon came out to sing the praises of the 'strong Consumer', but he predicts volatility in markets. Such 'banker-speak' usually ends up being self-fulfilling. So far it has been in 2022.

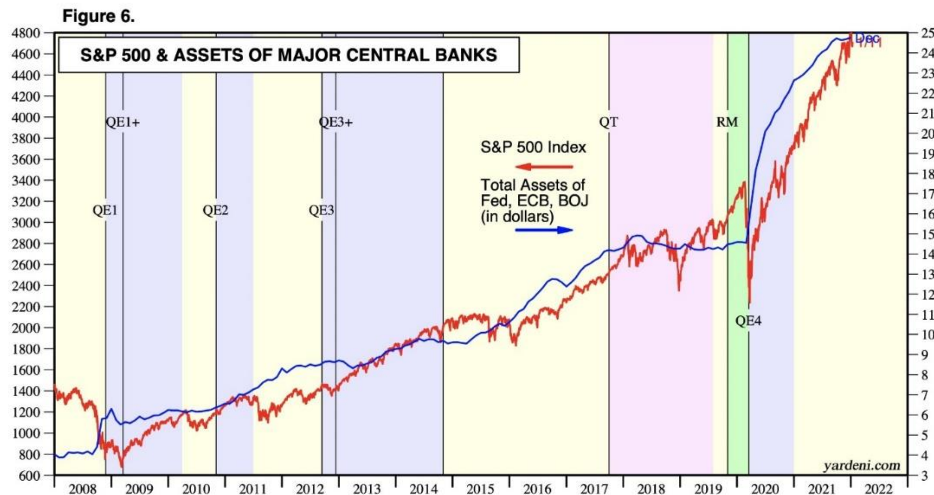
As we have discussed numerous times in the past, Wall Street uses the high-dollar stocks like Facebook, Amazon, Netflix, Google, Microsoft, Apple, etc. to lift index prices (see top row above) while they then sell many of the other stocks in the market. The investor sees the headline print where the major indices rise, but does not see the distribution of all the other stocks in the index underneath the headline number, distribution that has been fairly heavy for months.

Since April 2021, 5 stocks were responsible for over half the S&P 500's gains.[iii] As of January 5th, as the Nasdaq index tickled its all-time high (thanks to Wall Street lifting those 5 stocks), 40% of stocks in that very index were down *50%* from their 52 week highs. If a 20% decline is Wall Street-speak for a bear market … what do we call the 40% of stocks that were down ***half***?[iv] You can see many of those stocks in the above charts that are beneath the top row.

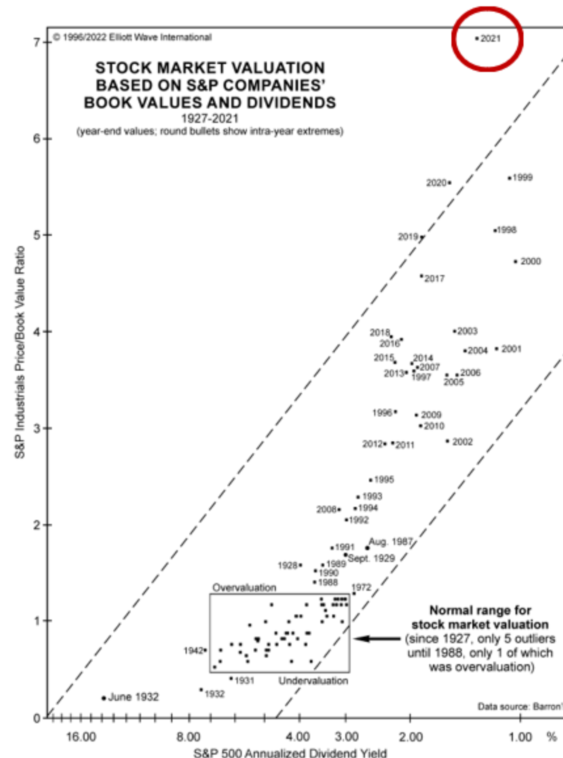
The market volatility in January saw major indices hitting highs, then rolling over based on the Fed's stated intentions to remove the $120 Billion per month of money printing they cranked out almost every month of 2021. Volatility can be topping behavior, but it remains to be seen whether the top is actually in on the long 12 year rally. There are clearly games underway as the chart section above illustrates. If we are indeed topping, it will be because the Economic Cycle has run its course, perhaps only because the Fed can no longer manipulate it without being fully obvious itself as ***the*** source of the rising inflation that punishes ordinary people.

The risk-taking euphoria has shown itself everywhere among market participants, and retail investors most of all are subject to the psychology the Fed feeds. Professional trader Sven Henrich summed it up tongue-in-cheek as the recent 5% decline drew the retail crowd right back in to 'buy the dip' as the Fed has trained everyone to do relentlessly since 2009:

Sven knows that the market indices are almost solely driven by central bank money printing. So, while the Fed is saying it will just hike rates and reduce its balance sheet (reducing the pace of money printing is still ***enlarging*** its balance sheet, not 'reducing' it), the Fed's trained market participants know the Fed cannot do so without major consequence: the emperor has no clothes. Will Wall Street beat stocks down until the Fed surrenders by again printing even more, just as it did in Q4 of 2018? Here is the visual that confirms this simple relationship:



Sven is also aware of the over-valuation of stock prices due to Fed games. Here is the chart we shared in our last Quarterly letter, updated through the end of 2021. We note that the valuation moved above the record over-valuation from the prior version which was recorded in August 2021. Stocks are more highly priced versus book value than ever before:



One topic we have written about numerous times is the difference between 'price' and 'value'.

That is best illustrated in the housing market, which also illustrates quite well the conundrum created by the Fed's tricks. A house may rise in value, something quite pleasing to everyone who owns their house, but the reality is that the ***value*** stays essentially the same.

We wrote recently about $400,000 houses jumping in price in six short quarters to $500,000. The number feels good to the homeowner, but the reality is that if they were to sell the house, they could merely buy the ***exact same house*** a few neighborhoods over.

The value did not change at all.

Who it DID change for, however, is everyone who does not yet own a house. If they value that exact house, they're going to need to pay up substantially in price to get it.

That crowd now finds they would need an additional $100,000 (squirreled away over the course of years in after-tax earnings), to buy that very house. That price is going to cost them dearly in terms of 'quality-of-life' value. The new-buyer crowd will now face many more valuable years of working and saving to acquire that house.

For context, at today's historically unheard low interest rates, the national average for a 30 year fixed rate mortgage on a house is 3.35%. At even that ultra-low rate, the prospective home buyer will either pony up that extra $100,000, something it took a lot of time to save, or they will borrow it, costing them $58,660 in interest paid to the Fed's banking constituents.

As we've covered before, the biggest banks are not really 'constituents', but rather they own the Fed. So, in the house example, the Fed's activities served to transfer 30 years of working and saving, costing American borrowers another $58,660 in interest to be transferred to banks.

This goosing of home prices can reach a point where it is simply not sustainable. Has it yet? Maybe. Here is a look at the sales of houses in some key markets in December 2021, compared to the same markets in December of the prior year, 2020:

Closed Sales, December 2021

	Dec-21	Dec-20	YoY
Denver	4,504	5,230	-13.9%
Jacksonville	**2,937**	**3,198**	**-8.2%**
Las Vegas	4,005	4,096	-2.2%
New Hampshire	**1,814**	**2,227**	**-18.5%**
North Texas	**11,088**	**11,347**	**-2.3%**
Northwest	**8,017**	**9,008**	**-11.0%**
Portland	**2,582**	**2,789**	**-7.4%**
San Diego	2,913	3,517	-17.2%
Total	**37,860**	**41,412**	**-8.6%**

Source: Bill McBride

We can see that home prices already cooled off last December, not coincidentally right when the Fed reduced their pace of printed money they were pumping into mortgage markets.

Now overlay this house-price illustration over the Economic Cycle chart and consider that the inflationary, money-printing policies do not have an unlimited capacity. When the Fed stops printing, borrowed money costs more so people have to pay less for the assets themselves.

In other words, everyday people eventually get priced out of everyday living by Fed policy. The Fed can change its definitions of inflation, but they cannot change the *impact* that prices of assets like houses have on the public. Math, rather, tells us that the Fed's games have natural limits. The question is when the 'market' environment will say we reached them.

Nonetheless, the Fed did succeed once again in 2021 in pumping asset prices by further destroying the power of US Dollars.

Following are the 2021 results in various paper asset prices:

INDEX	TYPE	2021 Q4	YTD
Standard & Poor's 500	US Based Large Stocks (500)	**11.0%**	**28.0%**
Dow Jones Industrials	US Based Large Stocks (30)	**7.9%**	**20.9%**
Nasdaq Composite	US Based Large Stocks	**8.3%**	**21.1%**
Standard & Poor's 400	US Based Mid-Cap Stocks (400)	**8.0%**	**23.7%**
Russell 2000	US Based Small-Cap Stocks (2000	**2.1%**	**14.3%**
Dow Jones Transports	US Based Transportation Stocks	**17.9%**	**32.6%**
Dow Jones Utilities	US Based Utility Stocks	**12.8%**	**16.8%**
EAFE International Index	International Large Cap	**2.7%**	**11.5%**
MSCI Emerging Markets	Diversified Emerging Markets	**-1.3%**	**-2.5%**
Commodities	Bloomberg Commodity Index	**-1.6%**	**27.1%**
Barclay Aggregate Bond	Intermediate Bond	**0.0%**	**-1.6%**
10 Y US Treasury	10 Y Us Treasury	**0.8%**	**-3.5%**
3 Month T-Bill	Cash Equivalent	**0.0%**	**0.0%**

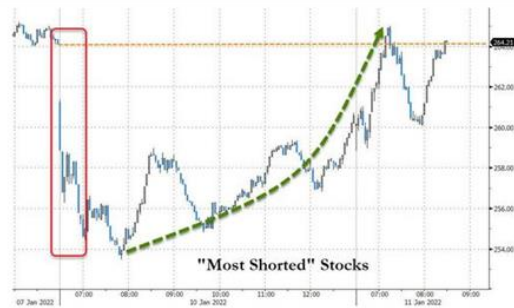
Sources: *Bloomberg, vanguard.com, yahoo.com*

So, in concluding this quarter's Update, we will again repeat what we have stated many times: the Fed has turned the moving prices measured by asset markets into a game.

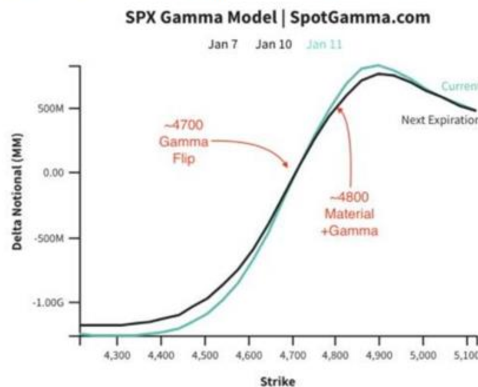
You can see from the Cartoon that accompanied the e-mail that delivered this letter, there are others that see the asset markets through that truth-lens as well.

And while the Fed knows it has concocted this game, they continue to use it despite the record wealth and income inequalities it has created between those who own stocks (and receive compensation in stock from their companies) and everybody else.

The game is becoming stunningly visible in the now-frequent articles that are published by Wall Street Investment Desks that track 'gamma', a concept that tracks how Wall Street 'dealers' move market prices to levels where they can extract the most profit from people who trade in the options markets. Here's an illustration from a recent article on the topic:



Additionally, SpotGamma's models continue to suggest **high volatility until the 4700 strike is recovered – and it is not until 4800 that we would see significant dealer based support**.



Source: Nomura

The preceding chart illustrates that Wall Street 'Dealers' will stand to profit the most if they move the S&P 500 back to the $4,700 price level … so they do.

Regardless, the game is an important one for our clients. It is no longer based on fundamentals. Remove the Fed, and the fundamentals collapse. The game ***does*** have limits. So, at a minimum we should be mindful of that truth and be prepared to protect assets when markets conclude we have reached those limits.

From a fundamental standpoint, we are seeing warning signs as well now. Supply chain constraints, inflationary pressures on input prices, and vaccine mandates are all combining to affect both supply of goods (shrinking) and demand (slowing). And while earnings growth is still expected to be positive, the rate-of-increase is slowing notably now that stimulus checks have stopped dropping into mailboxes and bank accounts across the country and the anticipated Green New Deal has shrunk in size. Even the stimulus efforts have knucklehead consequences as the child tax credit dollars that pumped into mailboxes caused 1.5 million spouses to leave the workforce. That means 1.5 million taxpayers disappeared. So, the stimulus was *not* free.

These factors all play directly into the Economic Cycle illustration that we looked at earlier, as does the overvaluation measure of the S&P 500 versus Book Value.

If you would like to discuss whether you'd like to give the Fed the benefit of the doubt and aim for additional upside we can certainly do that. If instead, you would like to down-shift, we can do that too. And if you would like to attempt to get the best of both worlds, with skin in the game but a hand on the ejector lever, that too is a strategy we can work towards.

The choice varies by investor and is unique to their overall situation. The markets will do what they're going to do, regardless of the individual choices.

Whatever your specific preference, do feel free to give us call us at (614) 698-0333 (FFF)!!

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[i] https://www.thebalance.com/current-u-s-federal-government-tax-revenue-3305762

[ii] https://www.bloombergquint.com/gadfly/jobs-report-makes-a-march-fed-rate-hike-nearly-a-done-deal

[iii] https://www.zerohedge.com/markets/goldman-rings-alarm-collapsing-market-breadth-51-all-market-gains-april-are-just-5-stocks

[iv] https://www.zerohedge.com/markets/massive-meltdown-40-nasdaq-companies-are-down-more-half-their-highs