ENR Medium Risk Portfolio

December 2021

Portfolio Details

Portfolio	ENR Medium Risk Portfolio	Program Inception	January 2009
Currency	USD	Best Year	23.20% (2009)
Minimum	$250,000	Worst Year	-5.50% (2018)
Trustee	European Private Banks	IRA Eligible	Yes
Advisor	Eric N. Roseman	Number of Securities	19
Firm Assets	$277.6 Million	Portfolio Yield	0.95%
Max. Mgmt. Fee	1.50%	Redemptions	Daily

ENR Medium Risk Portfolio, in U.S. Dollars, in Percent

	2021	2020	2019	2018	2017	2016	2015	2014	2013	2012	2011	2010
ENR Medium Risk[1]	13.76	1.86	10.79	-5.50	6.19	2.80	-2.91	-1.08	14.24	11.20	-4.80	10.30
MSCI World Index	20.14	14.06	25.19	-8.20	22.40	8.15	-0.32	5.50	27.37	16.54	-5.02	12.34
Barclays Aggregate Bond Index	-1.61	7.86	9.16	0.01	3.73	2.56	0.55	6.32	-2.02	4.22	7.84	6.54

[1] The ENR Medium Risk Portfolio was originally launched as JGAM Medium Risk Portfolio in 2009. Performance returns from 2009 until September 2013 are calculated using a model portfolio for clients with assets under management ranging between $1 million dollars and $5 million dollars. Performance information prior to September 2013 includes a 1% annual management fee but does not include custodian and brokerage fees. From October 1, 2013 to November 30, 2015, performance reflects the results of the largest account under management after the deduction of all fees. As of September 2018, performance is calculated using an equally weighted average of all accounts above $100,000. Performance figures are net of all fees. Depending on the size of the amount invested, management fees might be higher or lower. Results expressed in U.S. dollars.

ENR Medium Risk Portfolio Allocation: December 31, 2021

Asset Allocation		Top Ten Holdings	
U.S. Equities	51.6%	Nestlé	6.49%
International Equities	6.5%	Fortinet Inc.	5.60%
Gold & Gold Mining	5.6%	SPDR Select Sector Health Care ETF	5.44%
Portfolio Dislocation Insurance	9.4%	Berkshire Hathaway Class B	5.37%
Cash	26.8%	Hussman Strategic Growth Fund	4.73%
		Cambria Tail Risk ETF	4.71%
		The Blackstone Group	4.35%
		MetLife Co.	4.22%
		SPDR Select Utilities ETF	4.14%
		iShares Gold Trust	3.74%

Investment Objective

The **ENR Medium Risk Portfolio** seeks capital growth mainly from a diversified portfolio of large-cap global equities, investment-grade bonds, and foreign currencies. The strategy may also invest in commodities, publicly traded real estate securities and other alternative investments. If necessary, inverse stock ETFs may be used to hedge against market declines amid financial market dislocations or bear markets.

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Fourth Quarter Report 2021

Portfolio Performance Summary

In the fourth quarter, the **ENR Medium Risk Portfolio** gained 4.46% compared to a rise of 7.49% for the MSCI World Index and 0.02% for the Barclays Aggregate Bond Index.

For the 12-month period, ending December 31, 2021, the **ENR Medium Risk Portfolio** gained 13.76% compared to a rise of 20% for the MSCI World Index and a loss of 1.61% for the Barclays Aggregate Bond Index.

U.S. Stocks Beat Foreign Shares by Widest Margin in 24 Years in 2021; Powell Ends Tech Party in Brutal January Sell-Off

The S&P 500 Index continued to outpace most foreign markets again in 2021 and this time, by the widest margin since 1997. Powered by gains in big technology companies and to a lesser extent, financials, U.S. equities beat international stocks by more than 19 percentage points as measured by the MSCI EAFE Index or Europe, Australia, and the Far East. The S&P 500 Index gained 27% last year; the broad market has doubled over the past three years. The MSCI World Index of major markets rallied 20%. The global benchmark finished the year with its largest percentage weighting in history tied to U.S. stocks at 69% of the index. The only major global index to post a loss in 2021 is the MSCI Emerging Markets Index, down 4.6%.

Fixed-income securities and foreign currencies declined in value. Commodities, real estate, fine art, NFTs and digital currencies all logged strong returns in 2021 and along with stocks, helped to make the last decade one of the best for risk-based assets.

However, the FOMC and Jerome Powell have started taking away the proverbial punchbowl from the party. With U.S. inflation hitting a 40-year high through December (+7%), the central bank has admittedly been behind the inflation curve. Many investors are betting that rising interest rates and a technology stock swoon in January could bring America's winning streak to an end in 2022. Long viewed as conventional wisdom, overvaluation remains a challenge for U.S. assets. In addition to the S&P 500 Index trading at its second most expensive P/E multiple in history at 39 times trailing earnings (based on Shiller PE Ratio), the U.S. dollar is at a multi-year high, residential real estate has overtaken the 2006 peak, and bond yields are heading higher as the Federal Reserve (Fed) begins to hike interest rates for the first time since 2018.

Inflation has become a major hurdle for the Fed heading into 2022. After reassuring the financial markets that inflation would be 'transitory,' the Fed has backpedaled since the fourth quarter, and has grown increasingly hawkish. Inflation, for the most part, is the result of the lingering Covid-19 pandemic. Last year's explosive growth in auto prices is due largely to a semiconductor shortage, which was caused in part by the pandemic but also by trade policy. Much of the rise in food and energy prices comes down to pandemic-related production problems, though weather and a major drop in operating rigs in the United States also accounted for the hike in prices. Markets are now pricing in the first interest rate hike as early as March for a total of three rate hikes in 2022 by the Fed.

In our view, both stocks and bonds have been discounting away the Omicron impact over the last few weeks. This is probably justified. Although Covid infections are surging worldwide, the increasing evidence suggests that Omicron is much less deadly than previous Covid variations. Ultimately, financial markets are worried about whether the new variant will lead to widespread lockdowns that will devastate the economy. Such worries are manifested by the fact that 10-year Treasury yields are largely inversely correlated with the Covid hospitalization rate in the United States. U.S. benchmark bond yields have been rising rapidly since the start of the year, suggesting markets do not think a lockdown is in the cards.

Since 2010, when the developed world began to operate in a zero or near-zero lower interest rate environment, cyclical swings in the Fed's balance sheet have become a huge factor impacting asset market performance. Stocks ran into problems in 2011, 2015-16 and again in late 2018 when the Fed either stopped QE (quantitative easing) or started QT (quantitative tightening). The risk to the stock market will become progressively bigger as time goes by. Many investors believe the Fed is lagging the inflation curve. Our worry is the opposite: the Fed could move too aggressively, upsetting risk assets and disrupting underlying economic recovery.

Fixed-income securities suffered losses in 2021. Bonds posted their first losing year since 2018 based on the iShares Barclays Core U.S. Aggregate Bond Index, down 1.67%. U.S. Treasury securities also saw broad-based losses with the iShares 7-10 Year Treasury Bond Index declining 3.27%. Going international did not help returns. The U.S. dollar rallied again last year. The J.P. Morgan Global Government Bond Index declined 2.54% and the J.P. Morgan Emerging Markets Bond Index fell 1.51%. Investment-grade debt also posted losses with the Bloomberg Intermediate Corporate Bond Index shedding 1%. Municipal bonds and junk-rated debt (high-yield) are the only segments of the bond market to finish 2021 in the plus column.

The U.S. Dollar Index gained 6.4% in 2021 and is now beginning the eleventh year of a secular bull market – twice its historical bull market duration since Nixon broke the gold window in 1971. The dollar is no longer undervalued. Virtually every foreign currency posted a loss vis-à-vis the greenback last year. Safe-haven currencies like the Swiss franc (-3%) and the Japanese yen (-11.4%) declined. Among the majors, only the Chinese yuan rallied, up 2.7% against the USD.

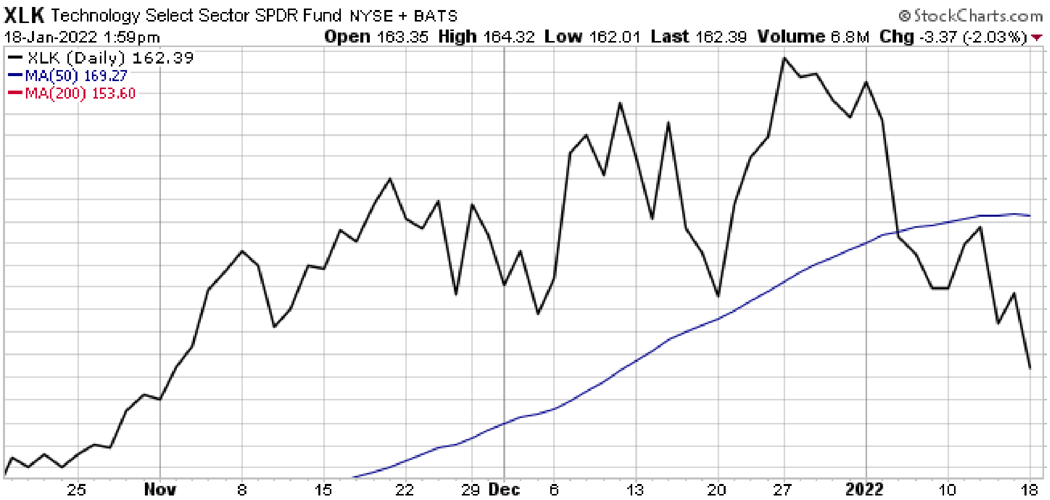
Commodities ranked as the top performing asset class in 2021. The Refinitiv/CRB Index surged 38.5% last year to post the best double-digit gain among mainstream asset classes. Base metals, energy, and agricultural commodities boosted the benchmark to its highest level since 2015; however, the CRB Index is 50% below its 2008 all-time high. Nevertheless, last year was a big winner for many raw materials as supply shortages triggered by Covid, shipping bottlenecks, and rising global demand boosted prices. West Texas intermediate crude rallied 55% and natural gas spiked 47%. But the huge gains were recorded in lithium (+477%), ethanol (+125%), coal (+111%), oats (+90%), and coffee (78%) among others.

The precious metals complex proved to be a big disappointment last year – despite hot inflation. Gold prices declined 3.6% to close the year at $1,827.50 an ounce, and silver closed 12.7% lower at $23.06 an ounce.

Volatility, as measured by the CBOE Volatility Index, a fear gauge based on options tied to the S&P 500 Index, plunged 24.3% to close the year at 17.22.

Portfolio Review

The **ENR Medium Risk Portfolio** logged its seventh consecutive profitable quarter in Q4 and finished the year just shy of a net 14% total return. Stocks provided all our positive performance attribution. Gold, gold mining and portfolio hedging incurred losses. Bargain-hunting, however, largely proved unprofitable as markets grew more challenging after August, especially in the mid-cap sector. Despite some losses throughout the year, the portfolio recorded its third straight calendar year gain. Large-cap equities dominated positive performance attribution.



Global markets are experiencing some painful bouts of volatility in January, mostly in the growth stock space. Technology stocks have been especially hammered (see above chart). The immediate question is, should investors begin to de-risk and take a highly defensive posture? Our answer is that it may be too early to completely shun stocks, but risks will progressively increase over time. In contrast to last year when the Fed had equity investors' backs, the central bank is now signaling much less support. Treasury bond yields need to stabilize for the markets to calm down. This will be key to monitor going forward, as the upward move in Treasury yields has pressured stocks, particularly growth stocks thus far in the New Year. Bonds have recently broken through 1.75% and might be headed to 2% on the benchmark ten-year Treasury.

Since December, we have significantly increased our portfolio hedges to 15% to help safeguard the stock portfolio and reduce volatility. Stock exposure remains in the 60% range and cash relatively high at 22%. We hold no bonds. Gold and gold mining are about 6% of the strategy.

As for the Fed and this upcoming tightening cycle, it is important to point out that the central bank might be too late hiking rates and possibly, might backtrack once more pain is administered to financial markets. That is what happened in January 2019 following a 20% plunge for the broader market in late 2018. Stocks usually continue to rise even after the Fed begins to lift rates, underscoring the reflective nature of rising rates. Invariably, all tightening cycles eventually lead to a significant fall in stocks, indicating that monetary tightening has become restrictive. There is no hard and fast way to tell when a tightening cycle is becoming restrictive. In some cycles, stocks flop sooner than they do in others, but rapid yield curve flattening is a clear indication that money is becoming tight. While stocks tend to rise after the Fed raises rates, the rate of return in the stock market almost always diminishes along with a rising-rate cycle. A negative equity rate-of-return reading is often seen at the end of a tightening cycle.

Performance Attribution

The stock portfolio posted strong results last year. Cyber security powerhouse **Fortinet Inc.** (NASDAQ-FTNT) has been on a tear, up 142% in 2021, and now up a cumulative 359% since July 2019. The **Blackstone Group** (NYSE-BX), the world's largest private equity firm, soared 105% as earnings went ballistic amid a record year of deal-making activity.

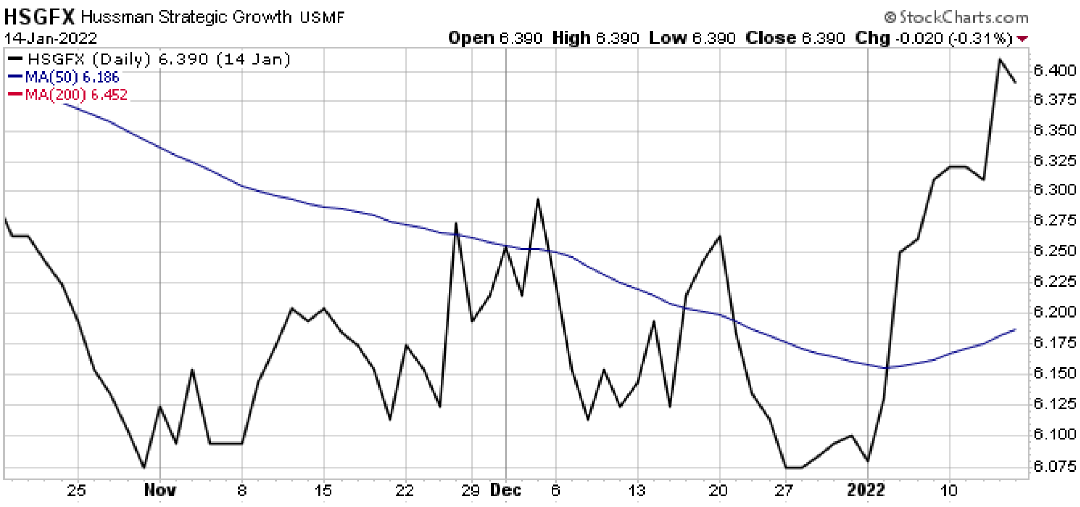
Costco Wholesale (NASDAQ-COST), **MGM Resorts International** (NYSE-MGM), **MetLife, Inc.** (NYSE-MET) and **Berkshire Hathaway Class B** (NYSE-BRKB) all helped to boost returns, too. We also got help from old stalwarts like **Nestlé** (Zurich-NESN) and **Procter & Gamble Corp.** (NYSE-PG). Apple, Inc. (NASDAQ-AAPL) was purchased amid a temporary price correction last winter; we subsequently earned 45% buying the world's most valuable company 'on the dip.' Sector index funds were also star performers; the **Health Care Select SPDR Fund** (NYSE-XLV) surged 26% and the **Utilities Select Sector SPDR Fund** rallied almost 18% last year:

2021 Performance of Securities (including dividends): As of December 31, 2021, in USDs (Open Positions)

Company	Total Return
Fortinet	+142.00%
Blackstone Group	+105.11%
Costco Wholesale Corp.	+50.70%
Apple, Inc.	+44.91%
MGM Resorts International	+42.40%
MetLife, Inc.	+38.55%
Berkshire Hathaway B	+29.00%
Health Care Select Sector SPDR Fund	+26.02%
Nestlé	+21.76%
Procter & Gamble Corp.	+20.04%
Utilities Select Sector SPDR Fund	+17.66%
Johnson & Johnson	+11.36%
Lockheed Martin Corp.	+3.10%
ConocoPhillips Corp.	+2.61%
Amazon.com	+2.40%
Barrick Gold	-3.41%
Hussman Strategic Growth Fund	-3.76%
iShares Gold Trust	-4.00%
Cambria Tail Risk ETF	-4.21%
MSCI World Index	**+20.14%**
S&P 500 Index	**+26.90%**
Barclays Aggregate Bond Index	**-1.61%**

Portfolio Hedging

Portfolio hedging was unprofitable in a strong year for stocks. September was especially challenging for the strategy because we did not have sufficient downside protection. However, the markets bounced back sharply in the last quarter of the year, we pared our exposure and made money. I have since increased our dislocation exposure as I expect a rough market to materialize over the next few quarters. As I mentioned earlier, the Fed is not providing the same levels of liquidity anymore as we progress into 2022.



As the fourth quarter closed, we initiated our largest allocation to the 'Dislocation Insurance' theme in the portfolio. My goal is to target stock-market exposure around the 60% range while hedging volatility with **Hussman Strategic Growth Fund** (HSGFX), **Cambria Tail Risk ETF** (TAIL), gold and gold mining. I might also buy long-term Treasury bonds again, but I am in no hurry until the markets are done throwing fixed-income securities into the dustbin. Treasury securities have been smashed over the past 12 months and continue to correct in January.

Bonds, from 1998 until 2020, provided a negative correlation to stocks. Yet, I have noticed several important occasions over the past two years when bonds failed to cushion stock losses. For most investors, if bonds sell-off in a big equity downdraft, it is a big problem. In my opinion, investors need to be creative and think 'outside the box' as it pertains to portfolio protection in 2022.

Launched in 2000, the Hussman Strategic Growth Fund is another important hedging instrument to cushion your stocks from potential losses. Like TAIL, it should be used strictly as a portfolio insurance tool to protect your equity positions; HSGFX is a not market-timing product, and it is not a 'buy-and-hold' mutual fund for the next ten years. Over the last decade amid a secular bull market for stocks, HSGFX has declined 6.23% per annum as equities raced to the Moon. Portfolio manager, Dr. John Hussman, will unlikely produce gains in a rising stock market environment.

However, when the market suffers a prolonged or even a short-term dislocation, this Fund has produced solid gains to help offset stock market losses. With equities suffering sharp pullbacks over the last ten days, HSGFX is producing profits again as markets become more challenging. HSGFX seeks to achieve long-term capital appreciation, with added emphasis on the protection of capital during unfavorable market conditions. It pursues this objective by investing primarily in common stocks and using hedging strategies to vary the exposure to markets.

The Hussman Strategic Growth Fund serves to protect your stock portfolio when markets tumble So far in a volatile January, HSGFX is up 6% (see chart above). That is what a proper hedge is supposed to do when markets buckle. As HSGFX commenced trading back in 2000, the Fund logged great returns as markets suffered two macroeconomic shocks in 2000 (housing bear market & dotcom bust). Unfortunately, the Fund lost money in the 2008 financial crisis – the only dislocation period since 2000 when it failed to generate a profit. Hussman earned big profits the first nine years of the millennium while suffering equally big losses after the credit crisis lows in 2009. Again, you do not want to 'buy-and-hold' this Fund for the long-term. Its purpose is strictly to provide your portfolio with a buffer against stock market losses. When markets rally, HSGFX will lose money. The Hussman Strategic Growth Fund charges 1.15% in annual expenses and manages $370 million in assets.

HSGFX vs. S&P 500: Select Periods:

March 2020: +3.86% vs -16.36%
Q1 2020: +10.30% vs -20.67%
Q4 2018: +13.8% vs -15.01%
DEC 2018: +3.79% vs -7.94%
September 2011: +4.03% vs -6.06%
2008: -9.65% vs -37.58%
September 2008: -0.24% vs -8.83%
October 2008: -5.23% vs -16.56%
July 24, 2000 to December 31, 2002: +52.32% vs -39.91%

Dividend Announcements

The last six months saw some big increases in dividend payouts for stocks in the portfolio. The largest increase goes to Barrick Gold, which yields an annualized 5% based on a new quarterly dividend of $0.23 cents per share. That is more the Dow Jones Utilities Average! Blackstone Group enjoyed one of its best years since going public in 2007, boosting its special payout by 81%. Costco, Nestlé, and P&G all raised distributions by 10% or more in 2021:

- Barrick Gold Corp. +156.0%
- Blackstone Group +81.0%
- Costco Wholesale +12.6%
- Nestlé S.A. +11.3%
- Procter & Gamble +10.0%
- Lockheed Martin +7.7%
- Johnson & Johnson +4.9%
- Metlife +4.3%

Fourth Quarter Trading

The fourth quarter saw activity as we redirected risk. Though we earned a nice profit in the October to December period, it was not without its share of volatility. We were stopped-out of several companies, including Boeing, IAC/Interactive and Citigroup. We took profits on Allstate Corp. and Lazard Global Infrastructure Fund. To reduce our risk, we cut exposure to Blackstone Group in the fourth quarter after explosive gains.

The portfolio initiated the following positions in the fourth quarter:

- Barrick Gold Corp.
- Kraft Heinz
- ConocoPhillips
- Cambria Tail Risk ETF
- Hussman Strategic Growth Fund
- ProShares Ultra Short Dow 30 ETF

The portfolio liquidated the following positions in the fourth quarter:

- Pro Shares Ultra Short Dow 30 ETF
- Kraft Heinz
- Boeing
- Allstate Corp.
- Lazard Global Infrastructure Fund
- IAC/Interactive
- Citigroup
- Verizon Communications

Portfolio Asset Allocation

As of December 31, 2021, the **ENR Medium Risk Portfolio** held 58% in common stocks, 9.4% in dislocation insurance assets, 5.6% in gold and gold mining, and 27% in cash. The portfolio's asset allocation has seen an important reduction in equity risk over the last several months as markets become more challenging, the Fed curbs liquidity, and inflation runs hotter.

Compared to September 30th, equities are down significantly from 68% and even more compared to mid-year when we held 76% in stocks. I still prefer high quality companies with proven earnings and in most cases, rising dividend payments. The macroeconomic environment has changed as central banks shift gears and begin to fight the inflation battle, draining excess liquidity, and probably triggering a market panic or deep sell-off in the process. Though speculation has been cooled lately, the absolute level of leverage, broad-based retail participation, and excessive valuations remains a real risk and are miles away from being unwound.

Portfolio construction is paramount to diversification. Your portfolio is structured across three main pillars: **Growth** stocks include technology companies like Fortinet, Blackstone Group and Amazon.com. **Value** equities include companies like Berkshire Hathaway, MetLife, and Lockheed Martin. On the far right of our spectrum (see below) are **Defensive** companies like Procter & Gamble Corp., Johnson & Johnson, and Nestlé.

Growth **Value** **Defensive**

|______________________________|______________________________|

A diversified portfolio should therefore have a balance between these three investment categories. It is called building a 'ballast' or achieving an equilibrium while attempting to dilute volatility. This way, you will maximize market cycles across major styles and take advantage of prevailing trends. For example, growth stocks have blasted ahead of value equities since 2009 and now fetch the highest premium versus the latter since 2016. Value equities, I believe, should eventually outpace growth stocks in the next market cycle or $NYA200Reconomic slowdown. This is what occurred in the 2000 to 2002 bear market. Value stocks heavily trailed growth companies for almost a decade until the bull market peak of March 2000. Now is a good time to build fresh positions in value-based securities after years of poor relative returns compared to expensive growth stocks.

As of December 31st, the portfolio holds a combined 19 securities. Individual stocks and stock ETFs/mutual funds represent a total of 19 securities. From an investment style perspective, growth stocks represent a combined 23% followed by 18% for defensive companies, and 17% for value-based equities. Some defensive companies also maintain value-based characteristics like high free-cash flow and strong balance sheets. These include Nestlé, Procter & Gamble Corp., and Johnson & Johnson. The United States remains our largest geographical allocation at a combined 52%, followed by 6.5% in Europe, and 2% in Canada. The portfolio closed the year providing an effective yield of 0.95%. The strategy does not use leverage or margin, does not invest in hedge funds, and is 100% liquid on a 24-hour notice on any given market business day.

Industry Allocation

In the fourth quarter, the three dominant sectors in the portfolio remained consumer staples, technology, and financial services. Financial services declined at quarter end as we took realized profits on Allstate and sold Citigroup at a loss. Industrials also dropped in Q4 to close at 3% following the sale of Boeing.

Portfolio Industry Allocation: December 31, 2021

Industry	Percent of Portfolio
Consumer Staples	13.6
Technology	13.6
Financial Services	10.3
Healthcare	8.3
Gold Bullion & Gold Mining	5.6
Industrials	2.8
Hotels/Casinos	2.7
Energy	2.0

In Q4, we added **ConocoPhillips** (NYSE-COP), arguably the best-managed U.S. large-cap major with the best shareholder fundamentals, including dividend payouts and buybacks. Oil producers are still too slow in responding to increasing oil demand, and political leaders are reluctant to correct their policy mistakes – they have designed policy to drive the world away from fossil fuels at a time when renewables are still insufficient to meet growing energy demand. In the U.S., the rig count is about half of what it was prior to the pandemic, and the ratio of oil price-to-rig count, a measure of an oil crunch, is at the highest levels in more than a decade. In the meantime, OPEC-plus has learned how to coordinate to keep prices up. It is worth noting that oil prices have recovered from the November selloff quickly, even though the dollar has been strong.

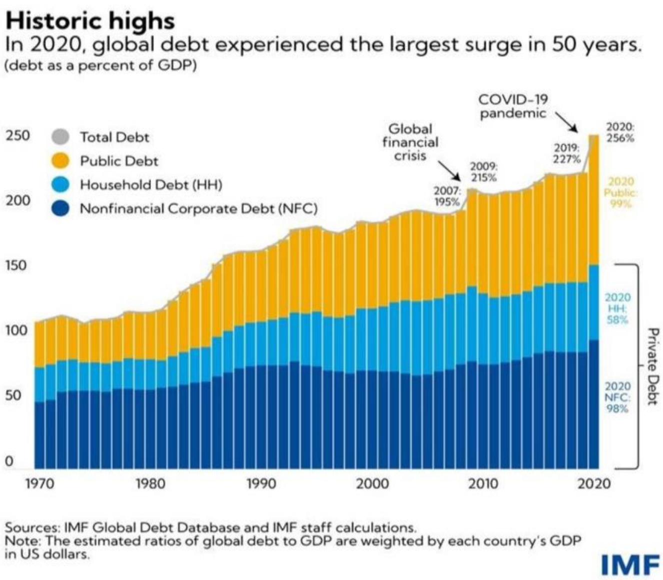
Currency Exposure

Unlike a decade ago, the American dollar and most U.S. asset classes are no longer inexpensive. In fact, you could argue there is a 'bubble' underway in stocks (growth stocks especially), bonds, fine art, digital currencies, and residential real estate. The USD is starting the eleventh year of a secular bull market that began in late 2011 (see chart below).

Since President Nixon broke the gold window in August 1971, the dollar has posted three rallies within the confines of a long-term bear market (1981-1985, 1995-2000 and 2011-2022). The average rally lasted five years; the duration of this bull market is obviously 'long in the tooth' and I expect the greenback to eventually fall hard, and for several years. The global exchange rate system, led by the dollar since 1946 and free-floating since 1971, is basically a bar filled with a bunch of drunks; the dollar remains the most sober over the past ten years. But the absolute levels of debt permeating across all sovereign nations is out of control, and fiat currency will be compromised at some point. It is for this reason that we continue to hold a position in gold.

The hardest currency in the world post-1971, the Swiss franc, fetched 4.30 to the dollar in mid-1971; today, it trades at a 9% premium to the dollar. The U.S. dollar has lost significant purchasing power over the past 50 years to inflation and long-term deficits. Nobody in Washington, D.C. cares about deficits, especially the Biden administration, which has foolishly embraced MMT or Modern Monetary Theory.

As we have already witnessed as recently as late 2018, any sustained spike in interest rates can blow the 'debt bubble' wide open. There is too much global debt (see chart below). U.S. national debt the last four years has gone from $20 trillion to $30 trillion. Any incremental rise in funding costs risks tearing a hole into the financial system and threatening outright deflation. The Feds know this, and that is why I think the next crisis will result in a new chapter of Fed asset purchases – equities.



Over the last ten years, we have remained largely overweighted U.S. dollars. I suspect this exercise will shift in favor of some foreign currencies and companies over the next few years, or sooner. But betting against the dollar since 2011 has roiled portfolios because the dollars' rapid ascent has diluted the gains from foreign stocks. For example, the MSCI EAFE Index (major markets, ex. USA) has gained just 5% per annum over the last ten years; but in local currency terms, the benchmark is up 7%.

As we closed the year, the portfolio held 88% in U.S. dollars, 6.5% in Swiss francs, 2% in Canadian dollars, and 3.7% in gold. Compared to September 30th, our U.S. dollar exposure was unchanged.

Gold

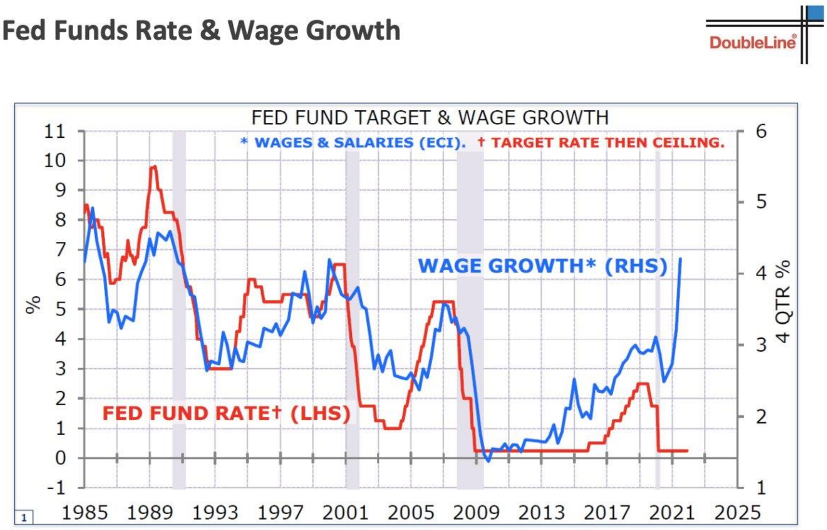
Gold is an enigma. Despite the hottest U.S. inflation rate in almost forty years, the gold price declined 4% last year. Meanwhile, stocks, commodities, fine art, collectibles, digital currencies, and most real estate all posted big advances. It seems illogical that gold would decline in a high inflation environment. This anomaly, in my view, can be partially explained by central bank or government manipulation of the gold price, and the bull market in Bitcoin and other digital currencies stealing some thunder away from gold. Another explanation is the strong dollar, clearly overbought and overvalued. Historically, in most years, gold and the dollar are negatively correlated.

Selling pressure in physical gold ETFs also undermined the market in 2021. According to the World Gold Council, gold exchange-traded funds were hit by net outflows of $9 billion last year – the biggest outflow since 2013 when gold prices crashed. Gold prices hit an all-time high of $2,069 an ounce in August 2020 but its move above $2,000 proved short-lived. Gold close last year at $1,827 an ounce. Weaker investor interest was the principle drag on prices last year as demand for gold jewelry, bars and coins, industrial usage and buying by central banks all rose last year. The World Gold Council claims 173 tons worth $9.1 billion was sold from physically backed ETFs in 2021. We remain bullish on gold and believe it should be a part of every diversified portfolio, especially as a secular peak in the dollar approaches.

Investment Strategy

This year will mark a transition from robust, stimulus-fueled expansion to a slower pace of growth in the advanced economies, while the emerging world still faces tight financial conditions and weak Chinese growth. Macro policy transitions pose greater risks to global growth than Omicron. Easing supply bottlenecks, U.S. dollar strength, and dwindling fiscal fuel for aggregate demand are poised to lead U.S. inflation sharply lower than expected, reducing the need for stealth policy tightening. I am not in the long-term high inflation camp. The Fed will tighten, but it is unlikely to be a prolonged cycle.

Fed Funds Rate & Wage Growth



Source: Minack Advisors, MSCI, BLS, NBER
ECI = Employment Cost Index is a quarterly economic series that measures the growth of total employee's compensation. RHS = Right hand side. LHS = Left hand side.

Current inflationary pressure is weighing on consumer sentiment, a dynamic that the Fed views as a threat to the economic recovery. Since September, the Fed's rhetoric has grown increasingly hawkish, with nearly four rates now priced into money markets for 2022. Meanwhile, the inflation breakeven curve is steeply inverted, and long-term inflation expectations are still benign, suggesting that markets think the Fed's tightening campaign will quell inflation. The Fed's current stance may represent peak hawkishness, particularly if supply-sourced inflation is already poised to roll over.

Order backlogs and delivery times have improved in recent months. According to the New York Fed's Global Supply Chains Pressure Index, 'supply-chain issues have peaked and might start to moderate' going forward. That should lead to lower U.S. inflation. This week, the producer price index (PPI), a measure of wholesale prices for goods and services, increased 0.2% in December, below consensus estimates of 0.4%. The Fed may move quicker and farther than anticipated in early 2022 to retain credibility as an inflation fighter. But fiscal drag, shrinking U.S. savings and weak foreign demand are likely to ease an overheated economy.

Government spending should ease in 2022 and technological changes will continue to put a lid on prices. The bigger risk is asset prices. Financial markets have grown to four times the size of the global economy, and when markets crater, deflation often follows. Typically, the Fed overkills on monetary policy. While 2021 was dubbed the ‘everything rally,’ some assets are clearly still in a ‘bubble’ of historical proportions: Cryptocurrencies, clean energy, tech companies with no earnings, and SPACs dominate my list. Each of these sectors has already crashed 35% or more from all-time highs. Should asset prices resume their decline, how will retail investors react? The retail mob rushed into the 13th year of the global bull market and excited late arrivals often signal the party is ending. From the United States to Europe, millions of people opened trading accounts for the first time, and many borrowed to buy stocks at a frenzied pace. Such manias rarely last.

China’s monetary austerity has been a headwind for global trade and commodities. The unfolding reflationary U-turn will take a few months to manifest in economic performance, particularly given China’s zero Covid tolerance. Rolling factory shutdowns and mobility restrictions remain strong headwinds to Chinese economic momentum. Through Q1, weak Chinese demand will dampen global growth, keeping the countercyclical dollar well bid and preventing a surge in Treasury yields. We have turned bullish on China and believe the Mainland A share market offers excellent value.

Valuations for the S&P 500 Index and most other major markets implies lower prospective equity returns in the years ahead, and policy uncertainty creates a window of risk for stocks. But it’s too soon to fully de-risk portfolios at a structural level because policy is only tightening from an exceptionally accommodative level, and the Fed may blink if, as we expect, inflation rolls over quickly amid cooling growth, which could spark a violent rally. This is what occurred in late 2018 after the broader market plunged 20%.

By mid-2022, economic momentum may shift from the United States to the rest of the world as China reflates. The dollar many then peak, providing a catalyst for the outperformance of non-U.S. equities where valuation is more attractive. The S&P 500 Index has been red-hot for more than ten years, and that dominance will not last forever. The last secular bull market that ended in March 2000 saw the S&P 500 Index crash almost 50% the next 2.5 years and the Nasdaq-100 Index of technology stocks plunged more than 80%. The chart below depicts the massive historical divergence between U.S. outperformance compared to the rest of the world since 1950. Previous multi-year bull markets for U.S. equities eventually gave way to better stock market returns overseas. I surmise a weaker dollar will be a part of this new trend when it occurs, boosting returns for dollar-based investors abroad.

Chart 10: US stocks vs Rest-of-World since 1950
US vs developed market equities (ex-US) price relative (US$)

Source: BofA Global Investment Strategy, GFD

BofA GLOBAL RESEARCH

Growth's dominance over value-oriented equities is stretched. Though softer growth and continued U.S. dollar strength would normally favor growth plays, the Fed's hawkishness has already pushed yields up, and long duration growth stocks' rate sensitivity is confirmed. We have adopted a more defensive sector bias, including firms with stronger balance sheets that sell brand name products and services. Also, value-based securities will be added on a gradual basis as the quarter and year progresses, probably with a bias to international companies.

We are now transitioning from a euphoric economic environment funded by the Federal Reserve to an environment that is much more uncertain. The classic textbook would be higher rates, lower stock prices. But the reality is there is so much liquidity out there, and investors want to generate a return on assets; the Fed will have to slam the monetary brakes hard to kill the economy and the stock market. Unless inflation continues to rise and heads into the double-digits, financial markets should survive a correction or a short bear market. Stock and country selection will be critical in 2022. Portfolio insurance might also be helpful to protect our stock holdings for the first time since the Covid-19 crash in March 2020.

Finally, we wonder if the Fed and its international cronies will ever allow the economic cycle to naturally unwind again. Before 2008, financial markets suffered regular bear markets as economic recessions unfolded, punishing leveraged operators, and putting them out of business. Companies defaulted on their debt obligations if they failed, and the business cycle was permitted to occur; it was the 'survival of the fittest' in capitalism. But we do not live in a normal economic environment since 2008. Central banks dominate financial markets, creating a floor on asset prices and venturing to buy bonds and even stocks in some countries to massage the financial outcome and deflect recession. This is not what Adam Smith intended.

By deterring or neutralizing economic recessions and a proper cleansing of the financial system, the Feds have basically 'kicked the can down the road.' The bastardization of the economic cycle comes at a price. The longer asset 'bubbles' are allowed to grow, and the longer businesses are permitted to operate amid fantasyland circumstances, the more painful the day of reckoning. We remain vigilant in 2022 and will continue to carry a healthy cash reserve, stick to high quality companies, and maintain the flexibility to short the market vis-à-vis ETFs and mutual funds, if necessary.

Thank you for your continued support. Have a happy and healthy 2022.

Sincerely yours,

Eric N. Roseman
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