Roadmap Similar to Late 1998 when LTCM Collapsed, Forcing Fed to Stop Hikes

Fed to Press Hard Until Markets Break

As we conclude June and the second quarter, the S&P 500 Index is set to post its worst first half return since 1970 and its third worst start since 1957. Major markets and emerging markets will similarly post their worst start since 1998. And bonds – decimated since last winter – will log the deepest losses since 1970. The macroeconomic backdrop could not be worse as inflation rages to a 40-year high, a war in Eastern Europe drives new Cold War military spending, and the world slips into an economic recession over the next 6-12 months, or sooner.

The S&P 500 Index trades 20% below its all-time high in January. The MSCI World Index is also down by the same percentage. But the carnage is far worse for the tech-heavy NASDAQ, off a dizzying 30% from its best level.

Stocks have rallied over the past week following the recent carnage. Lower oil, a retreat in bond yields and very oversold market conditions have led to a bounce in prices, providing much needed relief to an otherwise very skittish market. Recession concerns are now rampant; even Federal Reserve Chairman Jerome Powell admits the risk. Many investors expect a recession to hit the U.S. economy later this year or in early 2023, while a recent CNBC survey suggests that 80% of fund managers think "stagflation" will be a long-term problem. Led by the short end of the curve, U.S. Treasury yields dropped sharply across the curve last week.

The Fed Funds futures curve is not only reducing the bet on additional aggressive rate hikes, but also looking for renewed monetary easing next year. This, together with softening commodity prices, suggest that investor concerns are shifting from inflation to recession.

History shows that every monetary tightening cycle either coincides or leads to an economic recession, and during economic recession, commodity prices – oil in particular – always come down. With the Fed getting very aggressive in raising rates and the U.S. economy slowing quickly, the commodities market is bracing for a potential recession. For example, while oil prices have come off sharply, copper has also fallen 23% from its recent highs (see chart below). My sense is that more downward adjustment in commodity prices is likely, particularly now that we expect the U.S. economy to slacken sharply in the next 8 to 10 months.

Will China help commodities recover? Unlike the early 2000s, this economic cycle is not bullish for most commodities because Chinese economic growth, domestic consumption and an ongoing credit crisis in residential property will not feed the bull market. China, unlike most OECD economies, especially in the West, is just starting to stimulate growth after a slowdown while other economies are aggressively tightening after over-stimulating since Covid erupted in 2020. This lack of global economic synchronization will dent the ongoing rally in raw materials, boosted by Russia's invasion of Ukraine in February. Indeed, some sectors of the complex have already peaked, including base metals, agriculture, and lumber.

Furthermore, any conflict resolution in Ukraine will initially drive commodities sharply lower while triggering a massive rally in stocks and bonds. In my opinion, Ukraine does not have the financial and military resources to win this war and the West is unlikely to continue supporting the country indefinitely. The West, including the United States, perceives Ukraine as part of Russia's historical sphere of influence, despite rhetoric suggesting otherwise. But the longer the conflict continues, the higher the risk of confrontation with Russia as pressure mounts on NATO. Meanwhile, the global balance of power is witnessing a monumental historical shift in 2022 as the world's second largest economy and growing military powerhouse, China, clearly sides with her ally Russia, and equally seeks to change the post-WW II geopolitical order. You can be sure China is carefully watching the events in Ukraine and recording strategy and military doctrine. Taiwan will be taken by China one day. China is adamant about getting rid of the United States in the Western Pacific, claiming it is her respectful sphere.

Investment Strategy

Regional Federal Reserve indicators point to a significant slowing in the second quarter, and potentially contraction. On the flipside, earnings estimates have barely budged – forward 12-month earnings per share estimates are 22.6% higher now compared to a year ago. This implies ‘another shoe’ will drop in the stock market this summer before a bottom is established. Historically, big bear market bottoms have mostly occurred in October; recent exceptions include January 2019, and March 2009. Other major bottoms were registered in October 1987, October 1990, October 1998, October 2002 and October 2011.

Will the Fed come to the markets’ rescue if stocks plunge another 15% or 20%? Unlike previous tightening campaigns since the 1990s, the Fed is now aggressively raising interest rates in a bear market with inflation raging; this is something the Fed has not done since Paul Volcker was FOMC boss in the early 1980s. Fed policy has decisively tilted towards fighting inflation, even at the expense of economic growth. More pain lies ahead for investors.

The way I see it, the Fed will continue to fight inflation with aggressive rate hikes until it triggers a financial accident; this might include a major hedge fund blowing up, similarly to August-September 1998 when the demise of credit specialist **Long Term Capital Management** forced the Greenspan Fed to ease off the pedal and stop raising rates. A blow up also forced the Fed to pause in late 1994 when a series of big rate hikes triggered the devaluation of the Mexican peso, and an emerging market currency crisis.

Investors should still position defensively ahead of more market turbulence this summer. I continue to advise above-average cash balances, defensive hedges like inverse stock market ETFs, managed futures, gold, gold mining, and alternative liquid mutual funds. Most of these products are listed below in the **ENR Advisory Extra Portfolio**.

I also think you can start cautiously buying high quality companies at these levels after big declines of 25% to 35% since last winter. Long-term investors should consider taking initial positions in some of these companies now with the intention of averaging down this summer. Market timing is impossible. If you find a great company 'on sale,' then start accumulating a stake. For example, for ENR managed accounts we started buying **Microsoft** (NASDAQ-MSFT) earlier in June following a 30% crash.

Another name I like is very cheap, contrarian and despised by the herd. Previously ViacomCBS, **Paramount Global Class B** (NASDAQ-PARA) is a true value stock by every measure. It is so cheap that Warren Buffett took a stake this past winter.

Paramount Global is a global media and entertainment company that creates content for audiences worldwide. The Company's TV Media segment consists of its domestic and international broadcast networks, including the CBS Television Network, Network 10, Channel 5, Telefe and Chilevision; premium and basic cable networks, including Showtime, BET, Nickelodeon, MTV, Comedy Central, Paramount Network, Smithsonian Channel, international extensions of these brands and CBS Sports Network; television production operations, including CBS Studios, Paramount Television Studios, and CBS Media Ventures.

The Direct-to-Consumer segment consists of a portfolio of pay, free, and premium global direct-to-consumer streaming services, including Paramount+, Pluto TV, Showtime Networks' premium subscription streaming service, BET+, and Noggin. Its Filmed Entertainment segment consists of Paramount Pictures, Paramount Players, Paramount Animation, Nickelodeon Studio, and Miramax.

Paramount is winning signatories in the competitive streaming wars. While Netflix is losing millions of members, Paramount is growing its streaming business. It is also home to the summer's biggest hit, *Top Gun: Maverick*.

PARA sports a $16.7 billion market-cap, trades at just 5.4 times trailing earnings, and pays a 3.80% dividend. The stock sells at a huge 27% discount to book-value and only 0.59 times price-to-sales. It is hard to find a cheaper large-cap value stock. Plus, **Berkshire Hathaway** owns 10.6% of the company.

ENR Advisory Portfolio

Brace for Earnings Downgrades in July

On a sector-by-sector basis, financials, technology, gold mining, media, consumer discretionary, industrials and real estate are the most attractive from a valuation perspective. Alternatively, consumer staples, energy, materials, and utilities are fully valued.

The **ENR Advisory Extra Portfolio** continued to consolidate in a rough month of June. The second quarter was a bloodbath for investors. In June, only a few positions posted a profit in the portfolio, including **iM DBi Managed Futures Strategy ETF** (NYSE-DBMF), up 4%, **Alibaba Group Holdings** (NYSE-BABA) surging 24%, and **Hussman Strategic Growth Fund** (HSGFX) rising 1.6%.

In June, the MSCI World Index declined 7.4%, the S&P 500 Index fell 7.5% the MSCI Emerging Markets Index declined 4.4%.

Natural resources, gold mining, and technology suffered the brunt of the selling in June. We also saw losses in leisure, industrials, and retailing.

This month, our BUY list is short. We are introducing value stock **Paramount Global Class B** (NASDAQ-PARA) to the portfolio – down 74% from its all-time high last year. We also like **Microsoft** (NASDAQ-MSFT) at this price, and **Berkshire Hathaway Class B** (NYSE-BRKB), now 24% off its best level.

Eric N Roseman
Montréal, Canada
June 29, 2022

Security	Listed	Symbol	Entry Price	Date	Current Yield	Current Price	Gain/ Loss	Advice
Paramount Global	NASDAQ	PARA	$25.28	Mar 26/21	3.80%	$25.28	NEW	BUY
MGM Resorts International*	NYSE	MGM	$21.52	Nov 3/20	0.03%	$29.25	36.02%	BUY
Silver Bullion	Unlisted	N/A	$16.46	Jul 30/19	0.00%	$20.81	26.43%	BUY
iShares MSCI Global Gold Miners ETF	NASDAQ	RING	$22.01	Jul 30/19	2.50%	$22.89	9.32%	BUY
Microsoft Corp.	NASDAQ	MSFT	$101.27	Dec 21/18	0.94%	$257.31	162.01%	BUY
MercadoLibre	NASDAQ	MELI	$297.43	Jul 4/18	0.00%	$644.80	116.79%	BUY
B2Gold Corp.	NYSE	BTG	$2.73	May 30/18	4.51%	$3.55	44.32%	BUY
Berkshire Hathaway Class B*	NYSE	BRK.B	$125.79	Feb 9/16	0.00%	$274.17	117.96%	BUY
Gold Bullion	Unlisted	N/A	$1,492.47	Jan 4/16	0.00%	$1,817.09	21.75%	BUY
SPDR S&P Global Natural Resources ETF	NYSE	GNR	$36.35	Jun 29/20	2.95%	$54.09	65.62%	HOLD
iShares Currency Hedged MSCI Japan	NYSE	HEWJ	$24.65	Sep 6/16	2.10%	$37.79	65.51%	HOLD
Target Corp.	NYSE	TGT	$107.91	May 1/20	2.49%	$142.21	38.25%	HOLD
Lockheed Martin Corp.*	NYSE	LMT	$354.70	Sep 27/21	2.61%	$420.37	20.88%	HOLD
Vanguard FTSE Emerging Markets	NYSE	VWO	$38.28	Dec 21/18	3.12%	$41.82	20.72%	HOLD
Morgan Stanley Global Franchise Portfolio C*	NASDAQ	MSGFX	$25.34	Jun 4/19	0.00%	$28.73	16.30%	HOLD
Hussman Strategic Growth Fund	NASDAQ	HSGFX	$6.32	Dec 3/21	0.37%	$7.04	11.80%	HOLD
iMGP DBi Managed Futures Strategy	NYSE	DBMF	$31.67	Mar 26/21	4.62%	$32.86	3.76%	HOLD
Groupe Bruxelles Lambert	BSE	GBLB	€ 77.04	Jun 4/20	3.44%	€ 80.00	3.39%	HOLD
Unilever PLC*	NYSE	UL	$51.42	Jan 27/22	4.29%	$45.52	-9.64%	HOLD
Alibaba Group Holdings*	HKSE	9988	$194.57	May 1/20	0.00%	HKD 114.50	-40.01%	HOLD