MACRO ANALYTICS & TECHNICAL ANALYSIS
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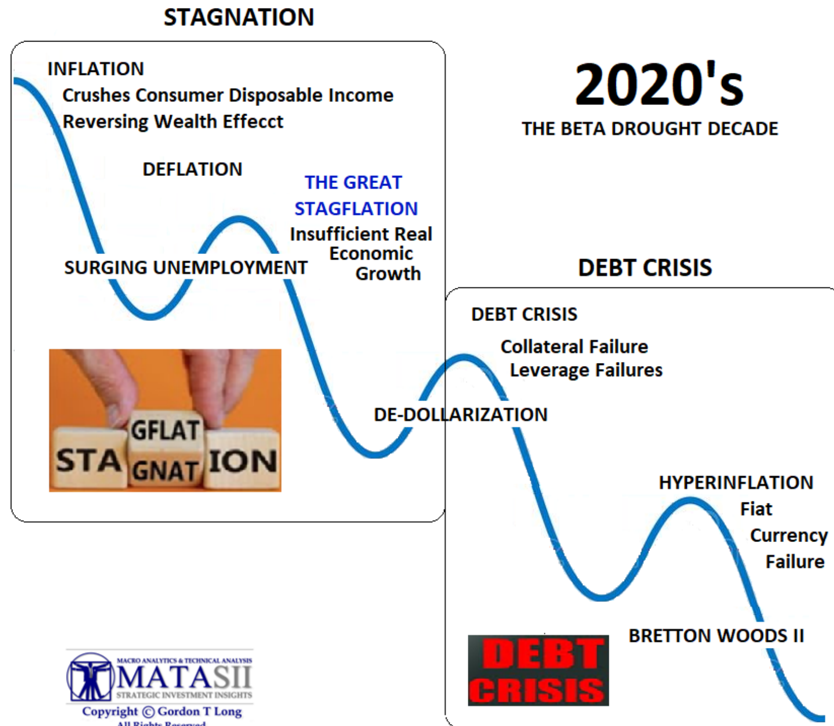
STRATEGIC INVESTMENT INSIGHTS



A GREAT STAGFLATION

The Transitioning Back To Sound Money

Release 1.0 Version-1.0

Through the Process of Abstraction the 2023 Thesis outlines how the Global Macro continues to be on a well defined path towards an eventual global Fiat Currency Failure and the resulting emergence of a new economic world order.

2023 will be further punctuated by rising geo-political tensions, expanding government control and shrinking public freedoms. US economic growth will further decline as a ‘livable working wage' becomes increasing a global issue. As a result Macro-Prudential policies of Financial Repression will accelerate through broadening Regulatory States in a major new shift towards “Regulatory Repression” to counter the era of Stagflationary economic problems.

Increasing centralized planning and control by sovereign government will manifest in a continued push towards the advancement of collectivism, statism and the erosion of personal freedoms.

Gordon T Long
1/15/2023

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A GREAT STAGFLATION

THE TRANSITIONING BACK TO SOUND MONEY

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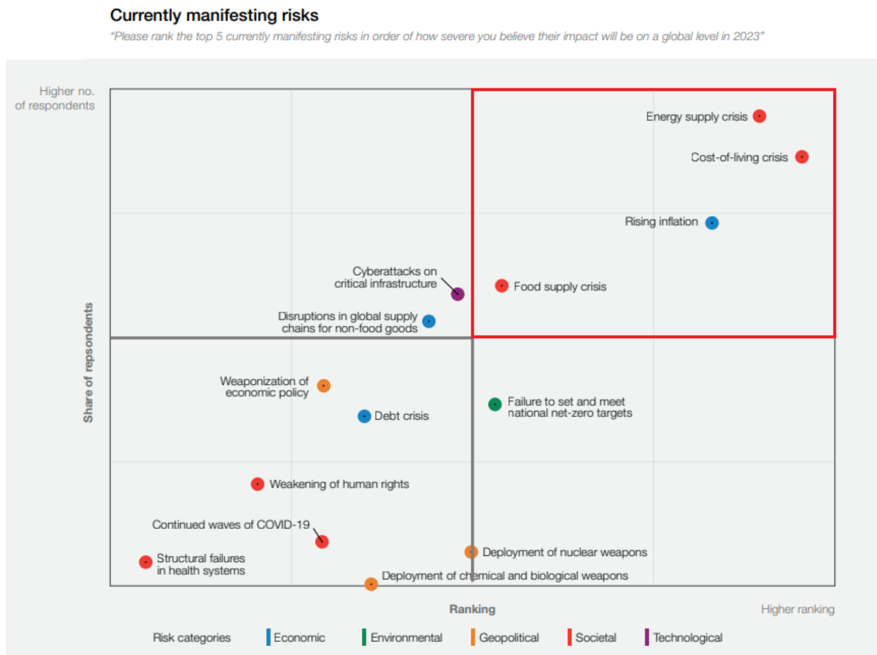
EXECUTIVE SUMMARY

Covid-19 has shown itself to be a triggering event which has destabilized a fragile global financial system.

Decades of unsound money, deficit fiscal spending and foreign financing of an economy built on "consuming more than it produced" left the US exposed to the ramifications of Covid-19.

The ramifications of the lock-downs of the work forces of the US & Developed economies has meant lost national income and trillions of dollars of government relief spending and a global shutdown of supply chains. The decaying shock waves continue to ripple across the globe.

Suddenly "Too many dollars chasing too few goods" launched monetary inflation pressures around the world.

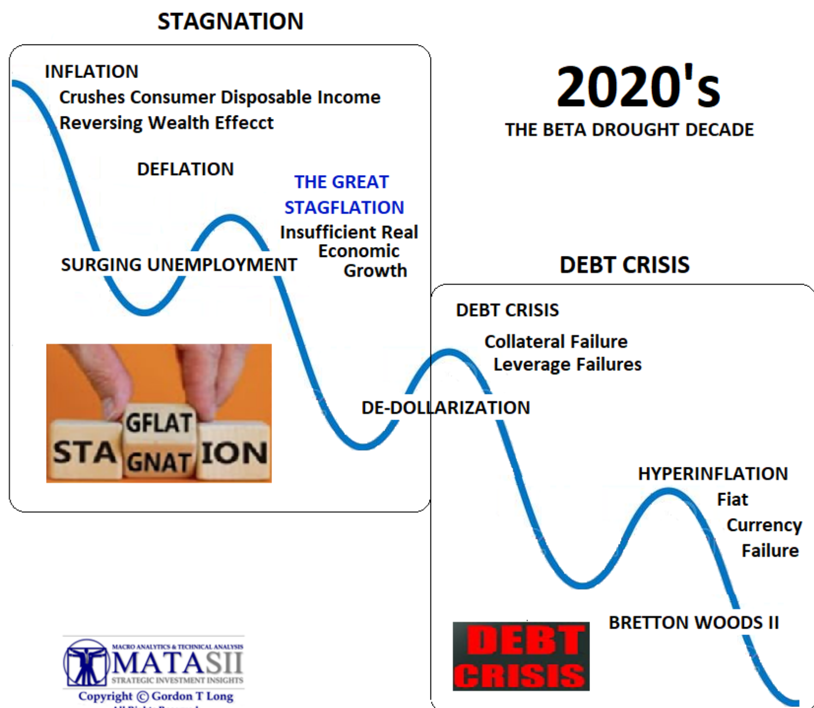


COST-OF-LIVING" CRISIS

Current global risks ranked by over 1200 of the top global experts surveyed by the World Economic Forum (shown above), overwhelming by 4 out of 5 surveyed, stated that "Cost-of-Living" was the largest risk facing their country and the world. They felt it was in fact a "crisis"!

The other factors in their top issues were: An Energy Supply Crisis, Rising Inflation and Food Supply Crisis. The magnitude of the 2022 rates of increase of all these factors may diminish on a percentage basis, but if history is any indicator their impact and continuation is likely to be felt for much of this decade.

Coupled with resulting slowing economic growth and surging unemployment will inevitably mean unprecedented stagflation. We have likely already entered the era of what may be someday called "The Great Stagflation".



THE GREAT STAGFLATION

Falling financial market valuations will continue throughout this, resulting Beta Drought Decade.

Historic valuations, excess leverage and unfundable debt in all facets of the global economy, whether consumer, corporate or government, will need to be brought under control and normalized.

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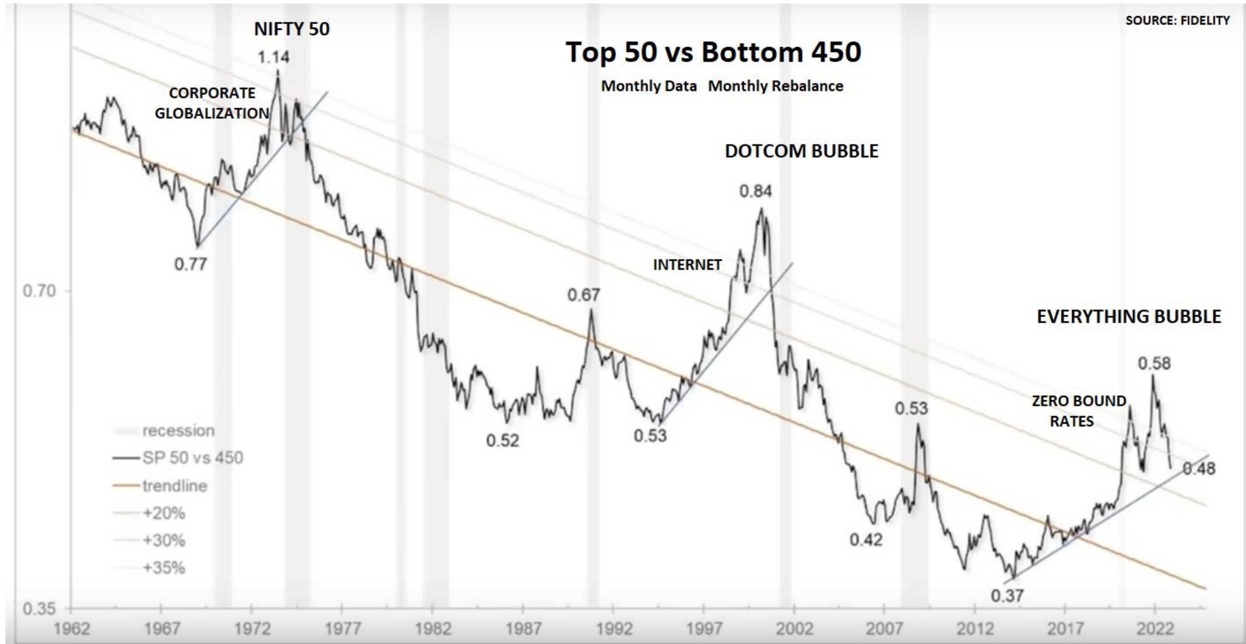
Standards of Living in the developed economies and especially the US can be expected to fall as productivity growth fails to deliver and support current standards-of-living and expectations.

As the chart below more graphically illustrates we have been experiencing "blow-off" bubbles ever since the US as the holder of the world reserve currency came off the gold standard and allowed the US dollar to become a fiat currency.



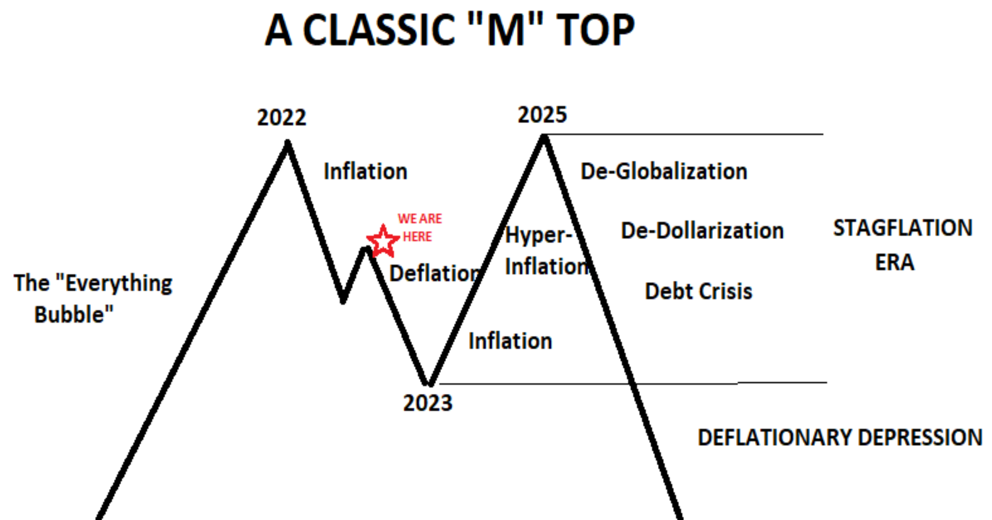
We can expect a Debt Crisis in this decade along with elements of hyperinflation which will force the resetting of fiat currencies. This will result in the transition back to some form of sounder money.

The roadmap ahead will be highly volatile, risky, and fraught with growing geo-political conflicts as the world shifts from a Uni-polar to Multi-polar world.

The world will be confronted with both Inflation and Deflation in different economic sectors and regions.

Too many events have yet to occur and resulting policy decisions taken to know with any real certainty how this will all evolve or turn out.

Our best guess based on the data, charts and analysis in this paper suggests it may look something like the schematic shown to the right. Further representations are to found in the Conclusions section.



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KEY MESSAGES

MATASII WARNINGS OF A STAGFLATIONARY ECONOMIC OUTCOME

- The Velocity of US M2 Money Stock did not rise despite unprecedented amounts of stimulus programs, Fed Facilities and dramatic increases in the Federal Reserve Balance sheet.
- The Velocity of Money in the US has steadily fallen, almost without interruption despite historic increases in liquidity.
- Over 20 years of a consistent falling Velocity of M2 Money Stock, suggests that in reality the US Economy must be shrinking! This is supported by our 2017 Thesis paper "Illusion of Growth".
- The Post Covid-19 S&P 500 market surge correlated precisely with the increase in the Federal Reserve Balance Sheet growth and not in real economic activity.
- The US Economy was, and would increasingly move towards; increasing economic stagnation as a result of the increasing role of bigger government, a more rapid shift towards socialist policies and ongoing Global Fiat currency debasement.
- The most current US Composite PMI ending in 2022 illustrates we have experienced not only a major collapse but in fact are now in contraction mode. Many indicators we have shown in recent newsletters suggest this is going to get much worse in 2023. Many analysts fail to see this as part of a major secular downturn versus nothing more than a shorter term cyclical downturn.
- The US 5s30s Yield Curve is currently inverted which is a strong indicator that minimally a US Recession lays ahead in 2023. Indications are that it will be worse and that the US is about to enter a longer term secular economic slowdown due to a number of factors including the structural breakdown of US's Industrial production prowess,
- We are witnessing the recent US Trade Balance change as US IMPORTS have started to fall! This is further evidence of weakening US Industrial Production. It may also be signaling even a more significant issue with potential collapsing US Consumer Consumption. In a 70% Consumption dependent economy this would be very serious!
- US GDP surged upward in 2021 and 2022, back in line with continued M2 Money growth.
- Money Supply Growth peaked in late 2021 and is falling while GDP is temporarily still rising with an expected lag.
- It is highly questionable whether the money growth experienced since Covid-19 can (or will be) sustained going forward while central banks around the world fight inflation.
- Even if we experience recessionary deflation pressures, it is highly likely the central banks will limit their actions to stopping Quantitative Tightening and further Fed Fund rate hikes. Only minor reductions in Fed Funds rate should be expected barring a full-out monetary depression.
- The period from the bursting of the Dotcom Bubble to the lows of the 2008 Financial Crisis can be seen in the context of the Rule of 20 as simply a longer term secular Bear Market and valuations.
- Going back close to 100 years we see that the S&P 500 Forward PE (currently 17.1) was higher than the Rule of 20 (currently 12.9) on only 5 separate occasions. Each time this occurred S&P 500 prices subsequently fell to match the Rule of 20 levels.
- Nearly a 100 year of data gives us a good probability that S&P 500 prices are headed lower over the next few years.
- We should fully expect major and violent counter rallies during this period of time before the "Buy-the-Dip", FOMO, Day and Gamma traders eventually go broke.
- Though both the S&P 500 and STOXX 600 peaked in 2020, the separation has widened with a noticeably lower STOXX 600 level.
- The STOXX 600 has broken through its long term support trend line; the S&P 500 has not and has effectively bounced off its long term support trend. Both are very close to their long term period averages. The S&P 500 is finding the long term period average as support; the STOXX 600 is finding it as overhead resistance.
- The analytics suggest that both equity markets US S&P 500 and EU STOXX 600) are in a critical near term consolidation effort which when resolved will mark a significant inflection point. Our current view is that this consolidation will be resolved with an equal leg to the downside.

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FEDERAL RESERVE MANDATE

- The result of three changes:
  - The post WWII adoption of the Breton Woods Monetary agreement,
  - The shift of the US Dollar to a Fiat Currency,
  - In 1980 when Fed Chairman Paul Volcker's in his fight against inflation took the Fed Funds Rate to near 19% to effectively stabilize the US and global economies while at the same time having International annual Balance of Payments settlements made by credit notes than via previous gold transfers.

  This effectively placed Federal Reserve policy as the undisputed and sole arbitrator of global monetary policy. This was not a role which the Federal Reserve was ever designed to assume nor had the tools and support to effectively administer.

- Central banks by their design are about effecting changes in Demand. They have little sway over Supply and the Federal Reserve has minimal sway over global supply and supply chains. This is especially true as the US has increasingly de-industrialized its manufacturing prowess and become a service economy and less the center of global trade.

- The world is now changing from the prior US centric Uni-Polar system to a Multi-Polar system with China, the EU and the BRIC nations having much stronger economic roles with differing needs. Being tied to the US dollar as the world's accepted reserve currency while the US continuously grew its twin deficits and increasingly consumed more than it produced, has become a major burden on the global economy and other emerging powers. We outlined this is our 82 page 2018 Thesis paper entitled "A New World Order".

- The Federal Reserve and government reporting agencies have continuously adjusted reported economic statistics. This has caused flaws within the following:
  - The Consumer Price Index (CPI),
  - The Economic Measure of Growth (GDP),
  - The Unemployment Rate,
  - The GDP Formula,
  - Reverse Repurchase Agreements (RRP)
  - US Treasury Issuances

THE GREAT MODERATION

- The history of US Inflation going back to the creation of the Federal Reserve at the turn of the 20th century using the published US CPI index shows:
  - Volatility in inflation over this period of time,
  - Periods of upper trend resistance and lower trend support,
  - Major market events can be identified at extremes in Inflation,
  - Between extremes Inflation often trends within controlled channels.
- The US economy is more stable and performs better when inflation is better controlled. It appears that level is between a moderate contraction of -3% and below inflation high of 5%.
- The Great Moderation period was between Federal Reserve Chairman Paul Volcker's success in halting a decade of high US inflation and the damage of resulting from the Covid-19 shock. This is seen to be approximately between 1980 and the spring of 2020.
- Before this period we had: Inflation Volatility, High Inflation, High Interest Rates and High Risk Premiums.
- We experienced a:
  - Dramatic Increase in Central Bank Balance Sheets and Fiscal Spending,
  - Dramatic shift in Government Fiscal Spending,
  - Global Disruption in supply and Supply Chains.
- We strongly believe this is about more than simply the fallout from Covid-19.
- The Great Moderation has ended because the current contributing factors to supporting US economic debt funding requirements are no longer sufficient.
- Debt Growth Is Outstripping Funding From Real Economic Growth.

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- Credit growth as measured by the Liquidity Gauge clearly indicates we can fully expect a Recession in 2023. The problem however is much more serious. We have the strong possibility that this is now a secular problem that will be with us for a significant part of the current unfolding decade.
- With credit entering a potentially protracted period of contraction we feel it supports our view of the coming Beta Drought Decade.
- The current selling of US Treasuries already suggests this as countries are liquidating their FX US Dollar Reserves. There are more reasons for this than just their need for money or wanting to get out of the dollar (de-dollarization).
- A major concern is the pressure it will place on the US to sell its debt to enable it to continue to finance government debt obligations.
- These obligations include new debt, rollover debt and unfunded liabilities ($84T in unfunded entitlement programs – Social Security, Medicare, Disabilities, and Government Pension Plans).
- We can expect the US Governments to address this with government supported credit guarantees or contingent liabilities accounting. We have referred to this coming approach as Financial Repression III (See Video: UnderTheLens - 11 23 22 - DECEMBER - Financial Repression

A DESTABILIZING SHOCK

- US Treasury prices were the highest during the WWII era and most recently as the Covid-19 pandemic shock occurred. They were the lowest (highest yields) during Fed Chairman Paul Volcker's inflation fight in 1980.
- We might consider that we have had five eras since the turn of the 20th century:

  1. The WWI Shock: Post Spanish Flu / WWI through the Great Depression
  2. The WWII Era
  3. The Inflation Era from 1964 (Vietnam War not paid for by War Bonds but by Credit & Energy Shock) to 1980
  4. The Great Moderation from 1981 until 2020
  5. Since the 2020 Covid-19 Shock

- The current economic situation has eerie similarities to the WWI Shock, which lasted from the Post Spanish Flu and WWI through the Great Depression.
- There are also some clear parallels with the Inflation Era from 1964 (Vietnam War not paid for by War Bonds but by Credit & Energy Shock) to 1980.

COST-OF-LIVING" CRISIS

Current global risks ranked by over 1200 of the top global experts surveyed by the World Economic Forum (shown below) overwhelming by 4 out of 5 surveyed stated that "Cost-of-Living" was the largest risk facing their country and the world. They felt it was in fact a "crisis"!

INFLATION PLUS DEFLATION

- We should expect increasing instabilities with both rising Inflation and Deflation. These will occur concurrently but in different economic and financial areas,
- According to research by Deutsche Bank, history shows that once inflation rises above 5% in developed economies, it takes at least a decade to bring it down to 2%.
- In 2023 we are highly likely to see major deflationary pressures associated with a potential Federal Reserve hard landing and recession.
- Inflation will be with us for the next decade. It may fall based on "official" numbers to ~4-5%, but it will be there nevertheless. We will be in an era of continuous policy initiatives to rein in inflation to manageable levels.
- We are now only in the first phase of what is likely to be a three phase process before we see inflation being possibly contained.
- Inflation fighting is about Politics as much as it is about Economics!

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DEVELOPMENTS IN THE KEY ELEMENTS OF STAGFLATION

KEY ELEMENTS OF STAGFLATION AHEAD

ELEVATED INFLATION (+4%)

SLOW GROWTH (<1%)

MAJOR UNEMPLOYMENT (+10%)

INFLATION ELEMENT

- In the 2020's, we are likely to find ourselves in a radically different situation to the 2010s. Inflation will always be a little too high (as opposed to too low). With both monetary and fiscal policy pivoting a full 180 degrees, we will again have a "tug of war", but this time a battle that pushes firmly in the direction of higher interest rates, rather than the disinflation and NIRP of the post-GFC era.
- The US may now be entering another Beta Drought. US returns are now at risk from both the prospects of higher inflation AND the headwinds to returns from high starting-point valuations.
- We fully expect a major crisis within the $2.2 Quadrillion derivatives complex to ignite yet another government money printing episode of even more egregious new government policies.
- The broken Credit Transmission Mechanism is now fractured for many reasons, but most of all because of a shortage of unencumbered collateral.
- We have reached the point where Credit growth can no longer sustain over-indebted and over leveraged systems. The US and most developed economies debt are quickly becoming unfundable without dramatic actions being taken.
- If this is not enough – US productivity is now in free fall because of a decade of mal-investment and under investment in productive assets. It will take the next decade (or possibly more) to clear the monetary mal-practice, fiscal excessive and global imbalances from the system. It will be a Beta Drought Decade.
- The coming decade will likely be referred to as the Great Stagflation. This is similar to the 1930s' which was labeled the Great Depression. There is all likelihood it may be worse and eventually be labeled the Great Stagflationary Debt Crisis.
- Inflation and Deflationary pressures will come at us increasingly from major shifts in the World Order as do domestic problems.
- Those discussions match with what we have already experienced in 2022 with regard to the results of the "60:40 Bond Total Real Return Index".
- Expect to see:
    - De-Globalization / De-Growth / De-Financialization / Re-Balancing / Re-Shoring,
    - Declining Productivity,
    - Falling Purchasing Power of US$ & Fiat Currencies,
    - De-Dollarization.

GROWTH ELEMENT

- US Economic growth is seen be extremely strong even when plotted on a log scale. However careful analysis shows it briefly leveled off near the end on the 1970's (red circle above).
- This closely aligns with the beginning of the Great Moderation when once again economies continued to steadily advance.
- We can see this was preceded with over a decade of rising Inflation (three peak cycles) that began with spending to financing the Vietnam War (the first War financed by credit), President Lyndon B. Johnson's Great Society (financed with fiscal deficits) and in 1971 when the US Dollar officially becoming a fiat currency when President Richard took the US off the Gold Standard.
- Banks Are Worried About Something?
    - Banks and holders of cash are dramatically increasing their holdings of Reverse Repos (RRP) Balances at the Fed instead of lending it out.
    - Commercial banks are significantly increasing their Loan Loss Reserves which always is a clear sign that they see defaults and loan delinquencies ahead.

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  - Loan & credit officers are steadily tightening lending Standards.
  - The Federal Reserve has been steadily tightening Financial Conditions as seen by the Financial Conditions Index.

- We have serious problems arising in the areas of Liquidity, Credit, Debt, Collateral & Lending Risk.
- IMF and World Bank Economic projections have been abruptly and significantly reduced for 2023. The World Bank is warning of a Global Recession.

UNEMPLOYMENT ELEMENT

- The Unemployment rate has been steadily rising over a longer period of time, despite a rapidly rising Participation rate, as the US effectively de-industrializes with over 54 thousand manufacturing facilities having left the US for China and more competitive Asian locations.
- An upper limit of 10% Unemployment rate recently broken by Covid-19 reached during the 1980-1982 Volcker created Inflation fighting recession.
- We have additional problems associated with:

  - Growing hidden costs of unemployment,
  - Exploding Disability roles and funding costs,
  - The ranks of Medicaid recipients and funding costs,
  - Over $90 Trillion in unfunded liabilities for Social Security and Medicare for unemployed elderly.

CONTSRAINED BOUNDARY CONDITIONS

- If inflation stays elevated (above 5%), then there is a strong possibility that the official unemployment rate will surge through the 10% range.
- This is particularly likely if the Fed Funds Rate remains elevated in the Federal Reserve's fight against inflation. This is highly likely since the rate is still very low versus Inflation and what it will likely take to effectively fight it.
- The commonly understood perception is that the US has shifted over the last 5 decades from being the dominant global manufacturer, to becoming a Service Economy. Few take that point further by pointing out that this has meant destruction in high paying jobs with fewer Service Jobs that in aggregate pay less than the lost manufacturing jobs. Additionally, in aggregate the export revenue of the shift is a significant net loss to the US Economy.
- It has taken a continuous reduction in interest rates to effectively avoid bankruptcy by financing employment in Zombie corporations, job creating mal-investment in Unicorns and high failure rate start-ups to keep unemployment from rising further than an already longer trend that has been rising despite this.
- Precarious US employment rates have become increasingly dependent on low rates to sustain mal-investment and poorly capitalized employers. Any de-stabilizing financial stress has the potential to send unemployment through the roof!

THE REALITY OF THE STAGFLATIONARY EVENT HORIZON

- A potential Stagflation problem is much bigger and much more intractable than most yet fully realize!
- The way to visualize what is occurring is to think of Stagflation as a potential Black Hole. It is easy to unwittingly and unsuspectingly get into, but extremely if not impossible to get out of once trapped in it.
- The hidden problem is that the distortions and reporting games we have been playing for a very long time, have let us get much too deep in the Black Hole than we understand, because our measures have failed to alert us of the reality of the situation.
- The political "Kick-the-Can-Down-the-Road" policy approaches have only fostered "tweaking" the warning measures to buy time and make it someone else's problem!
- Inflation through statistical distortions such as Hedonics, Substitution, Imputation and others which I have previously chronicled, have distorted Inflation as measured by the CPI to such a degree that Inflation, Inflation Breakevens and Real Rates are ineffective measures.
- Economic Growth is also seriously distorted by an obsolete formula that is based on sound money and adopted during the era of the gold standard and fails miserably to adequately describe real growth in an era of massive government debt, transfer payments and debt financed consumption now being nearly 70% of the economy.

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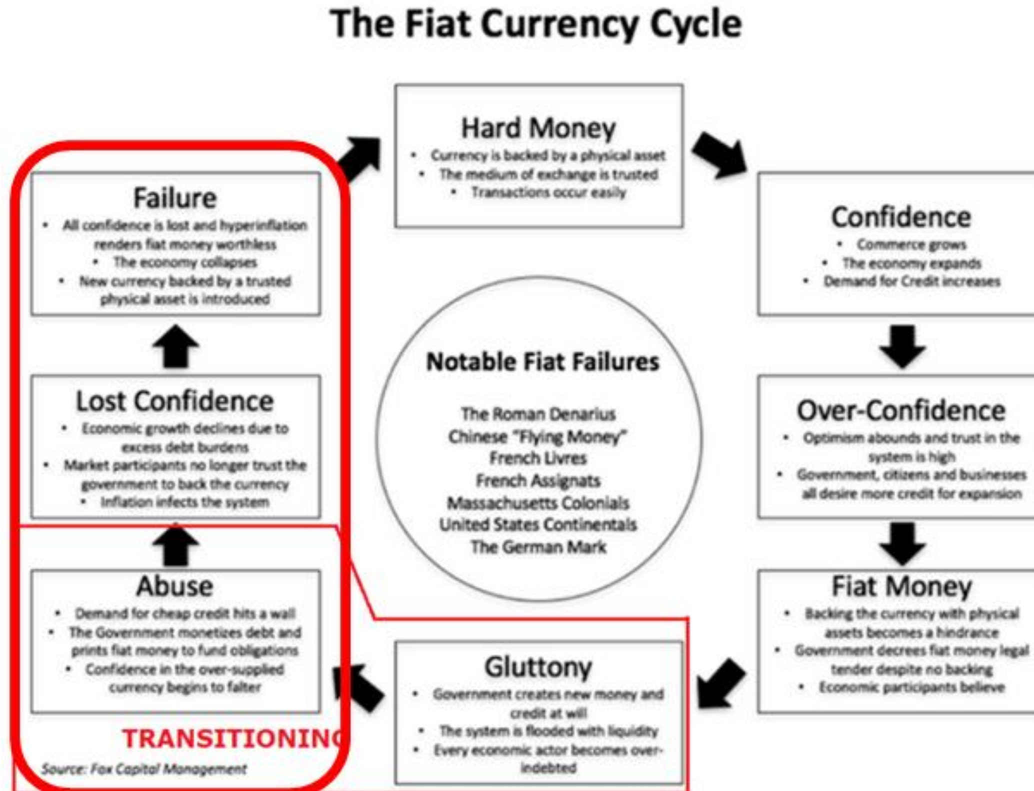
- The creators of the simple formula never imagined an economy like the one we operate in today.
- The central problem and difference with what occurred in the 1970's is important to understand. We not only have an order of magnitude worse "black hole" problem, but our tools are dull and our thinking seriously obsolete. Our politically polarized governance is also a big problem!
- The intractable problems we are highly likely to face during the Great Stagflation can be laid at the feet of poor and ineffective political leadership within a blatantly corrupt political process. Decades of "Kicking-the-Can-Down-The-Road" to future elected leaders by altering reporting and distorting hard realities in the central problem will soon have to be faced!

The continuous avoidance of reality has only made the problem much bigger than it ever needed to be. The delay may in fact unfortunately possibly lead to the economic and financial collapse of America as the world presently knows it!

CONCLUSION

- Though the rest of this decade will be challenging and fraught with political, economic and social changes continuously disrupting the stability of the financial markets it must be viewed in the proper context! It is what is required to resolve a historic global debt crisis and anchor fiat currencies as part of the required process of returning to a global platform of Sound Money.
- The US Standard of Living is likely to mirror the S&P 500 equity markets as measured by Household Net Worth as a Percentage of Disposable Personal Income during the next decade.
- Equity markets are headed lower primarily driven by slowing US consumer demand which initiates **a Reverse Wealth Effect**. A 70% consumption economy as over leveraged as the US has become while consuming more than it produced is finally testing the bounds of the global economy willing to continue to finance this massive world imbalance.
- In the short to intermediate term equity markets are likely to face a **major counter rally** when the Fed pivots and reverses Monetary Policy by; initially stopping rate hikes somewhere around a 5% terminal rate; then begin lowering the Fed Funds Rate as unemployment increases. By this time the QT target will have been met and halted (June 2023), at which time the Fed is likely to have already once again opened the liquidity spigots by increasing the Fed's balance sheet.



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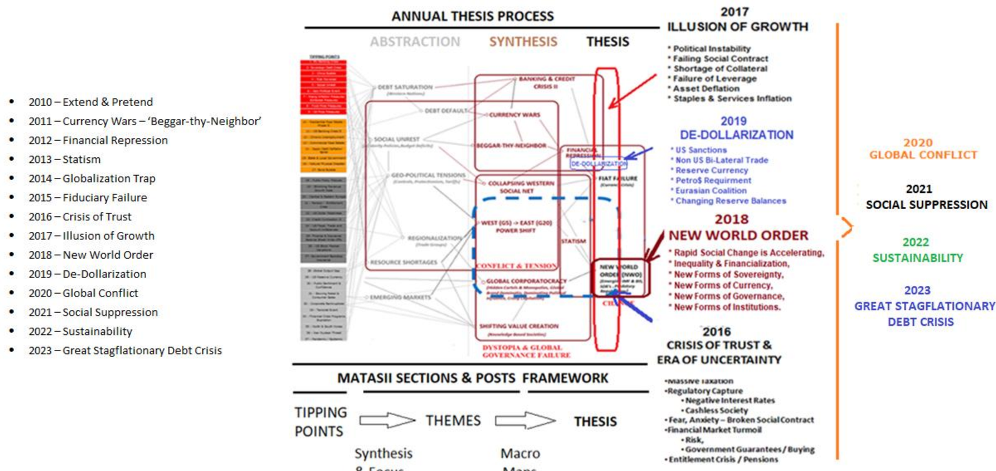
14 YEARS OF CONTINUALLY EVOLVING THESIS PAPERS

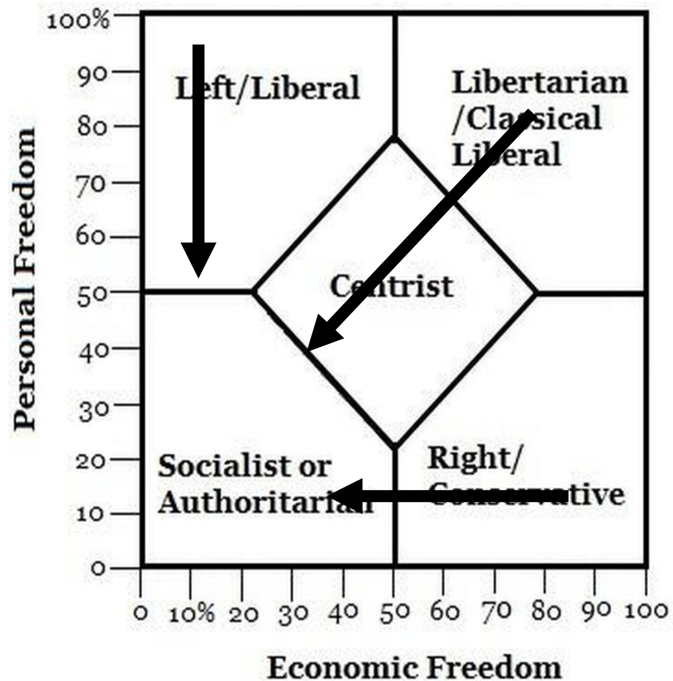


What 'We the People' have witnessed throughout the progression of these Annual Thesis papers is the continuous surrender of both Personal and Economic Freedoms to government control. These freedoms have been eroded primarily through the use of fear and our desire for the perceived guarantees of security and safety. This has historically been the roadmap that leads to more authoritarian governance systems such as Socialism and Communism.

ECONOMIC SECURITY
First it was Economic Job Security after the Dotcom Bubble implosion as Corporations:

- Outsourced,
- Downsized / Right-Sized,
- Off-Shored.

Our bedrock "Mom & Pop' employers and local merchants were lost to Corporate Franchisers, Malls and Big Box Stores.



FINANCIAL SECURITY
Then we experienced financial pressures in the form of:

- Skyrocketing College Costs / Student Debt,
- Shift from Defined to Contributory Pensions with the loss of Pensions,
- Benefit Reductions and Soaring Medical Costs with reduced hours worked.

PHYSICAL SAFETY
Then after 911, Terrorism and our Physical Safety altered as the world changed due to:

- Bin Laden & El-Quida,
- ISIS,
- Domestic School Shootings

HEALTH SAFETY
Now it is a Pandemic and the safety of the Health of family and friends.

- Covid-19 Pandemic,
- Social Distancing and Lockdowns

The following chronology is how Poor Policy Prescriptions, Expanding Government Control and a Reserve Currency & Risk-Free Benchmark problem have set the stage for a 'Cocktail' of Social Unrest & Shift towards Social Suppression **and now a major accelerated grab for broader political power. All disguised through socially driven words such as "Sustainability", Climate Change, Green Energy, Environment, Social & Governance (ESD) and Diversity, Equality and Inclusion (DEI).**

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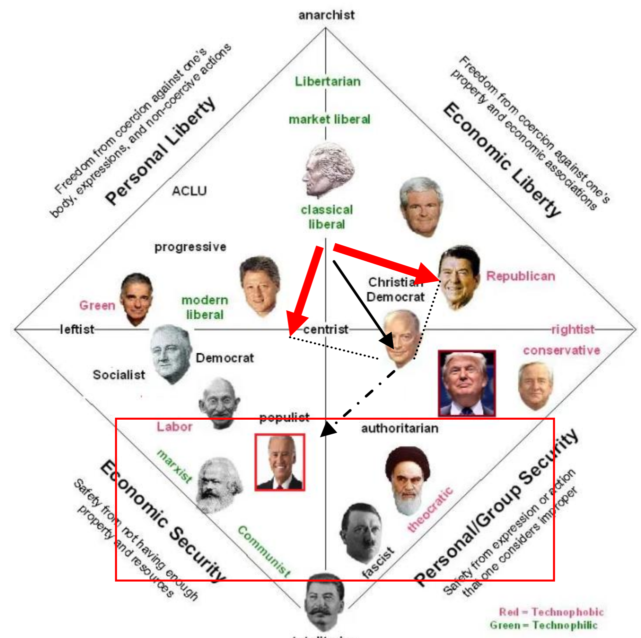
WAS THIS AN ORCHESTRATED PROGRESSION?

The above man-made initiatives were a result of, and contributors to, the following list of mounting Globalization problems. In turn these developments have pushed the political landscape further towards the bottom of the Nolan Chart, illustrated to the right.



THE GLOBALIZATION PROBLEM

I. Lack of Global Growth,
II. Insufficient Need for Labor (AI Robotics),
III. Population Becoming Unsupportable,
IV. Unfundable Entitlements & Pensions,
V. Unsustainable Global Debt & Leverage,
VI. Global Trade Imbalances,
VII. UniPolar to Multi-Polar World.

SPREADING & GROWING GLOBAL FALLOUT

The Global problems listed above have manifested themselves in the form of the following *crisis (see schematic at the bottom)*:

DOMESTIC: FINANCIAL – 2008-2009

US Mortgage Market – Started as a collapse in Credit Default Swaps (CDSs) underpinning Collateralized Debt Obligations (CDOs) which supported the US Mortgage Market through Fannie Mae and Freddie Mac (which forced both into government guaranteed Conservatorship).

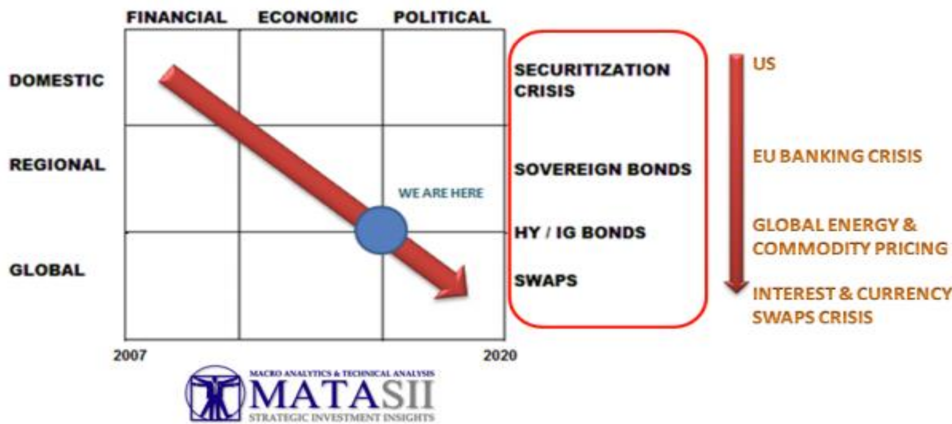
ECONOMIC: REGIONAL – 2012-2014

EU Banking Crisis – It started in Greece, spread to Cyprus and then the southern peripheral countries labeled the PIGS (Portugal, Italy, Greece & Spain) before being halted by and exploded in the EU Target2 payment system.

POLITICAL: GLOBAL – 2018-2020

Global Central Banks – An explosion of over $15T in Global Central Banks' balance sheet to supply liquidity to a collateral short lending edifice unable to maintain credit growth sufficient to continue to rollover debt and fund sufficient debt growth.

A GLOBAL-IZATION PROBLEM



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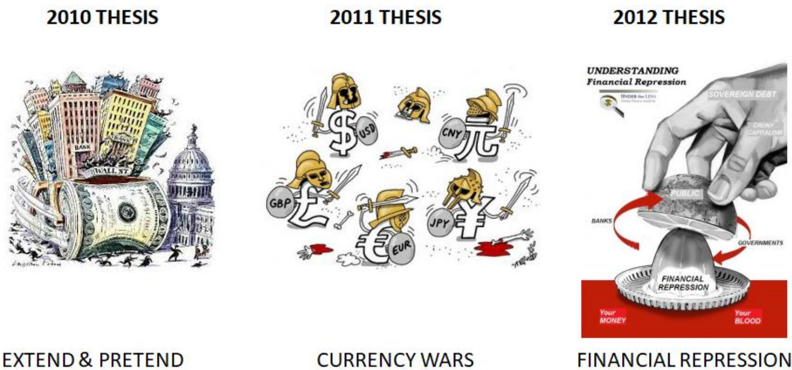
EARLY PART OF LAST DECADE

Our Annual Thesis papers documented the above evolution within the context of 'strategic' crisis developments.

In the early part of the last decade we witnessed the following Thesis papers:



- 2010 Extend & Pretend - Rather than address issues, our elected officials chose to *avoid* the tough decisions and to "Kick-the-Can-Down-The-Road".

- 2011 Currency Wars

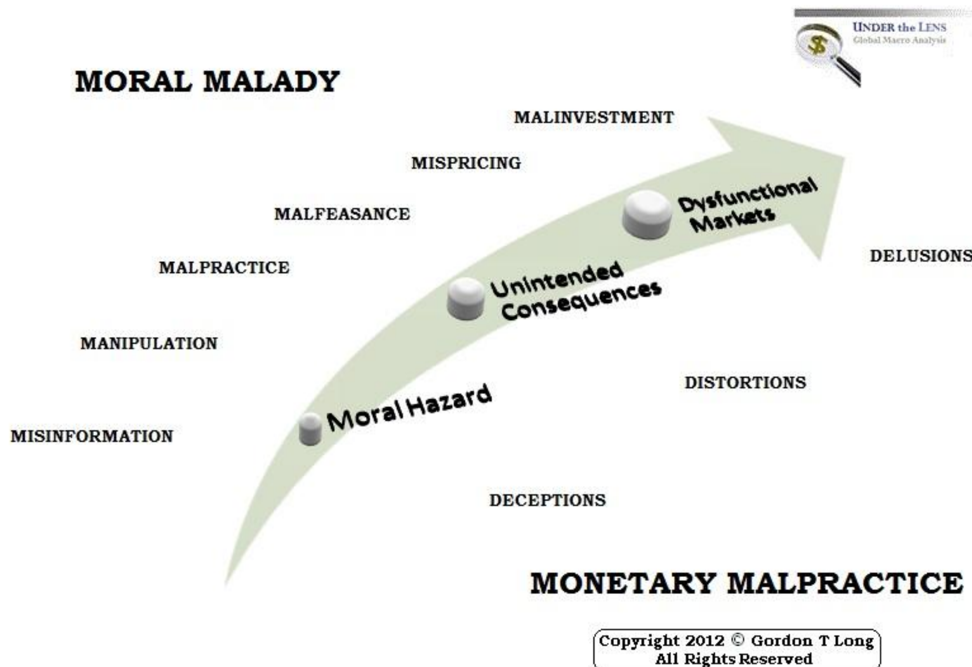
  The *easy way* to gain competitive advantage (short term) was to adopt "Beggar-The-Neighbor" policies of Currency manipulation.

- 2012 Financial Repression
  The *easy way* to solve a lack of productive investment (short term) is to implement macro-prudential policies of Financial Repression which misprices the price of risk and cripples effective market price discovery.

POOR POLICY PRESCRIPTIONS

MORAL MALADY
We witnessed policies that fostered Misinformation, Data Manipulation, Monetary Malfeasance, Mispricing of Risk and other short term "quick fix" approaches, all of which led to Malinvestment.

MONETARY MALPRACTICE
As a result we saw the emergence of Moral Hazard, Unintended Consequences and Dysfunctional Markets. The Deceptions, Distortions and Delusions that occurred can only be labeled as an Era of Monetary Malpractice.



MIDDLE YEARS OF LAST DECADE

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In the middle years of the last decade we witnessed with the followingThesis papers:

- 2013 Statism
  A failing Economic System as a result of Unsound Money forced governments as a consequence to enforce ***Control*** in lieu of a natural self correcting system.

- 2014 Globalization Trap
  Mounting ***Trade Imbalances***, as a result of developed economies consuming more than they produced, distorted current account balances and balance of payments resulting in unsupportable debt balances.

2013 THESIS

STATISM

2014 THESIS

THE GLOBALIZATION TRAP

2015 THESIS

FIDUCIARY FAILURE

2016 THESIS

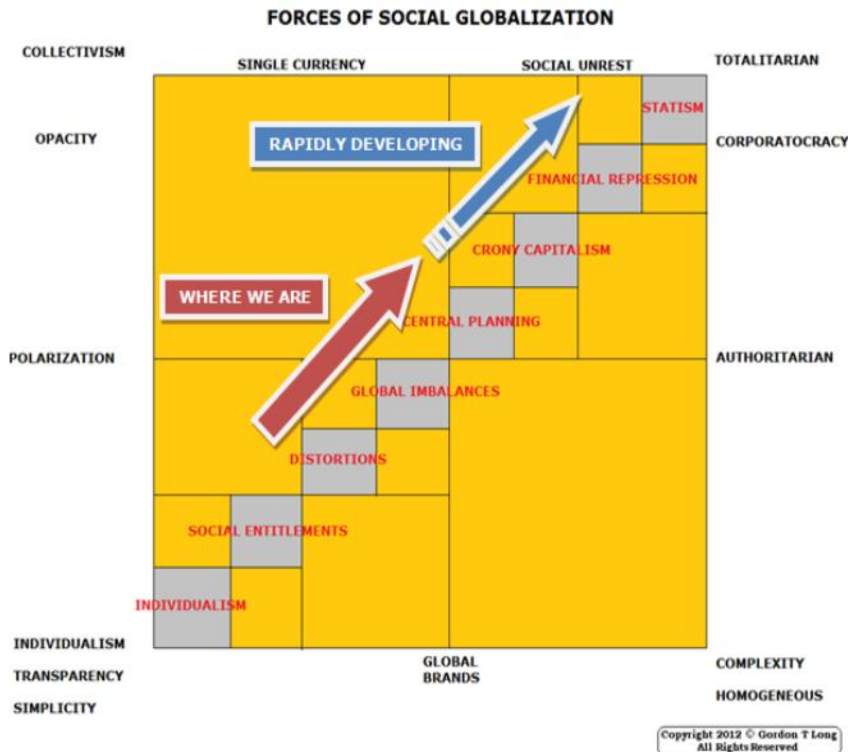
CRISIS OF TRUST

- 2015 Fiduciary Failure
  Developed economies became increasingly burdened and trapped by ***Unfundable Entitlement*** programs which were left to worsen and become the problem of future political administrations.

- 2016 Crisis of Trust
  An inevitable ***Loss of Trust*** of politicians, the government, financial institutions and the Status Quo grew within the electorate as populism grew. With it came new political leaders with socialist, nationalist and anti-government philosophies.

EXPANDING GOVERNMENT CONTROL

The above developments led to a shift towards Statism in the progression outlined below.



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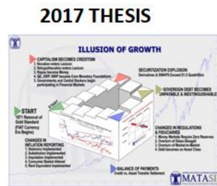
LAST PART OF THE 2010 DECADE

In the latter part of the last decade we witnessed with the following Thesis papers:

- 2017 Illusion of Growth -
  Government Deficit Borrowing is being double counted as "G" and "C" in the GDP formula hiding the degree of ***Insufficient Real Growth*** occurring over the last 3 decades.

- 2018 New World Order -
  The US is no longer the Unipolar controlling power in a new significantly changing ***Multi-Polar World***.

2017 THESIS



2018 THESIS

2019 THESIS

2020 THESIS

ILLUSION OF GROWTH | NEW WORLD ORDER | DE-DOLLARIZATION | GLOBAL CONFLICT

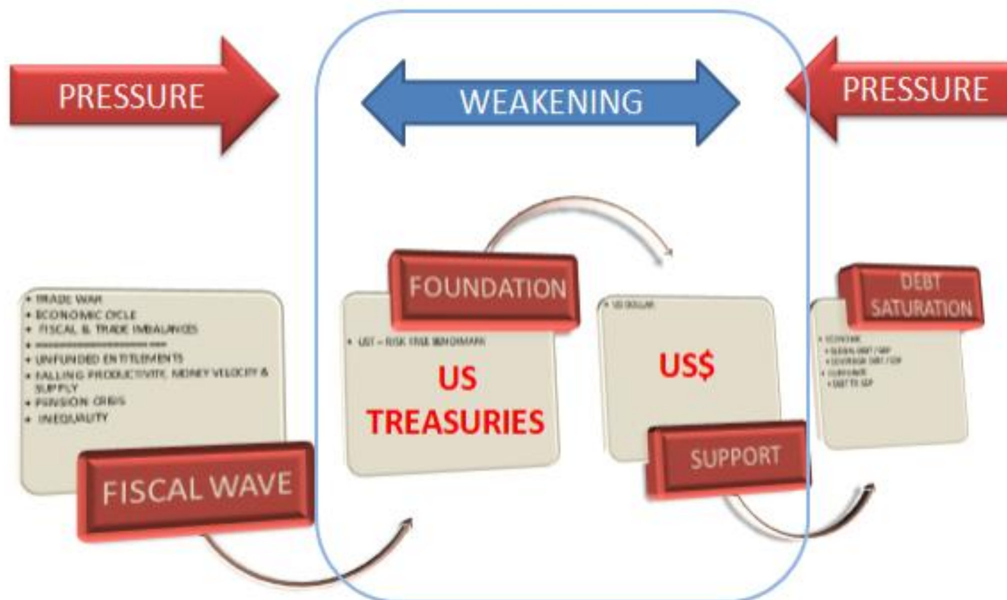
- 2019 De-Dollarization -
  The US' use of economic sanctions has effectively "Weaponized the US$", thereby forcing targeted countries (and their trading partners) to ***reduce their US$ dependency***. Additionally, BRICS have steadily been reducing their US$ currency reserves along with many countries adopting bi-lateral trade agreements using their own currencies.

- 2020 Global Conflict -
  Not since the Cold War have tensions been higher around the world. From the South China Sea, to Taiwan, Hong Kong, India, Iran, Syria, Yemen/Sudan, these conflicts continue to go unresolved with escalating ***Power Tensions***.

BOTH A GLOBAL RESERVE CURRENCY & RISK FREE BENCHMARK PROBLEM

The world's modern post WWII financial system is built on two bedrocks which are under assault:

1- US DOLLAR: The World's Reserve Currency & Trade Currency is the US Dollar.
2- RISK FREE BENCHMARK: The US Long Bond is still considered the benchmark for the pricing of risk.



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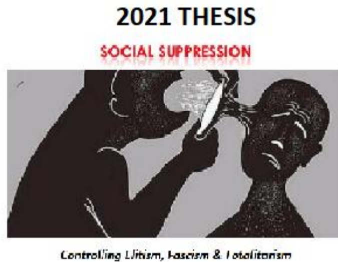
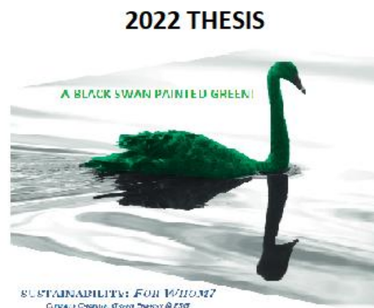
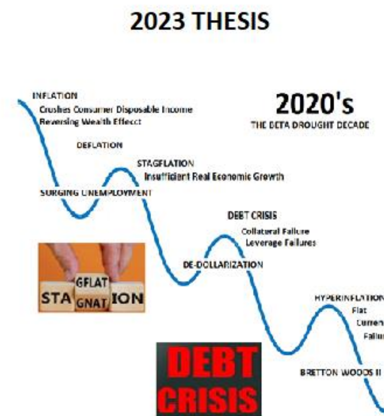
THE NEW 2020 DECADE

In the first part of the 2020 decade we have witnessed through the following Thesis papers increasing social oriented movements accompanied by higher levels of centralized government control:







SOCIAL SUPPRESSION | SUSTAINABILITY: *For Whom?* | THE GREAT STAGFLATIONARY DEBT CRISIS

- 2021 Social Suppression – A further and more pronounced shift to the "Left" in the political spectrum - We have witnessed Policies, Regulations and Approaches taken by developed economies' governments and accepted by the public that are much **more centrally controlled** with less acceptance of free speech and political discourse.

- 2022 Sustainability - A strong and more **visible Global coordination** towards Sustainability or "Green" policies employing UN sponsored controlling methods such as Carbon Taxes, Carbon Credits & Offsets, Corporate policies of ESG & DEI, Climate Immigration & migration along with funding agreements under GFANZ.

- 2023 The Great Stagflationary Debt Crisis – Covid-19 triggered **a destabilizing global Inflationary surge** that ended the 40 year "Great Moderation" Era. Globally high levels of Inflation, Slowing Economic Growth and rising Unemployment ushered in an era of Stagflation which, if protracted steadily, exposes global debt levels to rising cost risk & credit premiums and debt defaults.

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MATASII WARNINGS OF A STAGFLATIONARY ECONOMIC OUTCOME

KEY UPDATES

- The Velocity of US M2 Money Stock did not rise despite unprecedented amounts of stimulus programs, Fed Facilities and dramatic increases in the Federal Reserve Balance sheet.
- The Velocity of Money in the US has steadily fallen, almost without interruption despite historic increases in liquidity.
- Over 20 years of a consistent falling Velocity of M2 Money Stock, suggests that in reality the US Economy must be shrinking! This is supported by our 2017 Thesis paper "Illusion of Growth".
- The Post Covid-19 S&P 500 market surge correlated precisely with the increase in the Federal Reserve Balance Sheet growth and not in real economic activity.
- The US Economy was, and would increasingly move towards; increasing economic stagnation as a result of the increasing role of bigger government, a more rapid shift towards socialist policies and ongoing Global Fiat currency debasement.
- The most current US Composite PMI ending in 2022 illustrates we have experienced not only a major collapse but in fact are now in contraction mode. Many indicators we have shown in recent newsletters suggest this is going to get much worse in 2023. Many analysts fail to see this as part of a major secular downturn versus nothing more than a shorter term cyclical downturn.
- The US 5s30s Yield Curve is currently inverted which is a strong indicator that minimally a US Recession lays ahead in 2023. Indications are that it will be worse and that the US is about to enter a longer term secular economic slowdown due to a number of factors including the structural breakdown of US's Industrial production prowess,
- We are witnessing the recent US Trade Balance change as US IMPORTS have started to fall! This is further evidence of weakening US Industrial Production. It may also be signaling even a more significant issue with potential collapsing US Consumer Consumption. In a 70% Consumption dependent economy this would be very serious!
- US GDP surged upward in 2021 and 2022, back in line with continued M2 Money growth.
- Money Supply Growth peaked in late 2021 and is falling while GDP is temporarily still rising with an expected lag.
- It is highly questionable whether the money growth experienced since Covid-19 can (or will be) sustained going forward while central banks around the world fight inflation.
- Even if we experience recessionary deflation pressures, it is highly likely the central banks will limit their actions to stopping Quantitative Tightening and further Fed Fund rate hikes. Only minor reductions in Fed Funds rate should be expected barring a full-out monetary depression.
- The period from the bursting of the Dotcom Bubble to the lows of the 2008 Financial Crisis can be seen in the context of the Rule of 20 as simply a longer term secular Bear Market and valuations.
- Going back close to 100 years we see that the S&P 500 Forward PE (currently 17.1) was higher than the Rule of 20 (currently 12.9) on only 5 separate occasions. Each time this occurred S&P 500 prices subsequently fell to match the Rule of 20 levels.
- Nearly a 100 year of data gives us a good probability that S&P 500 prices are headed lower over the next few years.
- We should fully expect major and violent counter rallies during this period of time before the "Buy-the-Dip", FOMO, Day and Gamma traders eventually go broke.
- Though both the S&P 500 and STOXX 600 peaked in 2020, the separation has widened with a noticeably lower STOXX 600 level.
- The STOXX 600 has broken through its long term support trend line; the S&P 500 has not and has effectively bounced off its long term support trend. Both are very close to their long term period averages. The S&P 500 is finding the long term period average as support; the STOXX 600 is finding it as overhead resistance.
- The analytics suggest that both equity markets US S&P 500 and EU STOXX 600) are in a critical near term consolidation effort which when resolved will mark a significant inflection point. Our current view is that this consolidation will be resolved with an equal leg to the downside.

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In February 2020 as Covid-19 was only beginning to be unearthed, we released the UnderTheLens video entitled "The Coming Era of Stagflation", because even by then it was obvious where the US Economy was headed. We encourage you to review the video, for much of the content is still very much pertinent.

2020 FEBRUARY: UnderTheLens: 02-26-20 - The Coming Era of Stagflation

URL: https://youtu.be/i-kDfOj6-Ps

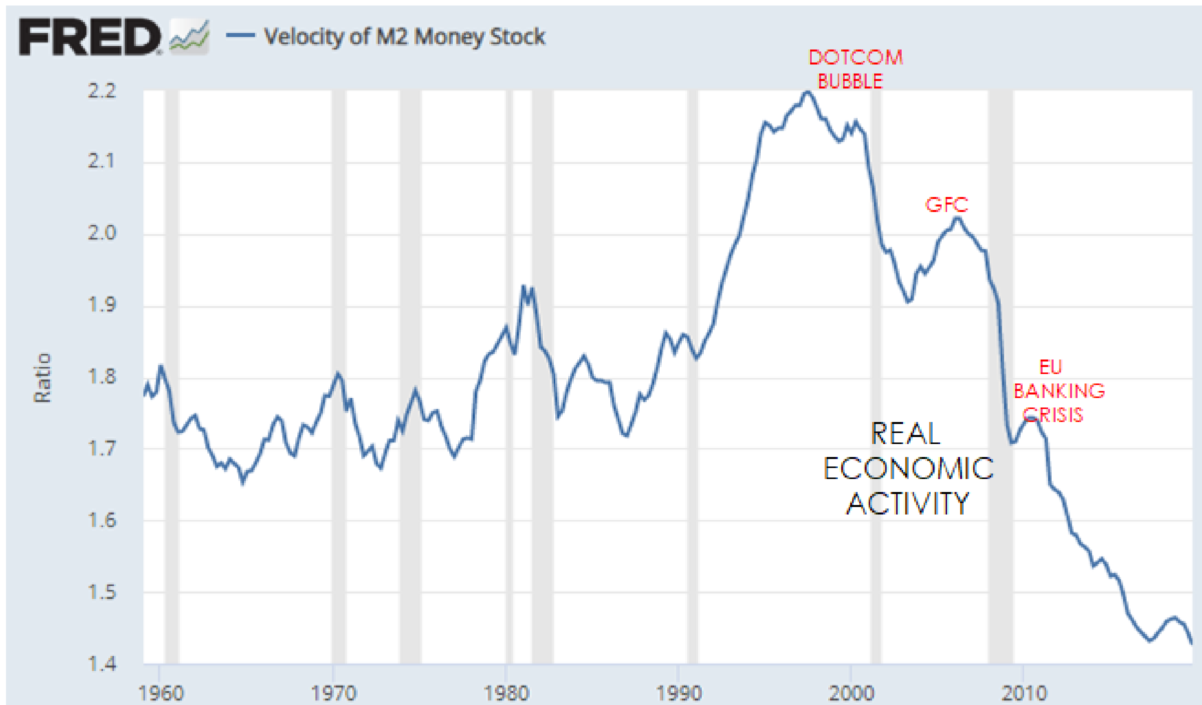
Supporting Newsletter -#1 – https://conta.cc/2wrg5Zm
Supporting Newsletter -#2 – https://conta.cc/3zRwJhl

COMING ERA OF STAGFLATION

Three of the many charts are worth reviewing by way of updates, since they are very telling in how events have unfolded since.

1- VELOCITY OF MONEY

Prior to Covid-19 the US Velocity of Money which historically has been an excellent representation of both Economic Activity and Inflation pressures looked like this:



VELOCITY OF MONEY: The velocity of money is **the frequency at which one unit of currency is used to purchase domestically- produced goods and services within a given time period**. In other words, it is the number of times one dollar is spent to buy goods and services per unit of time.

What was interesting about this chart was though in each of the crisis events highlighted, the Velocity of Money in actuality decreased after the events. This was despite money supply and liquidity being increased in each occurrence.

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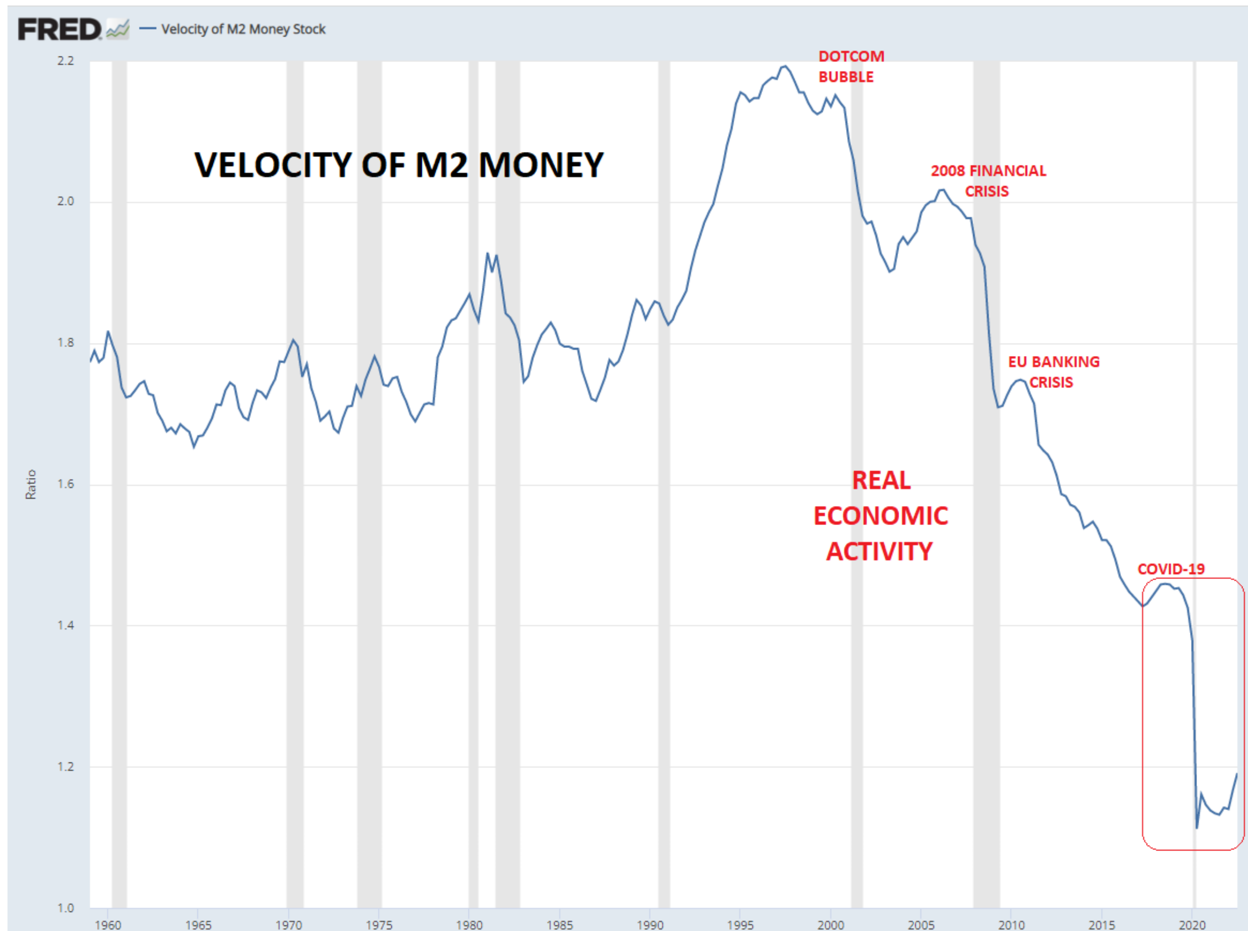
Today that same chart looks like this:

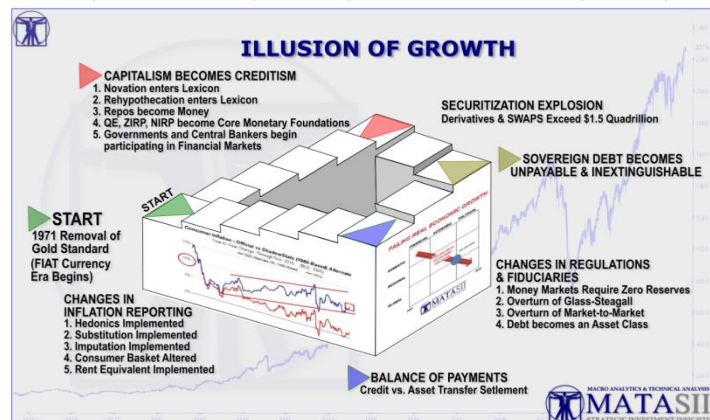


What it highlights is:

- The Velocity of US M2 Money Stock did not rise despite unprecedented amounts of stimulus programs, Fed Facilities and dramatic increases in the Federal Reserve Balance sheet.
- The Velocity of Money in the US has steadily fallen, almost without interruption despite historic increases in liquidity.

The question this raises is how can this be? I have yet to read a satisfactory answer!

In simplest terms it can only be interpreted in one way. Since Money velocity is calculated on a quarterly basis and is a function of calculating the ratio of gross domestic product (GDP) to the domestic money supply: V=PQ/M, **then the US Economy must in reality be shrinking**!



THESIS 2017: ILLUSION OF GROWTH

As shocking as that sounds it is the reality. In our 111 page - 2017 Thesis paper entitled "Illusion of Growth" we laid out the facts.

READ: https://matasii.com/wp-content/uploads/2017/01/Thesis-2017.pdf

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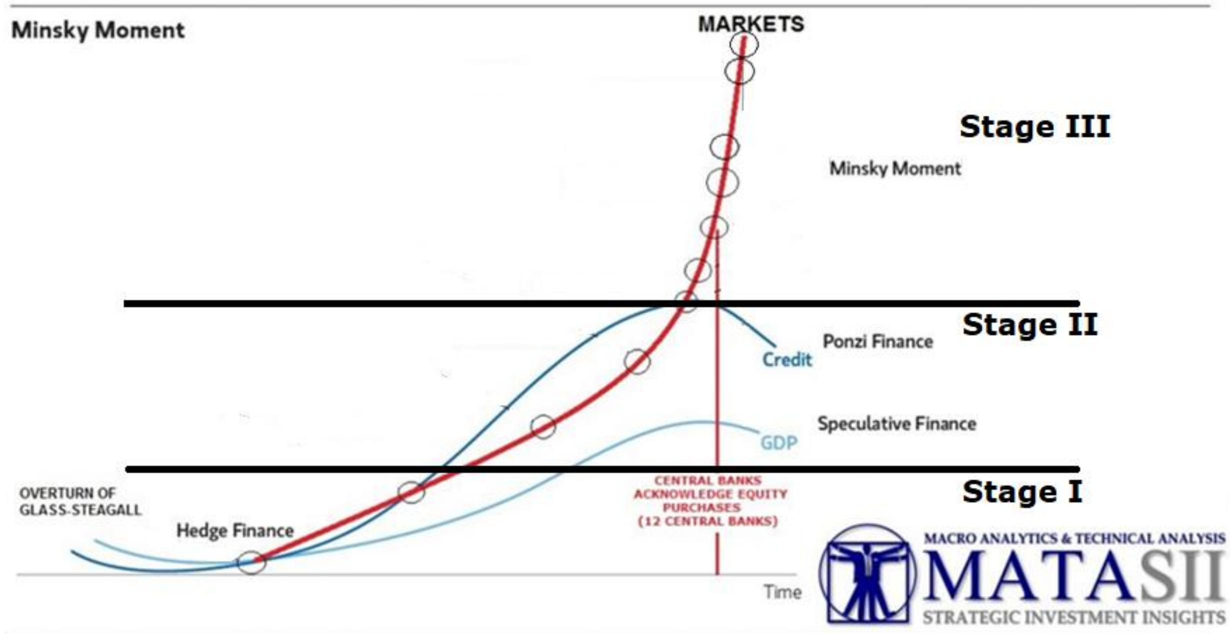
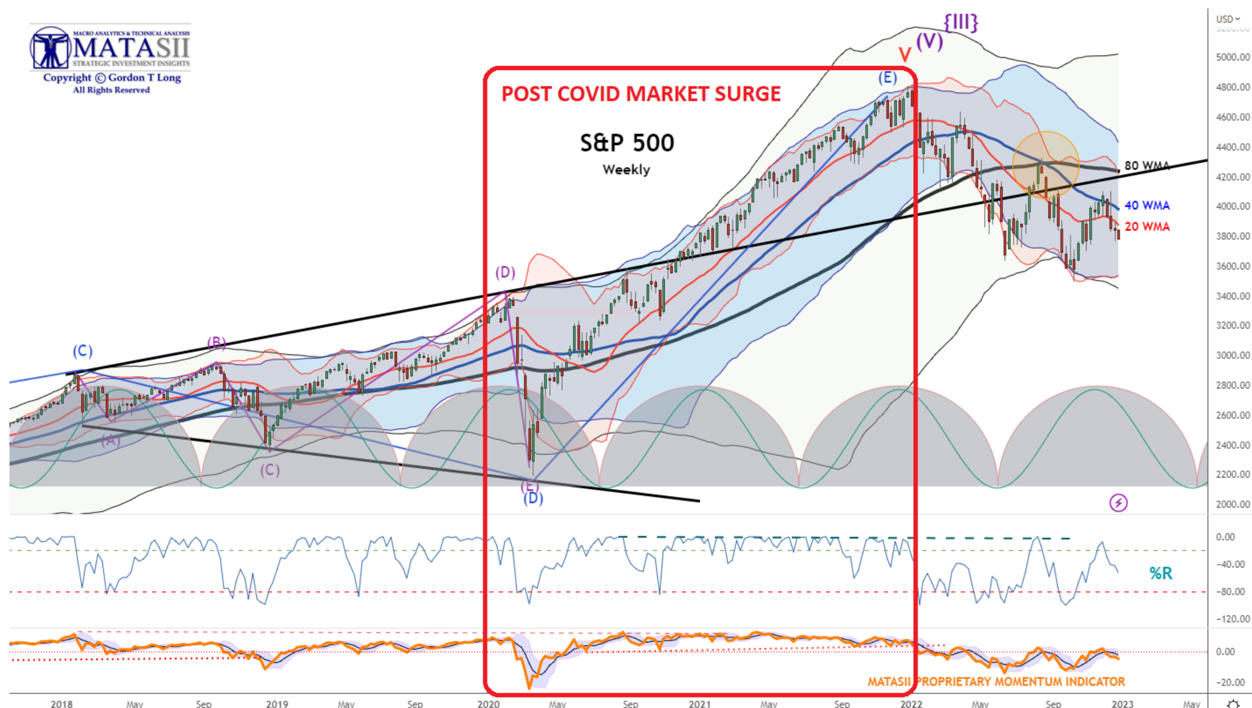
2- MINSKY MOMENT – Stage III

We outlined in "The Coming Era of Stagflation" the following chart that we were entering Stage III of effectively what we labeled as a potential Minsky Moment.



The subsequent Covid-19 market surge followed our projections almost perfectly as shown below:



As we continued to point out during this period in our weekly MATASII newsletters:

- The Post Covid-19 S&P 500 market surge correlated precisely with the increase in the Federal Reserve Balance Sheet growth and not in real economic activity.

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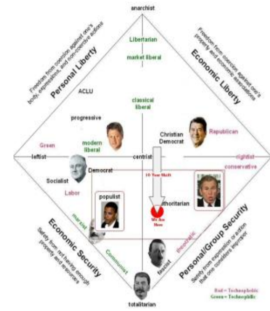
3- INCREASING ECONOMIC STAGNATION



W e additionally outlined in "The Coming Era of Stagflation" that the US Economy was and would increasingly move towards:

- Increasing economic stagnation as a result of the increasing role of bigger government,
- A more rapid shift towards socialist policies and
- Ongoing Global Fiat currency debasement.

Unfortunately all of this has transpired as we have chronicled over the last 2 years.

	POLICY	CENTRAL BANKS	ECONOMY
STAGE I	SOUND MONEY - Non-FIAT Currencies, - Policies	INDEPENDENT "SUPERVISOR" "... the Punch Bowl Away!"	MONEY A "STORE OF VALUE" SOUGHT AS A RESERVE CURRENCY
	VEL... OF MONEY		
STAGE II	CONSUMPTION & CREDIT versus INVESTMENT & SAVINGS C...ISM CAP...M	"P...RS" LIQUIDITY, FLOWS & CREDIT	...IAL REP...SSION *"MacroPrudential Policies"*
	ECONOMIC STAGNATION		
STAGE III	"DEMOCRATIC SOCIALISM" - Finance Entitlements - Fiscal Irresponsibility	GOVERNMENT POLICIES - Finance Government, - Financial Stabilization	MONETIZATION OF DEBT - Currency Debasement

2020 MAY: FOCUS: The Return of Stagflation

URL: https://matasii.com/login-main-welcome-page/

INVESTMENT THESIS

SLOWING GROWTH & INCREASING INFLATION PRESSURES

The US has officially entered a recession in February, according to the official agency charged with its determination. This ends the longest business cycle expansion in US history. What follows expansion is contraction. Contraction or negative growth ushers in one of the two ingredients of Stagflation. The second ingredient is elevated inflation.

Presently inflation is clearly evident in the form of asset inflation, but consumer spending on items not effectively measured by government inflation indexes (CPI, PCE) such as education, childcare, healthcare, professional & trade services. Inflation has been hidden by import goods deflation and statistical methodologies such as hedonic, substitution, imputation and basket measurement selection. The ravages of the biggest global Demand and Supply shock in history is about to wash ashore in America as a result of the Covid-19 Pandemic.

A slowing economy is going to place unprecedented strain on the ability of the American economy to fund its existing and new debt requirements without unprecedented levels of foreign investment which will not be available as a result of a concurrent global recession. Funding costs will rise for consumers, corporations and governments at the national, state and local level. Costs, taxes and prices will all rise! The era of Stagflation will arrive.

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MACRO ANALYTICS & TECHNICAL ANALYSIS
MATASII
STRATEGIC INVESTMENT INSIGHTS

The Debt Super cycle is coming to an end as well as an approaching global fiat currency failure.

MATASII has outlined three converging road maps all leading to an inevitable period of Stagflation:

THREE INTEGRATING ROAD MAPS - SIGN POSTS Way:

1. Velocity of Money – Deflation then Inflation (Link)
2. Crisis of Trust – Lost Confidence in Leadership, the System and Economy (Link)
3. Fiat Currency- Failure of US$ & US Treasuries (De-Dollarization) (Link)

SUPPORTING MATASII RESEARCH

1. **INSUFFICENT CAPITAL (BEING BLED): Insufficient Collateral Growth which will foster a "Collateral Contagion" within the lending sector.**
   - SEE: Video, Video, Video,
   - SEARCH: "Collateral"
2. **NO REAL GROWTH: Too much debt, leverage versus organic economic growth.**
   - SEE: Video, Video, Video,
   - SEARCH: "Leverage"
3. **INSUFFICENT CAPITAL (BEING BLED): Real Rate of Economic Growth is to slow relative to Growth rate in the Debt Burden.**
   - Thesis Paper 2017: Illusion of Growth,
   - SEE: Video, Video, Video,
   - SEARCH: "Illusion",
   - SEARCH: "Tipping Point: Shrinking Revenue Growth Rate"]
4. **DEFLATION: Velocity of Money is now too Slow relative to Growth in the Money supply**.
   - SEE: Video, Video, Video,
   - SEARCH: "Velocity"
5. **CREDIT CONTRACTION (RISING BORROWING COSTS): Borrowing Short & Lending Long is too Fragile, has Insufficient Robustness with too much Complexity & Counter Party Risk.**
   - SEE: Video,
   - SEARCH: "Tipping Point: EU Banking"
   - SEARCH: "Tipping Point: Credit Contraction II"
   - SEARCH: "Tipping Point: Global Sovereign Debt Crisis"
6. **WEAKENING DOLLAR: Dollar Shortage versus Triffin's Paradox's EuroDollar Dependencies.**
   - SEE: Video, Video,
   - SEARCH: "Tipping Point: Eurodollar Shortage"
   - SEARCH: "EuroDollar"
7. **GROWTH OUTSIDE DEVELOPED ECONOMIES: Global Imbalance between productive producing economies (Emerging) and unproductive consumption economies (Developed).**
   - SEE: Video, Video, Video
   - SEARCH: "Imbalance"
   - SEARCH: "Chronic Global Fiscal Imbalances"
8. **RISK AVERSION: Secular Shift in Sentiment similar to the 1920 / 1930 Analogy.**
   - SEE: Video,
   - SEARCH: "Tipping Point: Public Sentiment & Confidence"
9. **RECESSION: The US Recession and Global Recession have likely already started.**
   - SEE: Video, Video, Video, Video
   - SEARCH: "Recession"

NOTE: Search refers to the MATASII.COM sites search capabilities ***(top left corner of most site pages)*** and on the MACRO ANALYTICS YouTube Channel.

ACTIONABLE IDEAS

- **VALUE v GROWTH**:
  - Sustainable Free Cash Flow growth rate larger than real inflation rate,
  - We can expect to witness a shift from Growth to Value,
- **LONG**:
  - SII: Agriculture (Food Disruptions),
  - SII: Utilities

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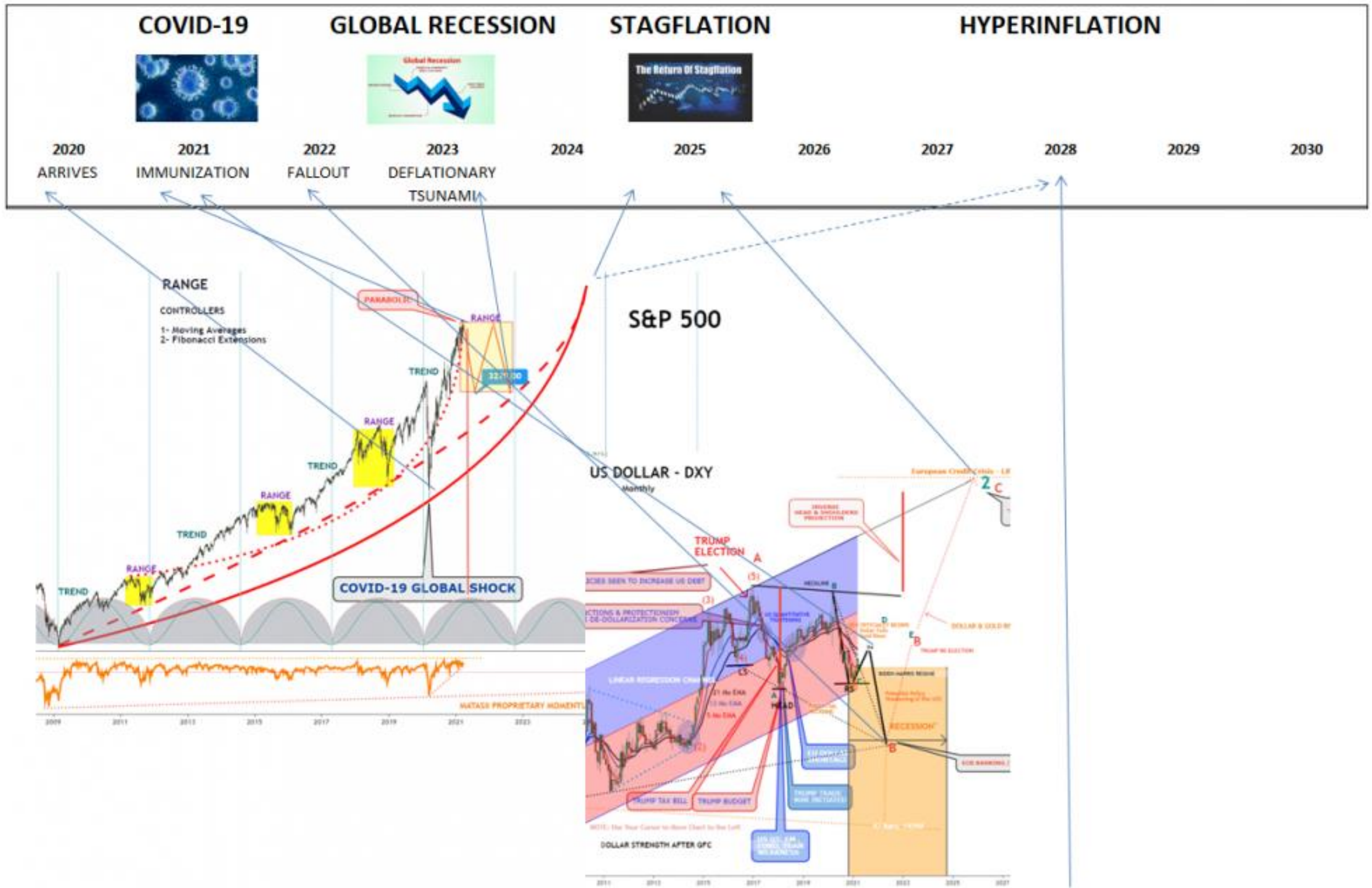
DATED March 29, 2021
(Revised later in this Thesis Paper)



TWO PARALLEL & REINFORCING TRACKS

US DOMESTIC ECONOMY

We're going to initially slip into recession because of inflation.

1. Shortages within the Global Supply Chain will initially force prices up for impacted products.
2. Rising costs (Inflation) are going to put a lot of pressure on businesses to reduce those costs by laying off workers (Deflation).
3. Rising prices (Inflation) are going to put a lot of pressure on consumers to cut back on their total spending (Deflation).
4. A Weakening US$ will make US Imported Goods (Almost Everything) Consumption more expansive (Inflation).

We're going to have inflation and recession simultaneously — stagflation."

GLOBAL ECONOMY

Global Demand will slow rapidly (Deflation) because:

1. US Demand has always been the driving force of Global Demand which will begin slowing rapidly (Deflation).
2. Global Demographics of the slowing rate of population growth will significantly reduce demand (Deflationary).
3. Programs in the 2010's such as QE brought demand forward. There is an unfilled hole (Deflationary).
4. As forced Corporate deleveraging occurs, Global Supply Chain Bankruptcies will further weaken overall demand (Deflationary).

We're going to have a Deflationary Tsunami which will make a US Recession a Global Recession.

MATASII ROADMAP
URL: https://matasii.com/matasii-subscriber-only-newsletter-links/

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2020 AUGUST: LONGWave: 08-12-20 - Stagflation Investing

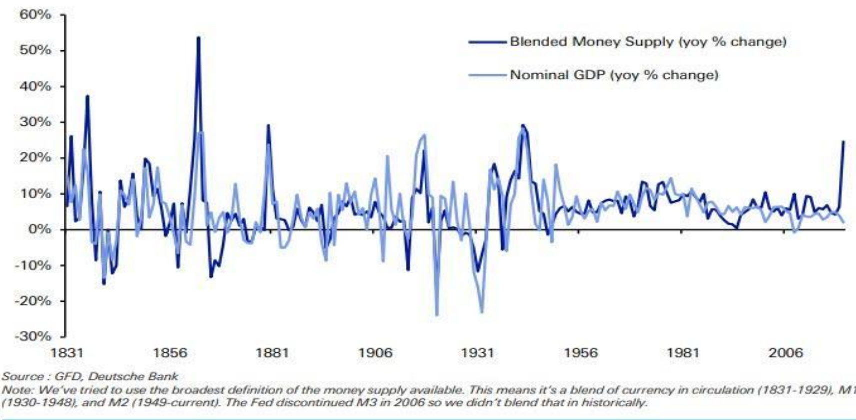
URL: https://youtu.be/uusq5VI0KFc

Supporting Newsletter -#1 - https://conta.cc/2XQpe8H
Supporting Newsletter -#2 - https://conta.cc/3gXZ8bo

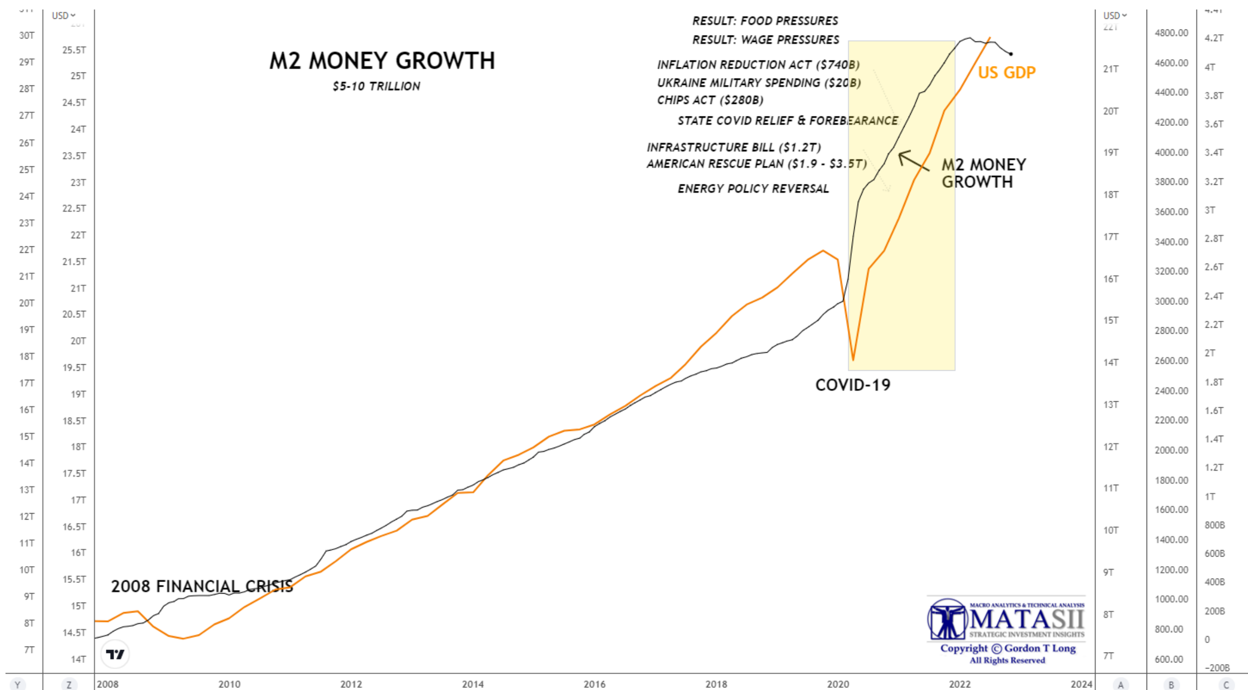
One of the charts in this video worth reviewing by way of updates is the tracking of US GDO to Money Supply growth.

MONEY SUPPLY v ECONOMIC GROWTH (GDP)

At the time of this video in August of 2020 Money Supply had dramatically separated from US GDP (below).



What we see today is the following:



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- US GDP surged upward in 2021 and 2022, back in line with continued M2 Money growth.
- Money Supply Growth peaked in late 2021 and is falling while GDP is temporarily still rising with an expected lag.
- It is highly questionable whether the money growth experienced since Covid-19 can (or will be) sustained going forward while central banks around the world fight inflation.
- Even if we experience recessionary deflation pressures it is highly likely the central banks will limit their actions to stopping Quantitative Tightening and further Fed Fund rate hikes. Only minor reductions in Fed Funds rate should be expected barring a full-out monetary depression.

We also note the following developments since the publication of "Stagflation Investing" concerning investment strategy:

THE MISERY INDEX

The long term Misery Index (Yardeni.com) is shown below where very simply the forward S&P 500 PE ratio is added to Inflation as measured by the CPI.

We can see that it highlights:

- There have been three noticeable peaks in the Misery Index going back to the 1970's; 1980, 2000 and 2022.
- The prior two peaks (1980 & 2000) were followed by deep drops in the equity markets and multi-year recessions.
- The period from the bursting of the Dotcom Bubble to the lows of the 2008 Financial Crisis can be seen in the context of the Rule of 20 as simply a longer term secular Bear Market and valuations.

- **THE CAPITULATION LAG:**
  - A longer term secular trend initiation often occurs in three steps. An "ABC" pattern where "C" = Capitulation.
  - Knowing the difference is the key which this chart assists in determining.
  - When we examine the above chart from a trading price perspective we see the following ABC pattern emerge:

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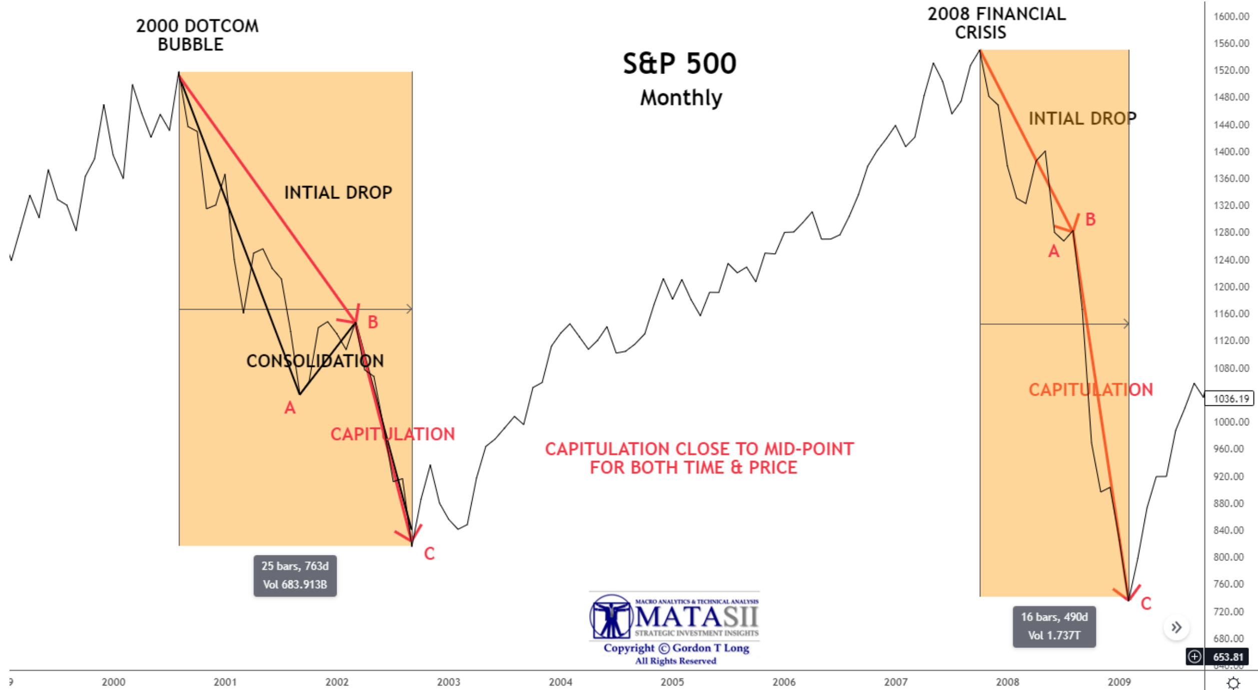

When we examine our current market position since the 2008 Financial Crisis from a "Breadth Perspective" we see eerie similarities:

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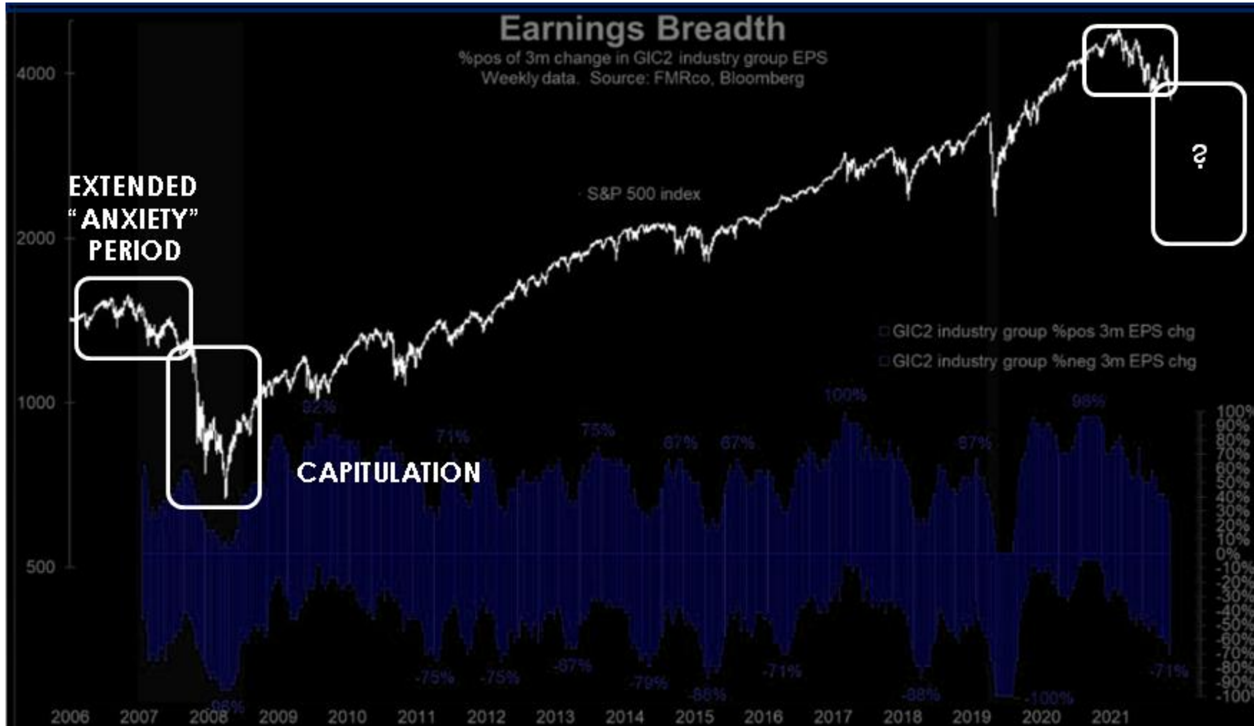
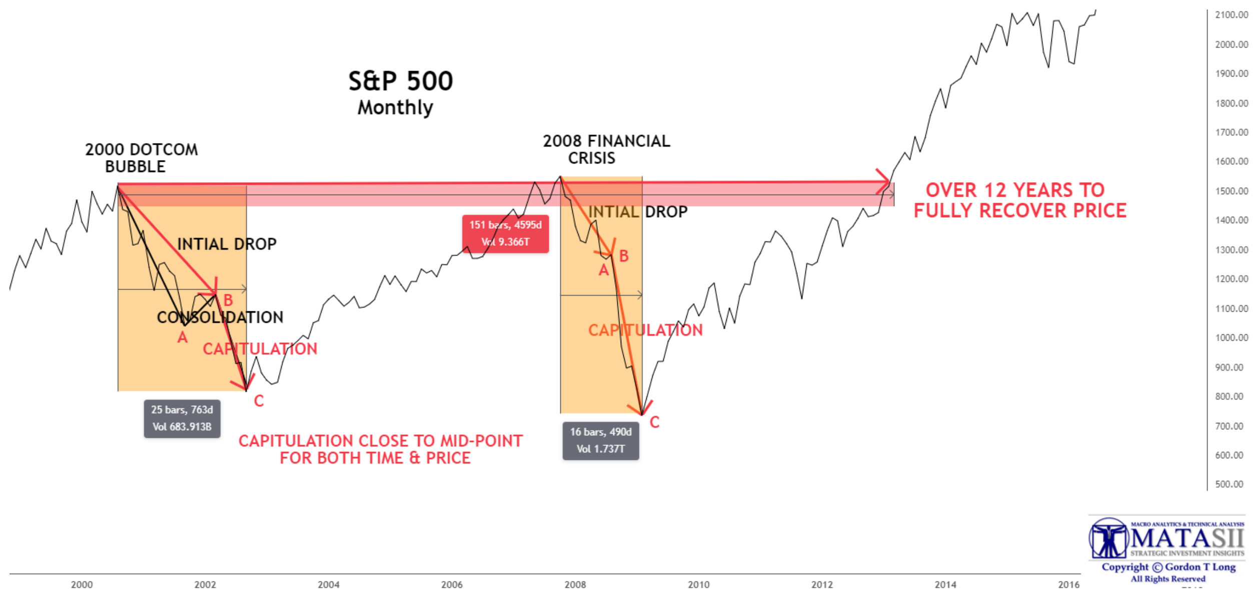


- **LONG TERM CONSOLIDATION:**
  - If we look at the time period for price to recover to levels reached during the Dotcom Bubble of 2000, we see it approximated 12 years.
  - This is similar in duration to the Beta Drought Decade we discuss later in this paper.



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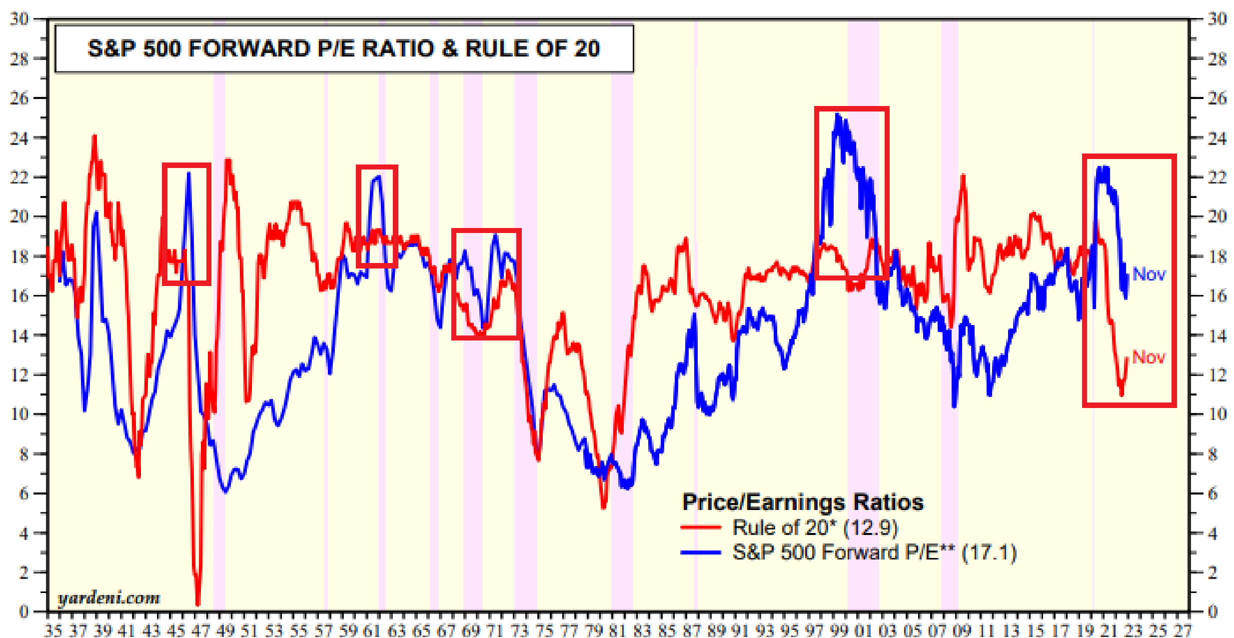
- **RULE OF 20**

  - Yardeni Research does some excellent valuation analysis using the historical values of the Rule of 20 versus the S&P 500 Forward PE (shown below).
  - The Rule of 20 is based on subtracting the yearly percentage change in the published CPI from 20. The lower inflation is as represented by the CPI the higher PE Ratio's can be. When the S&P 500 Forward PE's are above the Rule of 20, PE valuations can be considered excessive and normally soon regress to the Rule of 20 benchmark. More often than not this regression over shoots the Rule of 20.
  - Going back close to 100 years we see that the S&P 500 Forward PE (currently 17.1) was higher than the Rule of 20 (currently 12.9) on only 5 separate occasions. Each time this occurred S&P 500 prices subsequently fell to match the Rule of 20 levels.
  - Nearly a 100 year of data gives us a good probability that S&P 500 prices are headed lower over the next few years.
  - We should fully expect major and violent counter rallies during this period of time before the "Buy-the-Dip", FOMO, Day and Gamma traders eventually go broke



* 20.0 minus yearly percent change in CPI.
** Four-quarter trailing sum of reported earnings through 1978, then time-weighted average of analysts' consensus estimates for S&P 500 operating earnings per share for current year and next year. Monthly from January 1979.
Note: Shaded red areas denote S&P 500 bear market declines of 20% or more. Yellow areas show bull markets.
Source: Bureau of Economic Analysis, Bureau of Labor Statistics, and I/B/E/S data by Refinitiv.

The above analysis further supports the following video below (2022 JUNE: LONGWave - 05-11-22 - Recessions & PE Compressions), which outlined that we are likely on our way during the next recession to a PE compression of ~12-13 (or possibly lower).

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S&P 500 & STOXX 600

The graphic below compares the long term trend in the S&P 500 against the European STOXX 600.

What the charts highlight are:

- Though both the S&P 500 and STOXX 600 peaked in 2020, the separation has widened with a noticeably lower STOXX 600 level.
- The STOXX 600 has broken through its long term support trend line (black trend line), the S&P 500 has not and has effectively bounced off its long term support trend (red trend line).
- Both are very close to their long term period averages (horizontal dotted lines). The S&P 500 is finding the long term period average as support; the STOXX 600 is finding it as overhead resistance.
- The chart suggests that both equity markets are in a critical near term consolidation effort which when resolved will mark a significant inflection point.
- Our view is that this consolidation will be resolved with an equal leg to the downside as highlighted below:

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2021 JUNE: UnderTheLens: 06-23-21 - The Great Stagflation *1970'S v 2020's Style*

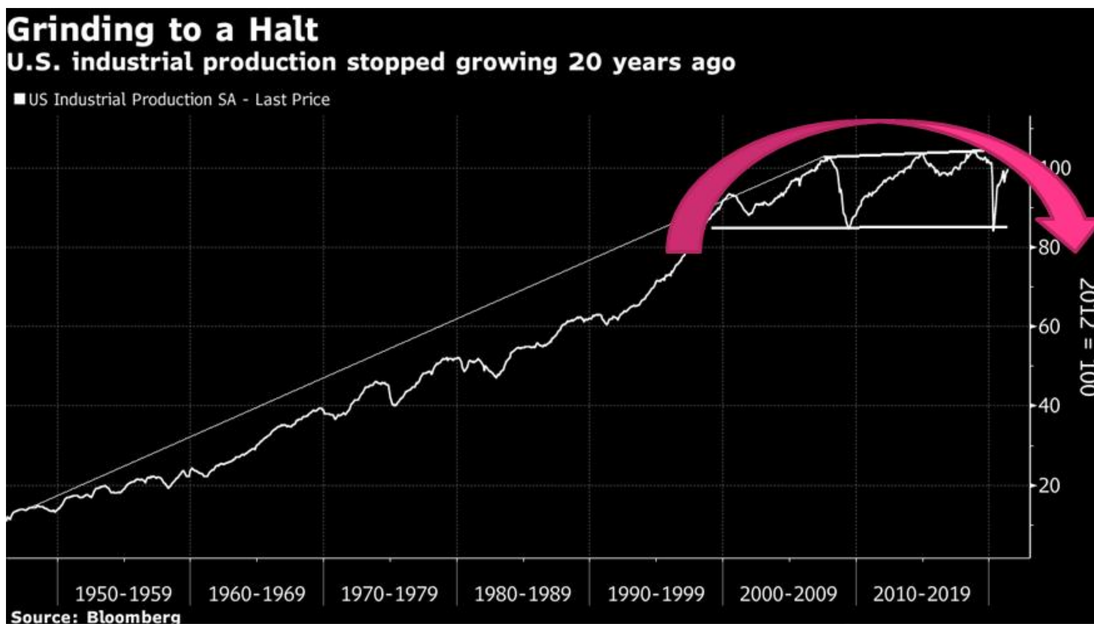
URL: https://youtu.be/fKamQkspaT4

Supporting Newsletter -#1 -https://conta.cc/3qCvwpT
Supporting Newsletter -#2 - https://conta.cc/3ydxKOS

Two of the many charts in this video are also worth reviewing by way of updates since they are very telling in how events have unfolded.

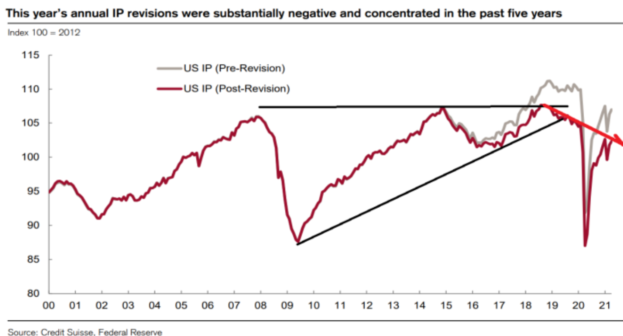
1- LONG TERM US INDUSTRIAL PRODUCTION

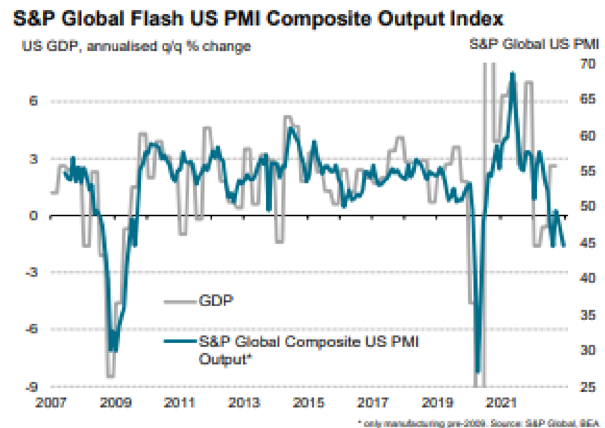
This long term chart of the trend in US Industrial Production was included in the video presentation. It is highly suggested that US Industrial production growth has stalled significantly since China entered the WTO IN 2002. It appeared in 2021 to be on the cusp of the beginning of a collapse?



As the chart below (left) shows, even after the post Covid-19 rebound, we have not returned to prior levels. In fact when we look at the most current US Composite PMI ending in 2022 (below right), we see we have experienced not only a major collapse but in fact are now in contraction mode. Many indicators we have shown in recent newsletters suggest this is going to get much worse in 2023.

Many fail to see this as part of a major secular downturn (above) versus a shorter term cyclical downturn.





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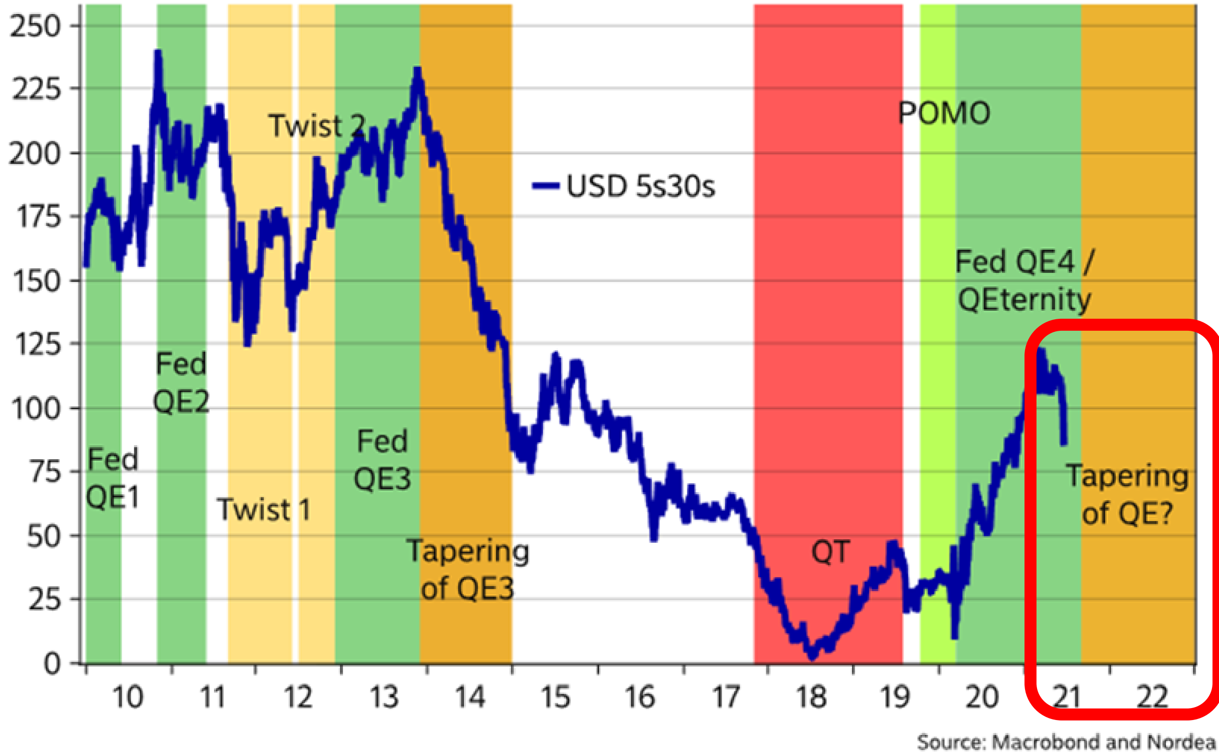
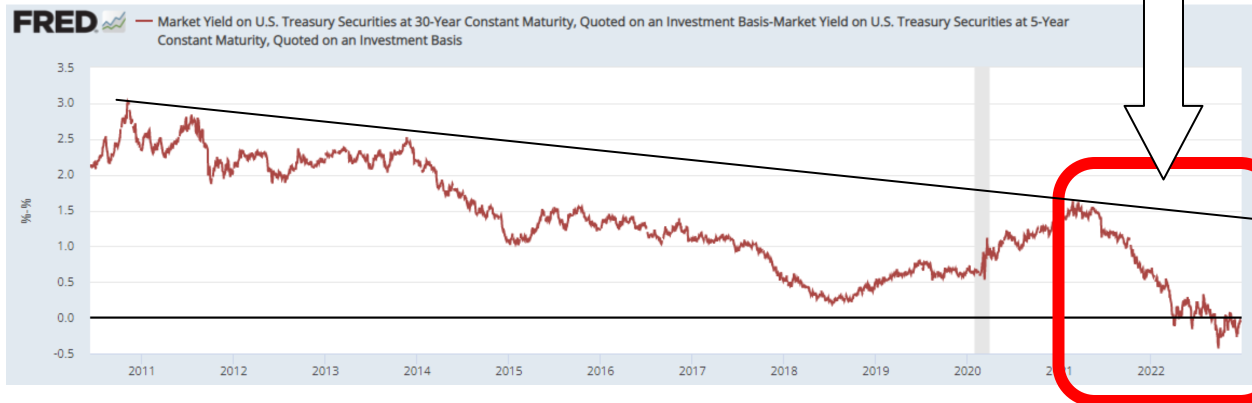
2- LONG TERM YIELD CURVE TREND

The Yield Curve is a very important indicator in understanding where the economy is likely headed. We showed the USD 5s30s Yield Curve in "The Great Stagflation" video in 2021. We believed it would fall as part of the ushering in an era of Stagflation. The current chart at the bottom of the page shows that this is exactly what did occur.



The US 5s30s is currently inverted which is a strong indicator that a US Recession lies ahead in 2023.



What the above long term charts strongly suggest is:

- The US is about to enter a longer term secular economic slowdown.
- The slowdown may be much more than a protracted recession because of the breakdown of US Industrial production prowess.

Additionally, we have seen the US Trade Balance change as US IMPORTS have started to fall! This is further evidence of weakening US Industrial Production. It may also be signaling something even more significant about collapsing US Consumer Consumption. In a 70% Consumption dependent economy this would be very serious!

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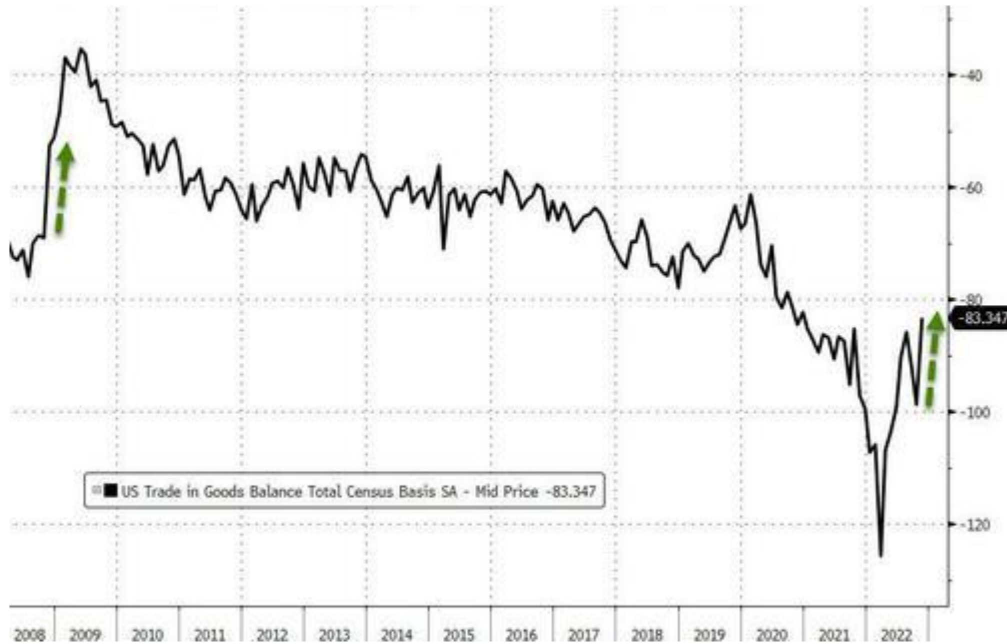
The goods trade deficit narrowed in November 2022 to its **smallest in two years after imports collapsed.**



Source: Bloomberg

This is the **biggest decrease in the deficit since 2009.**

The **shrinkage in the deficit was driven a 7.6% plunge in imports** - $252.2 billion, the lowest in more than a year. The value of exports also dropped, down 3.1% to $168.9 billion.

The decline in imports was broad based, **led by a 13% drop in the value of consumer goods.** Other inbound shipments of autos, food and beverages and industrial supplies also decreased, as did most export categories.

It would appear the American consumer has largely been spending on services instead of goods in recent months.

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2022 JUNE: LONGWave - 05-11-22 - Recessions & PE Compressions

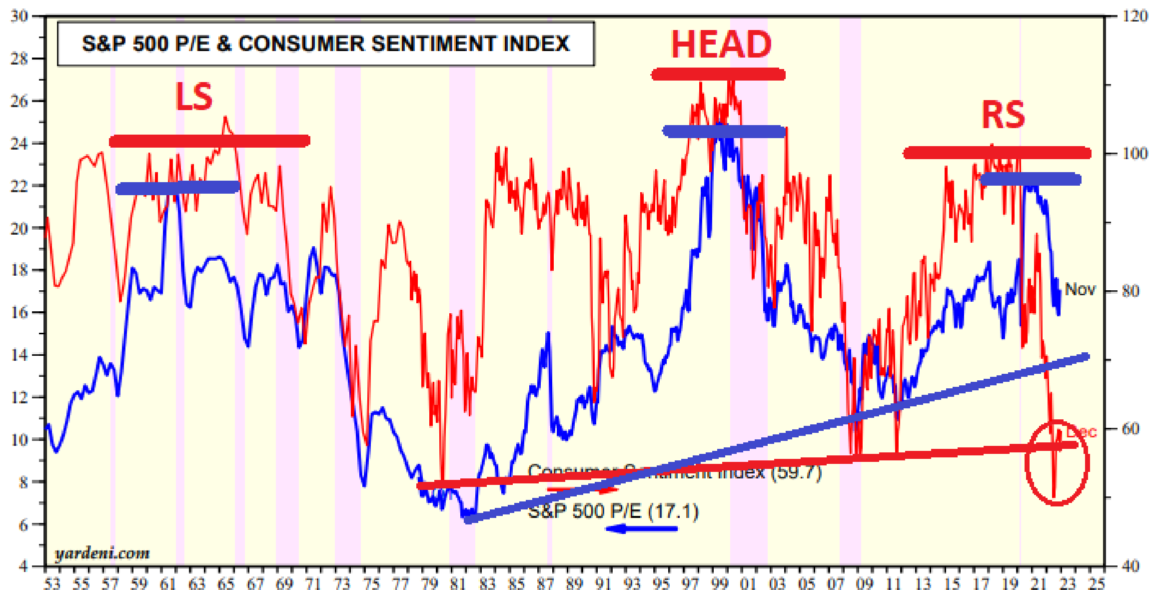
URL: https://youtu.be/M10F1KPoxts

SUPPORTING NEWSLETTER-#1 – https://conta.cc/3wrlKJq
SUPPORTING NEWSLETTER-#2 – https://conta.cc/3PB0ACj

The video outlined that we are likely on our way during the next recession to a PE compression of ~12-13 (or possibly lower).

Besides the work outlined in this video, we can further add the following analysis which compares a longer term view of the S&P 500 PE Valuation ratio against the Consumer Sentiment Index. What this illustrates is:

- Clear Head and Shoulder patterns have merged in both measures that closely mirror each other.
- The Consumer Sentiment H&S Neckline (in red) has been tentatively broken and is presently being retested.
- The S&P 500 PE Ratio Neckline (in blue) has not yet been broken.



* Four-quarter trailing sum of reported earnings through 1978, then time-weighted average of analysts' consensus estimates for S&P 500 operating earnings per share for current year and next year. Monthly from January 1979.
Note: Shaded red areas are S&P 500 bear market declines of 20% or more. Yellow areas are bull markets.
Source: I/B/E/S data by Refinitiv, Standard & Poor's, and University of Michigan Survey Research Center.

- A Long term H&S Pattern is a fairly reliable pattern, especially when the Neckline is broken.
- This further supports falling S&P 500 PE Ratios are likely ahead.
- Confirmation of the breakage of both necklines needs to be monitored closely in 2023.

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2022 DECEMBER: Newsletter – LONGWave - 12-07-22 - Global-Yield-Curve-Inverts

NEWSLETTER #2: THE DE-STABILIZING FISCAL SHOCK WAVE NOW KICKING IN

The rewiring of global supply chains and the attempts to transition to net-zero are two central reasons why it is likely to be a more volatile world – and this new regime won't be temporary! Increased volatility means higher VaR and higher risk a term premium which means higher US debt financing costs.

CHART RIGHT:
A higher macro volatility regime is typically needed to sustain a higher market volatility regime. We have entered a regime of higher macro and market volatility. This implies that market views may have to change more quickly and get more granular.

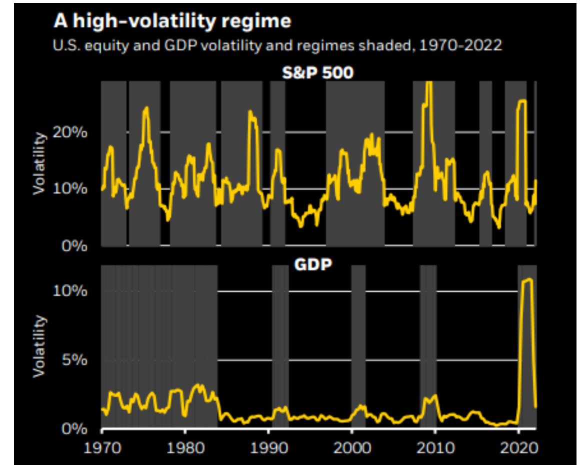
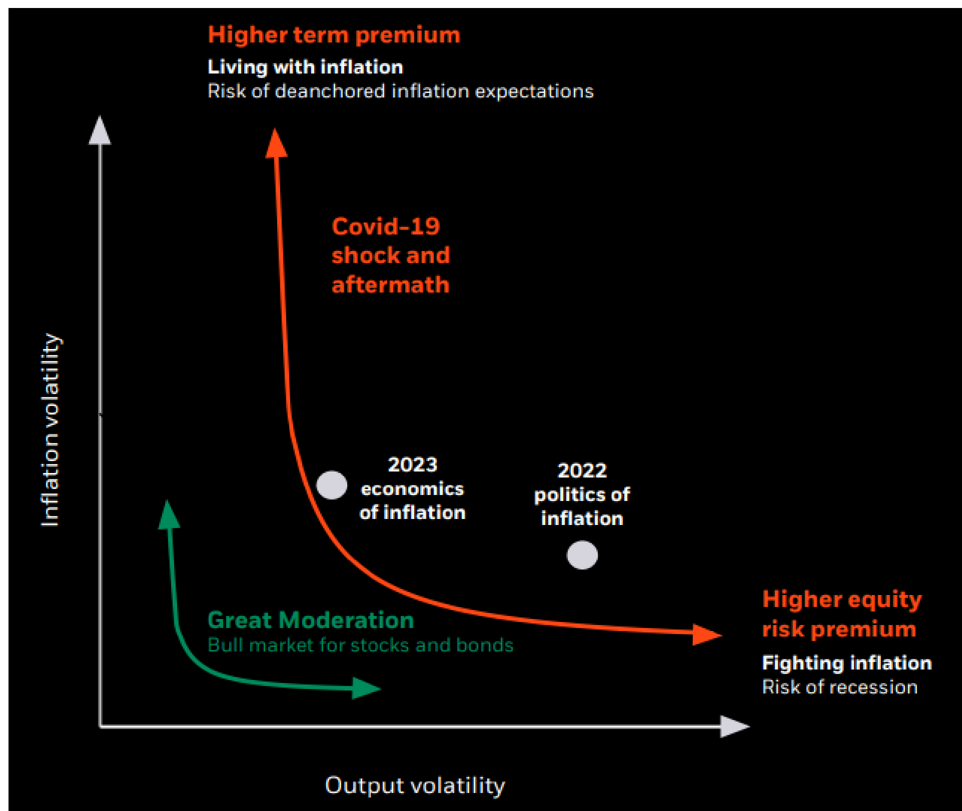


CHART BELOW:

The Great Moderation fostered a steady macro backdrop that set the stage for decades - long bull runs for both stocks and bonds. Central banks could soften demand shocks and pump up growth with looser policy – facing only a modest trade-off of inflation(the green line in the chart below).

The end of the Great Moderation means the trade-offs become much starker, as the orange line in the chart shows. The entire curve has shifted and lengthened, magnifying the impact of policy decisions. At one extreme (bottom right), central banks crush growth to rein in inflation. This raises recession risk and is particularly damaging for equities. That is a 2022 story. At the other extreme, central banks go easy and face the risk of inflation soaring (top left). Bond prices fall as investors demand a higher term premium. This will be the main conundrum for 2023. Bottom line: Don't expect a repeat of the Great Moderation's sustained stock-bond bull markets.



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FEDERAL RESERVE MANDATE

*"The Federal Reserve System has been given a dual mandate— **pursuing the economic goals of maximum employment and price stability**. It does this by using a variety of policy tools to manage financial conditions that encourage progress toward its dual mandate objectives— in other words, conducting monetary policy."* – Federal Reserve

KEY MESSAGES

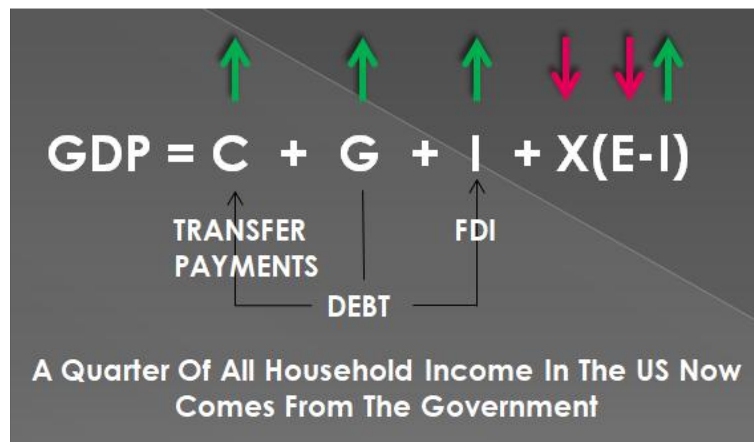
- The result of three changes:
  - The post WWII adoption of the Breton Woods Monetary agreement,
  - The shift of the US Dollar to a Fiat Currency,
  - In 1980 when Fed Chairman Paul Volcker's in his fight against inflation took the Fed Funds Rate to near 19% to effectively stabilize the US and global economies while at the same time having International annual Balance of Payments settlements made by credit notes than via previous gold transfers.

  This effectively placed Federal Reserve policy as the undisputed and sole arbitrator of global monetary policy. This was not a role which the Federal Reserve was ever designed to assume nor had the tools and support to effectively administer.

- Central banks by their design are about effecting changes in Demand. They have little sway over Supply and the Federal Reserve has minimal sway over global supply and supply chains. This is especially true as the US has increasingly de-industrialized its manufacturing prowess and become a service economy and less the center of global trade.

- The world is now changing from the prior US centric Uni-Polar system to a Multi-Polar system with China, the EU and the BRIC nations having much stronger economic roles with differing needs. Being tied to the US dollar as the world's accepted reserve currency while the US continuously grew its twin deficits and increasingly consumed more than it produced, has become a major burden on the global economy and other emerging powers. We outlined this is our 82 page 2018 Thesis paper entitled "A New World Order".

- The Federal Reserve and government reporting agencies have continuously adjusted reported economic statistics. This has caused flaws within the following:
  - The Consumer Price Index (CPI),
  - The Economic Measure of Growth (GDP),
  - The Unemployment Rate,
  - The GDP Formula,
  - Reverse Repurchase Agreements (RRP)
  - US Treasury Issuances



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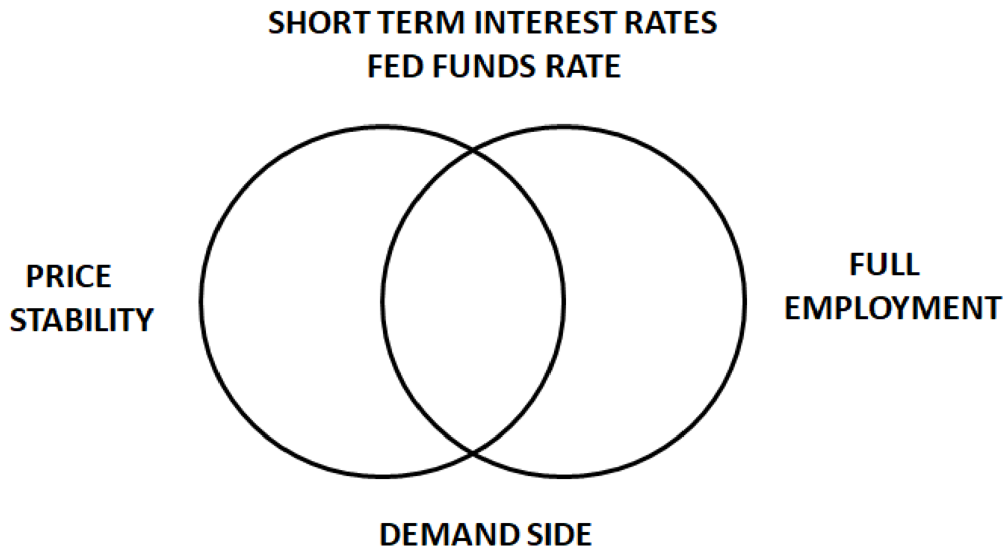
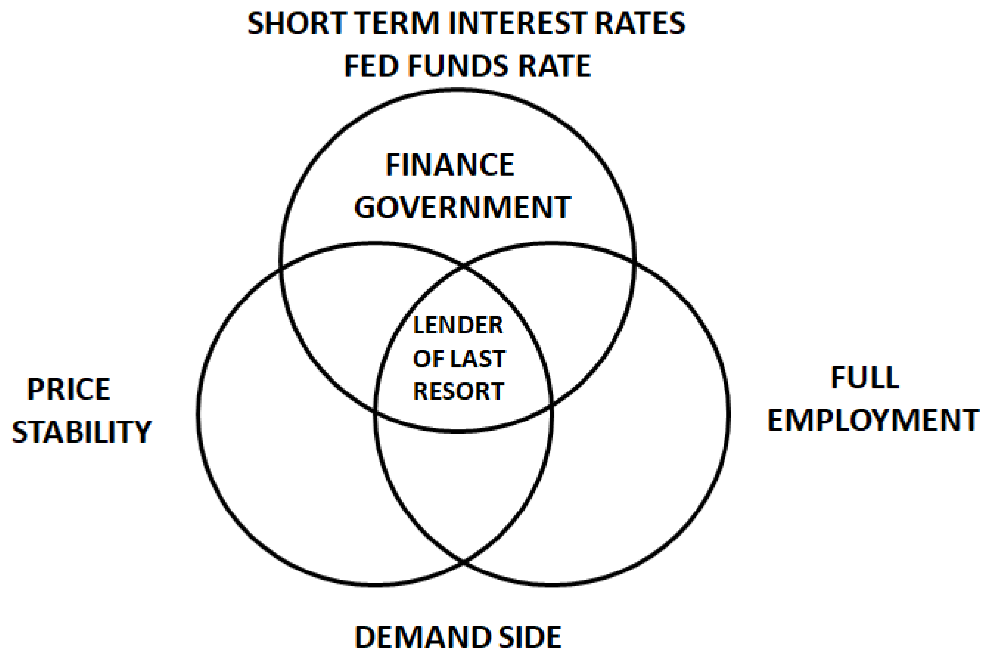
ILL-EQUIPPED, NOR DESIGNED FOR A MULTI-POLAR WORLD

In reality the Dual Mandate of the US Federal Reserve is much broader and more complex than appreciated or originally envisioned. Its most important role when created was to be the "ender of last resort" during moments of unexpected credit or financial destabilization in the US economy.



At its core the purpose of the Federal Reserve's dual mandate role was to ensure that the US Treasury was able to finance the government's increasing financial obligations via the US money centered banking structure. This was a structure whereby money could only be lent into existence via the creation of debt obligations.



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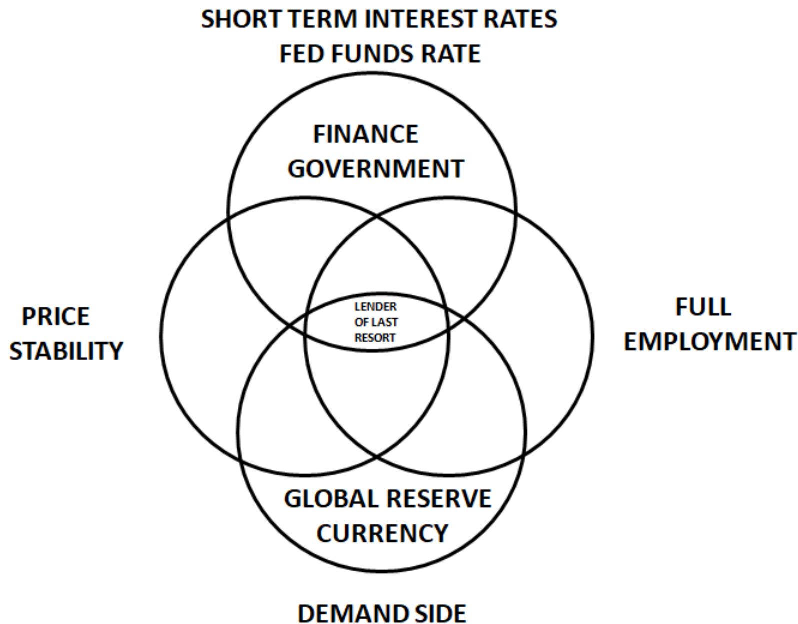
The Federal Reserve by default was most significantly changed by three events.

The first was with the post WWII adoption of the Bretton Woods Monetary agreement to basically foster the reconstruction of the world's economy. The outcome was the establishment of the US dollar as the world's reserve currency and by default US Treasury debt instruments as the risk free benchmark for basing the cost of money and credit.

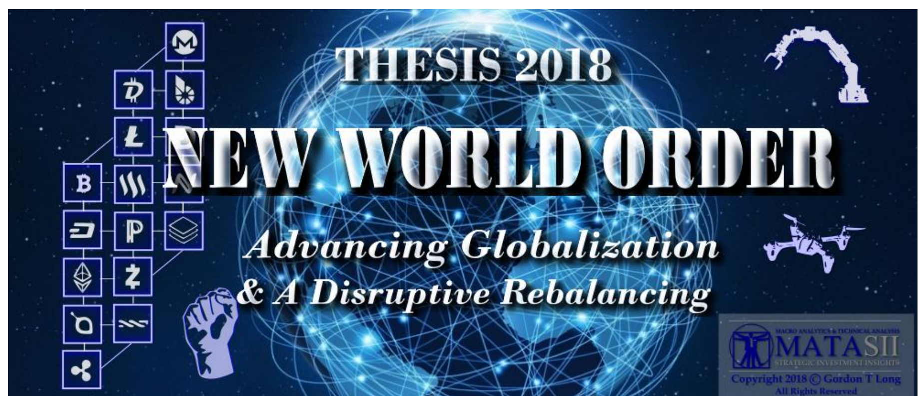


The second was the shift of the US Dollar to a Fiat Currency with the August 1971 withdrawal of the US$ from the Gold standard. The US dollar stopped being exchangeable in and denominated by the value of Gold. This resulted in a corresponding shift in global currencies becoming mostly Fiat Currency.

The third event was in 1980 during then Fed Chairman Paul Volcker's fight against inflation when he took the Fed Funds Rate to near 19%. To stabilize the global economy from its impact due to what was referred to as the Triffin Paradox, the settlement of global balance of payments was changed from Gold transfer to the acceptance of credit notes and instruments.

The result of these three changes effectively placed Federal Reserve policy as the undisputed and sole arbitrator of global monetary policy. This was not a role which the Federal Reserve was ever designed to assume nor had the tools and support to effectively administer. Central banks by their design are about effecting changes in Demand. They have little sway over Supply and the Federal Reserve has minimal sway over global supply and supply chains. This is especially true as the US has increasingly de-industrialized its manufacturing prowess and become a service economy and less the center of global trade.

The world is now changing from the prior US centric Uni-Polar system to a Multi-Polar system with China, the EU and the BRIC nations having much stronger economic roles with differing needs. Being tied to the US dollar as the world's accepted reserve currency while the US continuously grew its twin deficits and increasingly consumed more than it produced, has become a major burden on the global economy and other emerging powers. We outlined this is our 82 page 2018 Thesis paper entitled "A New World Order".



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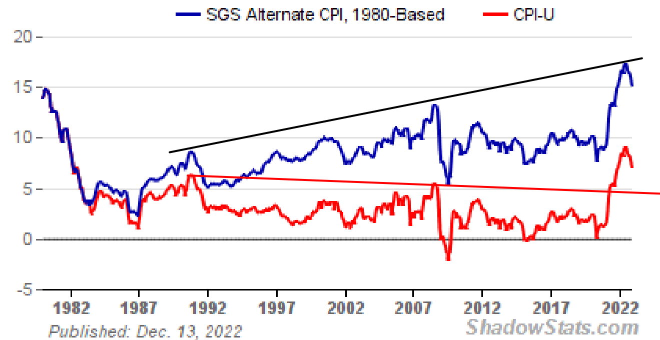
NOTHING SEEMS AS IT APPEARS

The above developments have forced the Federal Reserve and government reporting agencies to continuously adjust reported economic statistics.

Critical examples include the following:

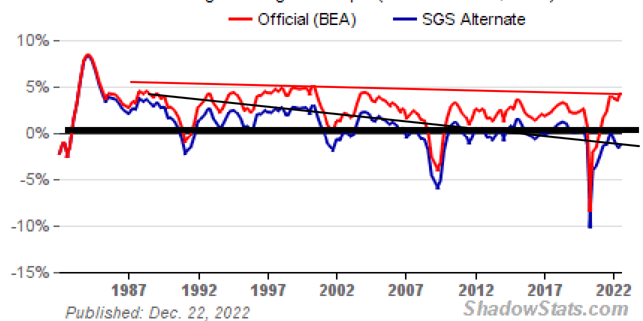
CONSUMER PRICE INDEX (CPI)



The US CPI shown to the right reflects the CPI as if it were calculated using the methodologies in place in 1980 (in blue) versus actually now reported (in red).

In general terms, methodological shifts in government reporting have depressed reported inflation, moving the concept of the CPI away from being a measure of the cost of living needed to maintain a constant standard of living. The Bureau of Labor Statistics (BLS) employs creative statistical distortion adjustments such as Substitution, Hedonics, Imputation and constant changes in the "basket of goods" to keep CPI reporting under reported.

ECONOMIC GROWTH (GDP)

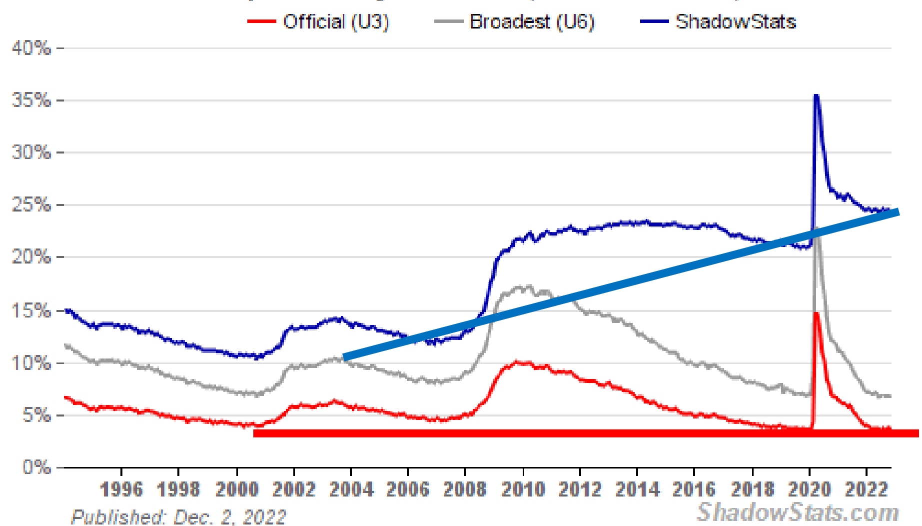


The US GDP shown to the right reflects the inflation-adjusted, or real, year-to-year GDP change, adjusted for distortions in government inflation usage and methodological changes that have resulted in a built-in upside bias to official reporting.

What we see is that the US GDP should have been reported at negative (contraction) since 2019.

UNEMPLOYMENT RATE

The seasonally-adjusted Unemployment Rate shown below reflects current unemployment reporting methodology adjusted for estimated long-term discouraged workers, who were defined out of official existence in 1994.



That estimate is added to the BLS estimate of U-6 unemployment, which includes short-term discouraged workers. The U-3 unemployment rate is the monthly headline number.

The U-6 unemployment rate is the Bureau of Labor Statistics' (BLS) broadest unemployment measure, including short-term discouraged and other marginally-attached workers as well as those forced to work part-time because they cannot find full-time employment.

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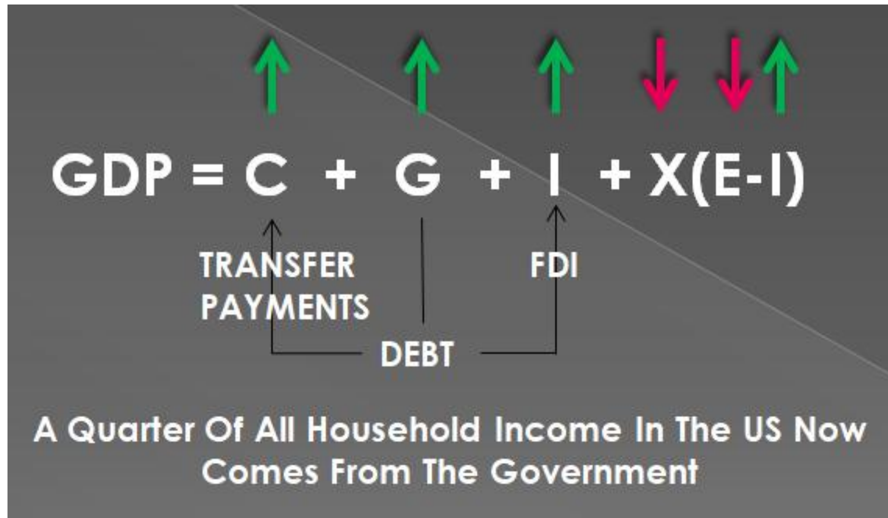
GDP FORMULA

Additionally, the actual formula used for measuring GDP is also seriously flawed and was never devised to reflect an economy with massive fiscal deficits, chronic trade deficits and current account deficits, nor the percentage of government expenditures in the form of transfer payments to citizens to be used for personal consumption.



For more detail see: 1) Illusion of Growth or 2) Stagflation Investing

REVERSE REPURCHASE AGREEMENTS

The problem with the Federal Reserve's Reverse Repo Agreement Program (RRP) is neither reporting nor a flawed formula (at least as far as we are aware), but rather why has this suddenly been required and to such a degree? Out of nowhere it is suddenly and quickly approaching $2.5 Trillion.

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Lending institutions have found it more attractive to park short term funds at the Federal Reserve than lending the money, buying commercial paper or buying longer dated treasury bills, notes or bond obligations. They perceive the Fed's posted treasury collateral and rate paid to be the best use of their liquid funds.

This would suggest the following:

1. To lend their funds has more risk either with the competitive rate they would have to pay or the quality of collateral they would have to accept.
2. They would have to accept long duration paper to match or beat the RRP rate being paid.
3. They would have to venture back into higher acceptance and commercial corporate paper.
4. They would have to adjust their balance sheet to better accommodate Basel II, III Accords for assets at risk (VaR) and capital adequacy.

This suggests the US has a commercial funding problem which did not exist prior to Covid-19, that has changed the core of US lending (at least temporarily).

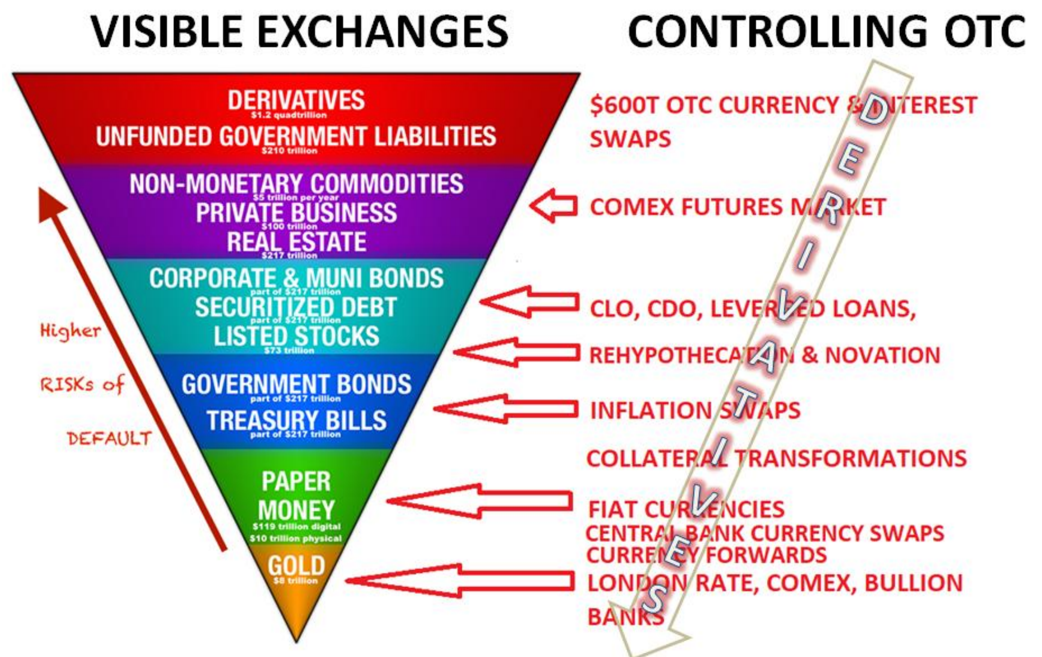
The exposure is that any unexpected shock or breakage (for example in high yield Zombie rollover loans) could abruptly freeze credit and lending and force liquidation.

US TREASURY ISSUANCES

As we have outlined in a number of newsletters, investors should pay particular attention to the US Treasury Secretary Janet Yellen and the stealth games she is currently playing to allow the Fed to tightening financial conditions by raising rates and the implementation of Quantitative Tightening (QT).

- 10-17-22-Central Banks A Catalyst For A Derivative Debacle
- 10-24-22-Watch Yellen not Powell!
- 10-31-22-Yellen Begins Showing Her Hand!
- 11-07-22-Yellen's Forced Derivative & Contingent Liability Card

It is our belief that she is employing the $84B in PPT (Plunge Protection Team) assets by using Swaps and Derivatives (i.e.: Inflation & CPI swaps, Inflation breakeven swaps et al – see right) to control the financial markets, financial conditions and destabilizing "breakages" caused by Fed tightening policies (i.e. Credit Suisse and HY Corporates).



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MACRO ANALYTICS & TECHNICAL ANALYSIS
MATASII
STRATEGIC INVESTMENT INSIGHTS

THE GREAT MODERATION

KEY MESSAGES

- The history of US Inflation going back to the creation of the Federal Reserve at the turn of the 20th century using the published US CPI index shows:
    - Volatility in inflation over this period of time,
    - Periods of upper trend resistance and lower trend support,
    - Major market events can be identified at extremes in Inflation,
    - Between extremes Inflation often trends within controlled channels.
- The US economy is more stable and performs better when inflation is better controlled. It appears that level is between a moderate contraction of -3% and below inflation high of 5%.
- The Great Moderation period was between Federal Reserve Chairman Paul Volcker's success in halting a decade of high US inflation and the damage of resulting from the Covid-19 shock. This is seen to be approximately between 1980 and the spring of 2020.
- Before this period we had: Inflation Volatility, High Inflation, High Interest Rates and High Risk Premiums.
- We experienced a:
    - Dramatic Increase in Central Bank Balance Sheets and Fiscal Spending,
    - Dramatic shift in Government Fiscal Spending,
    - Global Disruption in supply and Supply Chains.
- We strongly believe this is about more than simply the fallout from Covid-19.
- The Great Moderation has ended because the current contributing factors to supporting US economic debt funding requirements are no longer sufficient.
- Debt Growth Is Outstripping Funding From Real Economic Growth.
- Credit growth as measured by the Liquidity Gauge clearly indicates we can fully expect a Recession in 2023. The problem however is much more serious. We have the strong possibility that this is now a secular problem that will be with us for a significant part of the current unfolding decade.
- With credit entering a potentially protracted period of contraction we feel it supports our view of the coming Beta Drought Decade.
- The current selling of US Treasuries already suggests this as countries are liquidating their FX US Dollar Reserves. There are more reasons for this than just their need for money or wanting to get out of the dollar (de-dollarization).
- A major concern is the pressure it will place on the US to sell its debt to enable it to continue to finance government debt obligations.
- These obligations include new debt, rollover debt and unfunded liabilities ($84T in unfunded entitlement programs – Social Security, Medicare, Disabilities, and Government Pension Plans).
- We can expect the US Governments to address this with government supported credit guarantees or contingent liabilities accounting. We have referred to this coming approach as Financial Repression III (See Video: UnderTheLens - 11 23 22 - DECEMBER - Financial Repression

THE PERIOD OF THE GREAT MODERATION

The history of US Inflation going back to the creation of the Federal Reserve at the turn of the 20th century is shown below. It uses the published US CPI index. What is immediately apparent is the volatility in inflation over this period of time.

Another behavior that stands out is how periods of upper trend resistance and lower trend support are clearly evident.

We can additionally identify that:

- Major market events occurred at extremes in Inflation,

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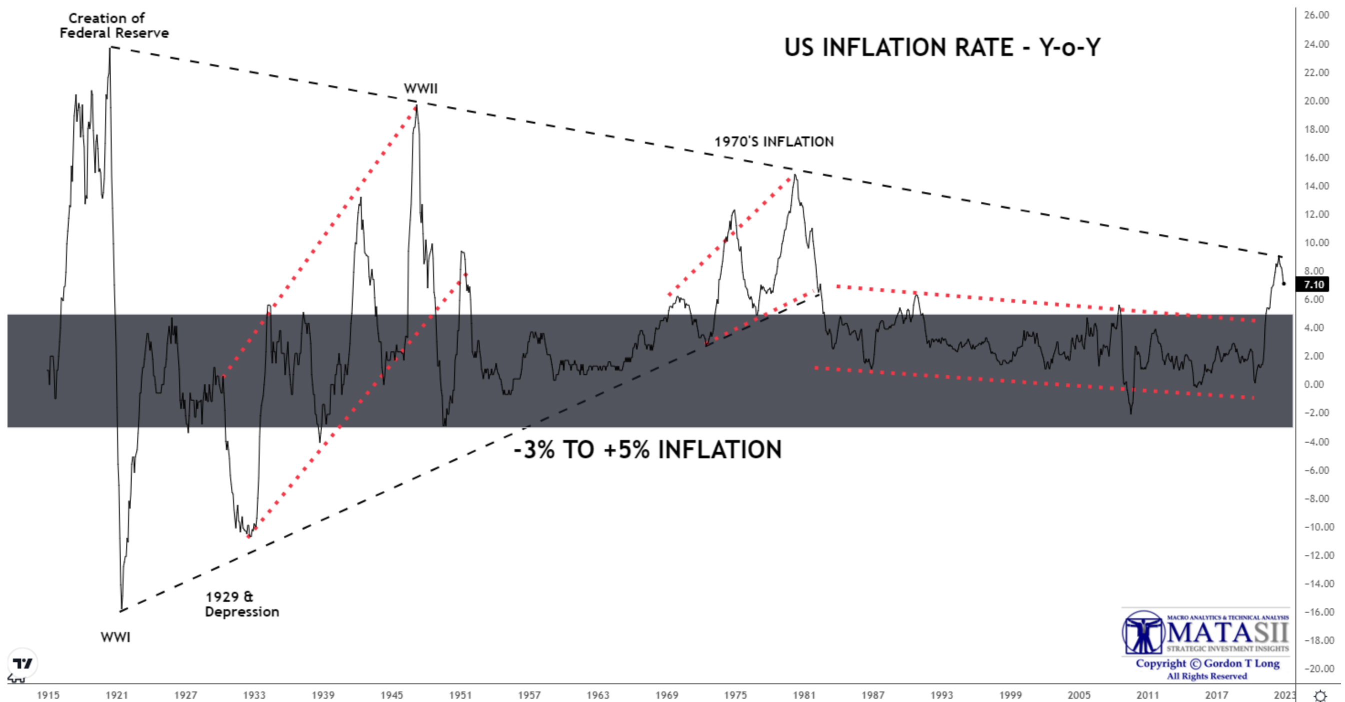
- Between extremes Inflation often trends within controlled channels,

However, what is particularly noticeable and seems logical is that the US economy is more stable and performs better when inflation is better controlled. It appears that level is above a moderate contraction low of -3% and below inflation highs of 5%.



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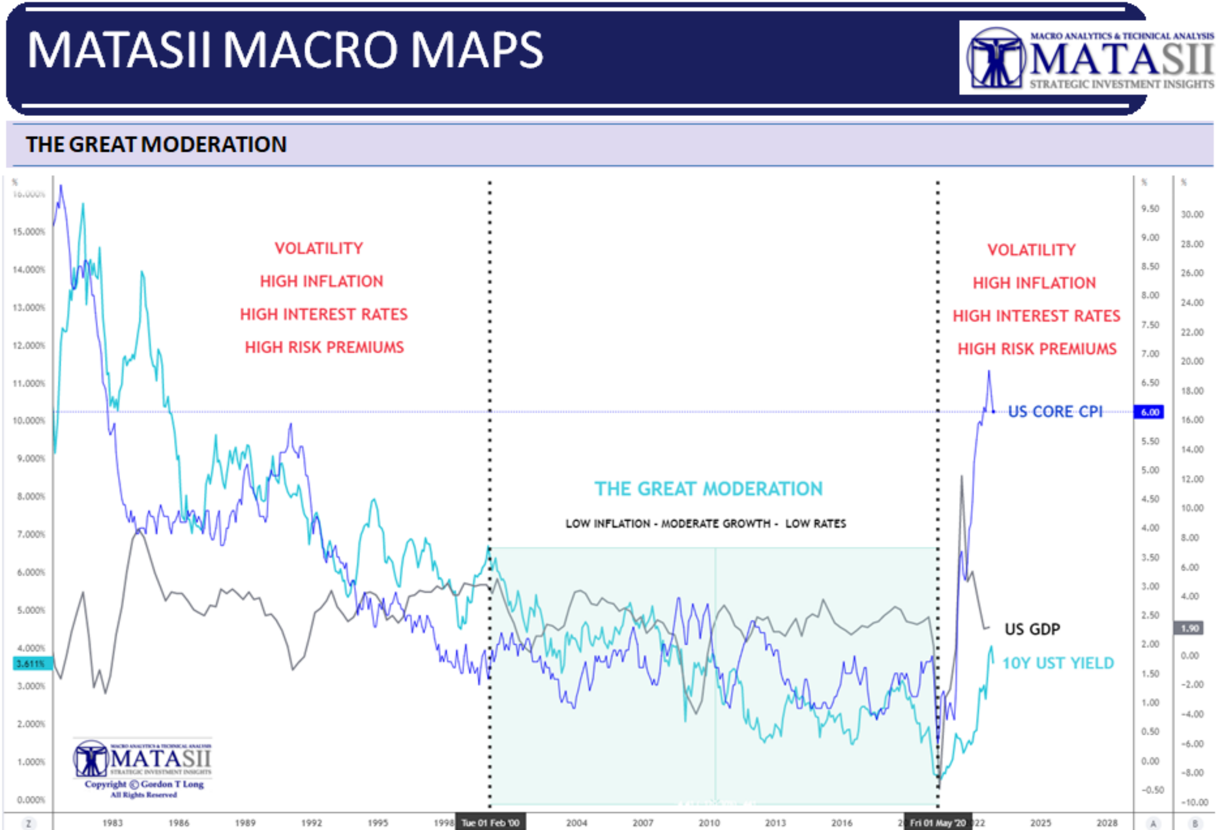
This is most evident in what has become called the "Great Moderation".

Below you can see that this period was between Federal Reserve Chairman Paul Volcker's success in halting a decade of high US inflation and the damage of resulting from the Covid-19 shock. This is illustrated in the chart below, between 1980 and the spring of 2020.

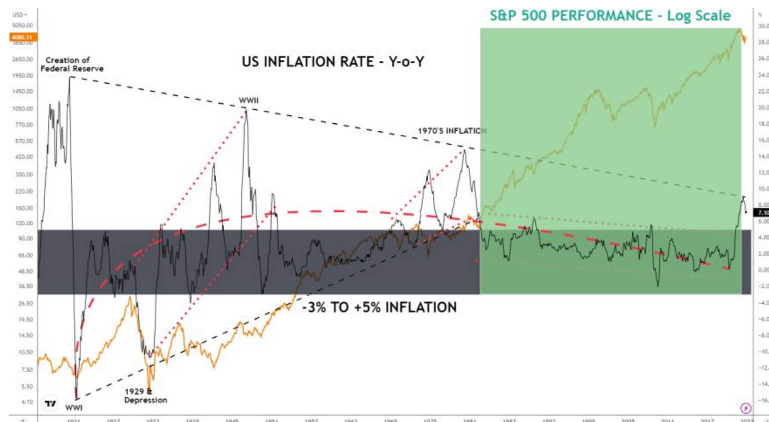


Before this period we had:

- Inflation Volatility,
- High Inflation,
- High Interest Rates,
- High Risk Premiums.

During this period we had historic stock market performance.

What we have witnessed as we spiked through the upper 5% Inflation bound is particularly troubling if we are expecting the Great Moderation to continue. It is about the rate at which conditions abruptly changed!



We experienced a:

- Dramatic Increase in Central Bank Balance Sheets and Fiscal Spending,
- Dramatic shift in Government Fiscal Spending,
- Global Disruption in supply and Supply Chains.

We strongly believe this is about more than simply the fallout from Covid-19.

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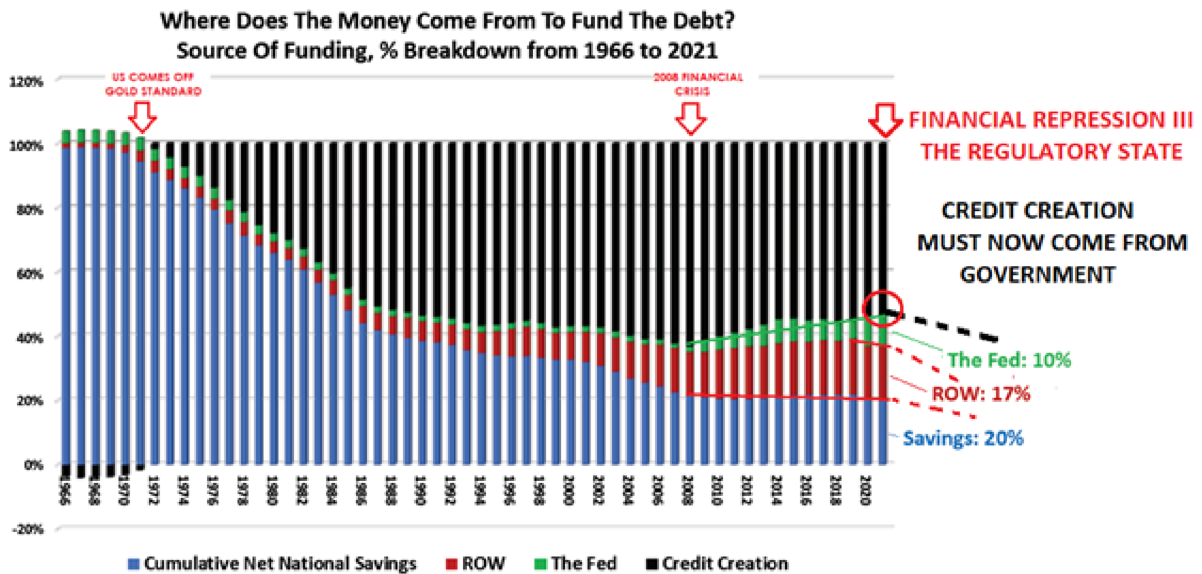
WHY HAS IT ENDED?

Why the Great Moderation ended we believe was because of a culmination of many existing de-stabilizing factors. Factors which we believe Covid-19 as an agent effectively accelerated as a catalyst or triggering event.

The factors we are referencing are major global structural and economic imbalance issues. Many of these we have highlighted extensively in our writings since the 2008 Financial Crisis. The easiest way to understand some of the factors is in the chart below where we illustrate how the US has shifted from a Capitalist System to more of a Credit System or to what we call Creditism. As the US has become a ~70% Consumption Economy, consuming more than it produces, its ability to finance its exploding debt has resulted in this shift.

MATASII MACRO MAPS

FINANCIAL REPRESSION III – The Regulatory State



Source: The Fed's Financial Accounts Of The United States; and the Bureau Of Economic Analysis

The back bars show the growth in Credit versus the blue bars representing cumulative net national savings employed in funding the US Economy. Deficit Trade, Fiscal and Current Account balances forced the US to increasingly depend on increasing credit until 2008, when credit growth was no longer able to sustain its rate in relationship to the growing size of needed debt financing. This was then supplemented through Quantitative Easing (QE) by increasing the size of the Federal Reserve balance sheet (green bars) and financing from the rest-of-the-world (red ROW bars).

The Great Moderation has ended because the current contributing factors to supporting US economic debt funding requirements are no longer sufficient.

Debt Growth Is Outstripping Funding From Real Economic Growth.

Going forward new approaches will be required!

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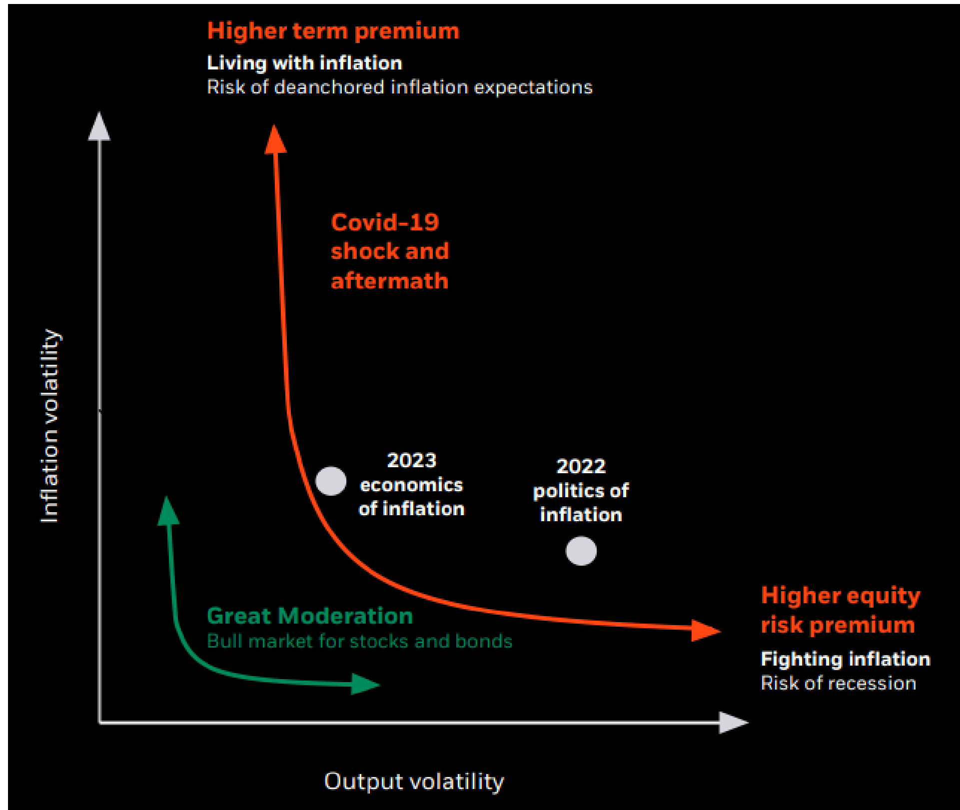
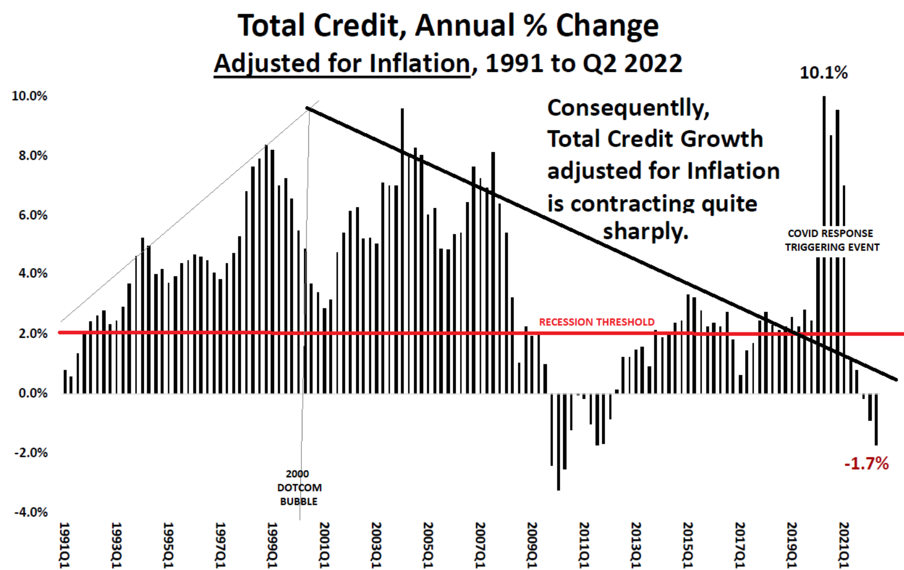
INCREASING COST OF MONEY



INSUFFICENT CREDIT GROWTH

Credit and Debt are the opposite sides of the same coin. Credit becomes debt once someone exercises the availability of credit. The US fractional banking system and money center banking structure are based on money only coming into existence when it is borrowed. Therefore the creation of Credit and Debt is central to the system economically expanding.

We have written extensively about the need for the US to maintain real credit growth above an annualized 2% level to stop the US from falling into a Recession. This is shown to the right by an annotated chart from Rich Duncan Economics' Liquidity Gauge.



Though the Gauge clearly indicates we can fully expect a Recession in 2023, the problem is much more serious.

We have the strong possibility that this is now a secular problem that will

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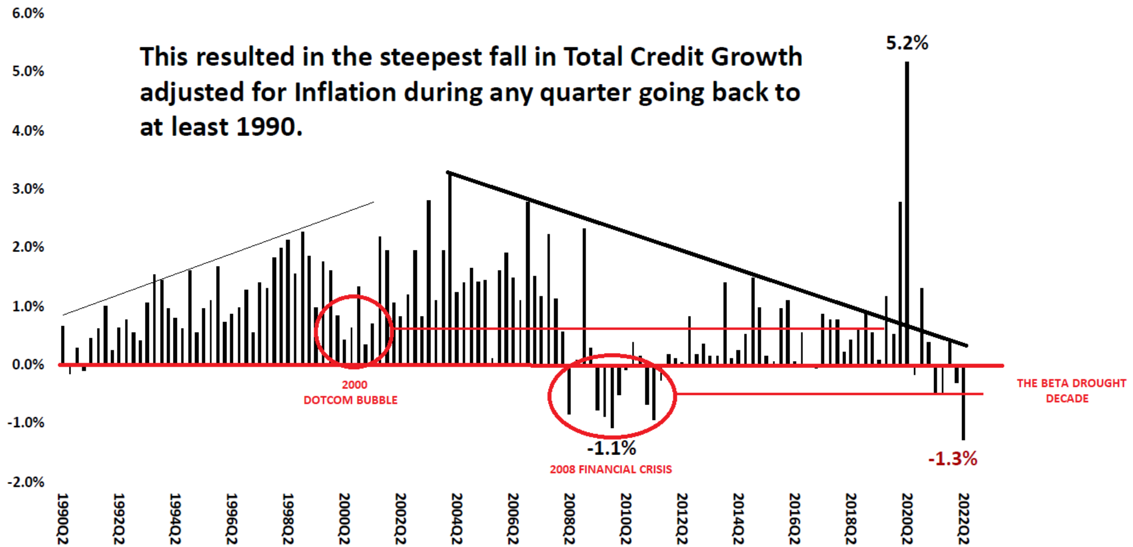
be with us for a significant part of the current unfolding decade.



With credit entering a potentially protracted period of contraction we feel it supports our view of the coming Beta Drought Decade.

The chart below, showing the current selling of US Treasuries, already suggests this as countries are liquidating their FX US Dollar Reserves. They're desperately short of dollars and are selling Treasuries as a way to get cash to prop up their own banking systems. In many cases, it is also them wanting to get out of the dollar (de-dollarization).

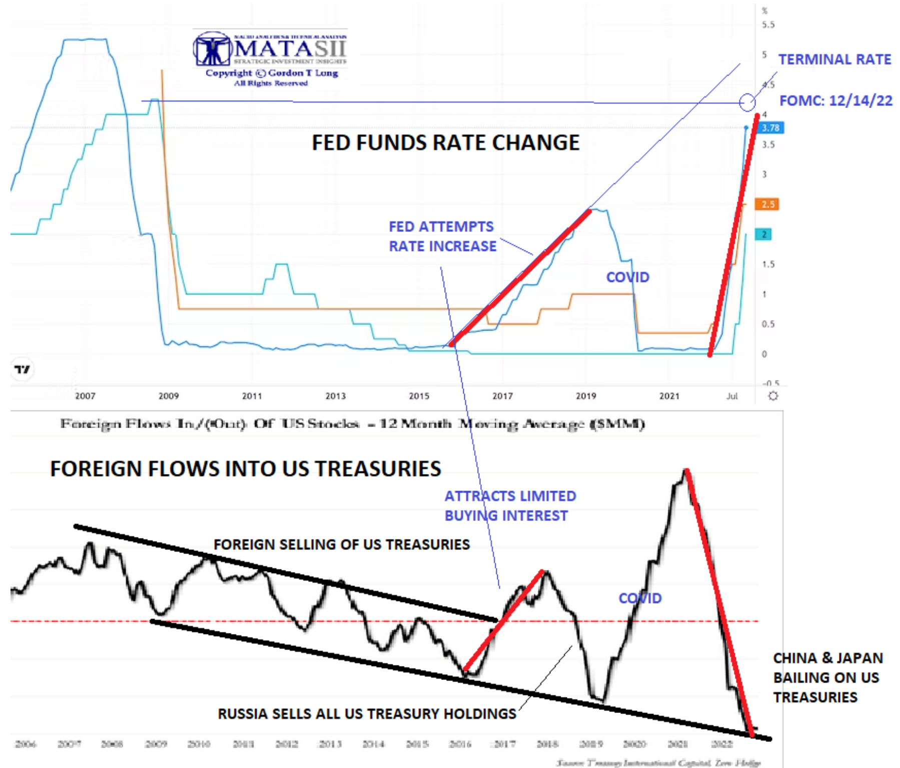
The bigger concern is the pressure it will place on the US to sell its debt to enable it to continue to finance government debt obligations.

These obligations include new debt, rollover debt and unfunded liabilities ($84T in unfunded entitlement programs – Social Security, Medicare, Disabilities, and Government Pension Plans).

We can expect the US Government to address this with government supported credit guarantees or contingent liabilities accounting.

We have referred to this coming approach as Financial Repression III.

(See Video: UnderTheLens - 11 23 22 - DECEMBER - Financial Repression)



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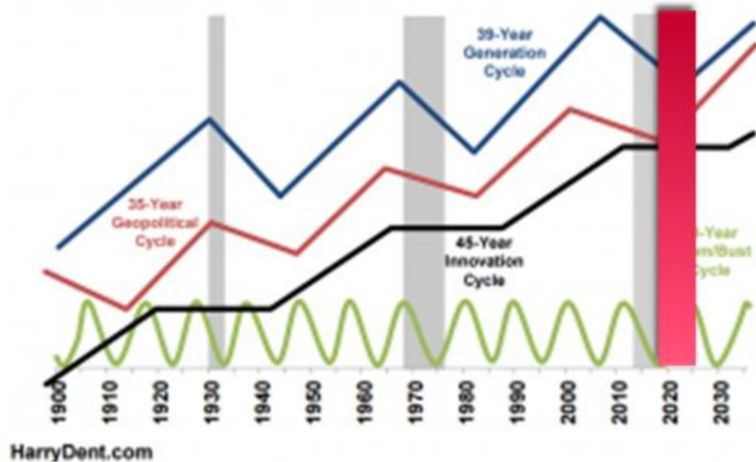
MAJOR CYCLES: *IT WAS FULLY EXPECTED!*

On May 9th, 2018 we published at MATASII.com the video: LONGWave – MAY – Follow the Cycles video.

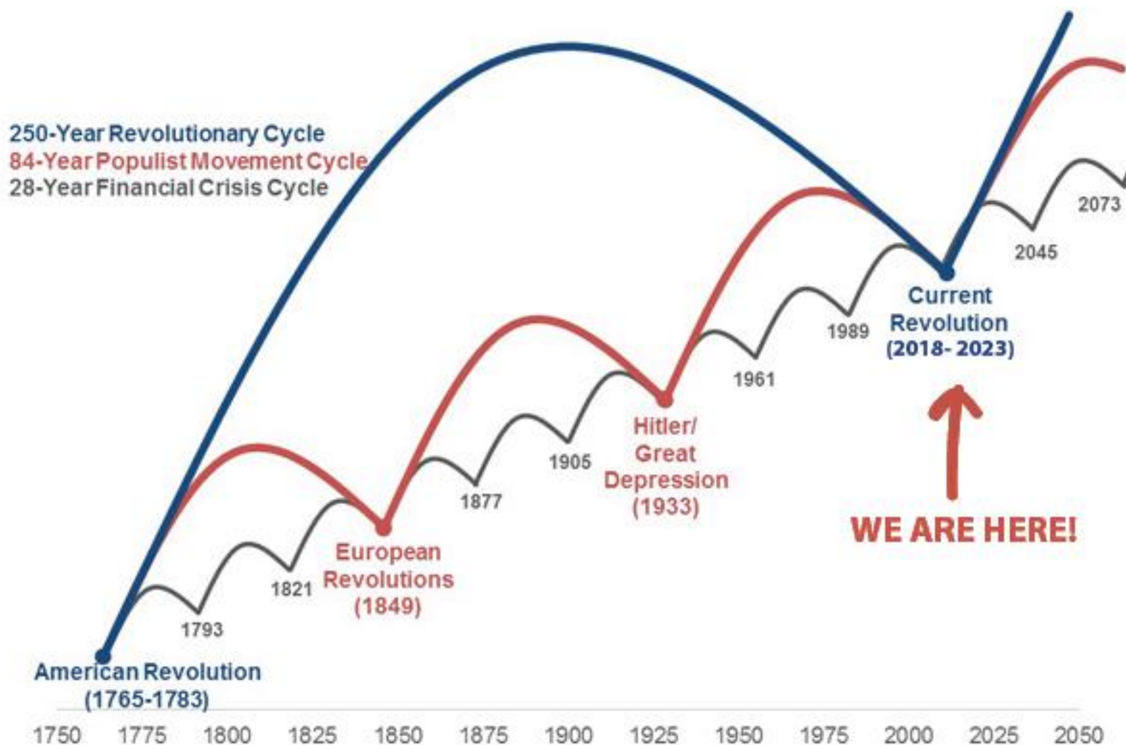
As the two graphics on this page from that video indicate, it was evident that between then *(when we felt the countdown began – see below)* and the end of 2023, almost all our Long, Intermediate and Short term cycles were indicating convergence and reversal.



The Cycles shown here and heavily used in our writings have often centered on Demographics and the supporting works of Harry Dent.

However the work of William Strauss and Neil Howe in their book "Fourth Turning – An America Prophecy" lays out the same warning. Their 1997 book predicted America would enter a generation-long era of fundamental civic and economic transformation starting around 2010 and that the 2020s would be a decade of crisis and climax.

Each turning lasts about 20 years, placing the end of the cycle near 2025, or sometime during this decade. This Fourth Turning is a crisis, a decisive era of secular upheaval, when the values regime propels the replacement of the old civic order with a new one.



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A DESTABILIZING SHOCK

KEY MESSSAGES

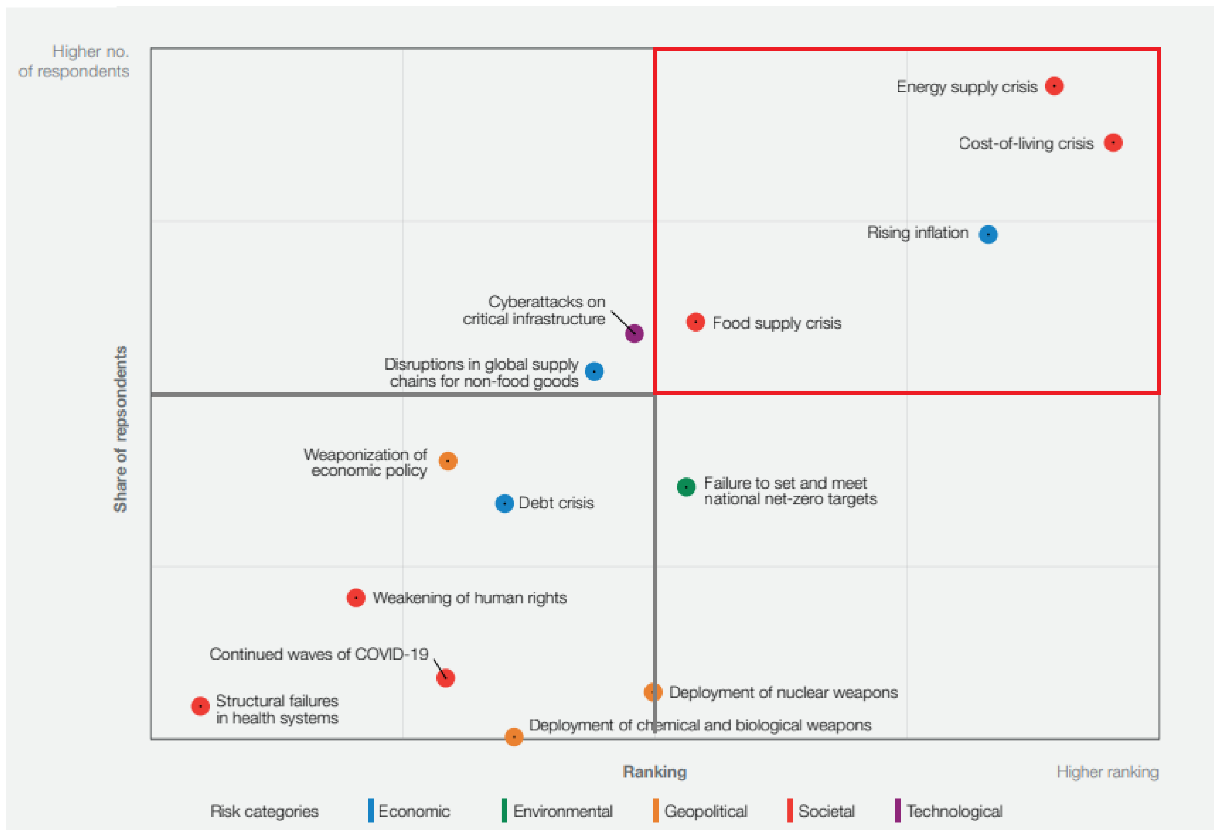
- US Treasury prices were the highest during the WWII era and most recently as the Covid-19 pandemic shock occurred. They were the lowest (highest yields) during Fed Chairman Paul Volcker's inflation fight in 1980.
- We might consider that we have had five eras since the turn of the 20th century:

6. The WWI Shock: Post Spanish Flu / WWI through the Great Depression
7. The WWII Era
8. The Inflation Era from 1964 (Vietnam War not paid for by War Bonds but by Credit & Energy Shock) to 1980
9. The Great Moderation from 1981 until 2020
10. Since the 2020 Covid-19 Shock

- The current economic situation has eerie similarities to the WWI Shock, which lasted from the Post Spanish Flu and WWI through the Great Depression.
- There are also some clear parallels with the Inflation Era from 1964 (Vietnam War not paid for by War Bonds but by Credit & Energy Shock) to 1980.

"COST-OF-LIVING" CRISIS

Current global risks ranked by over 1200 of the top global experts surveyed by the World Economic Forum (shown below) overwhelming (by 4 out of 5 questioned) stated that "Cost-of-Living" was the largest risk facing their country and the world. They felt it was in fact a "crisis"!



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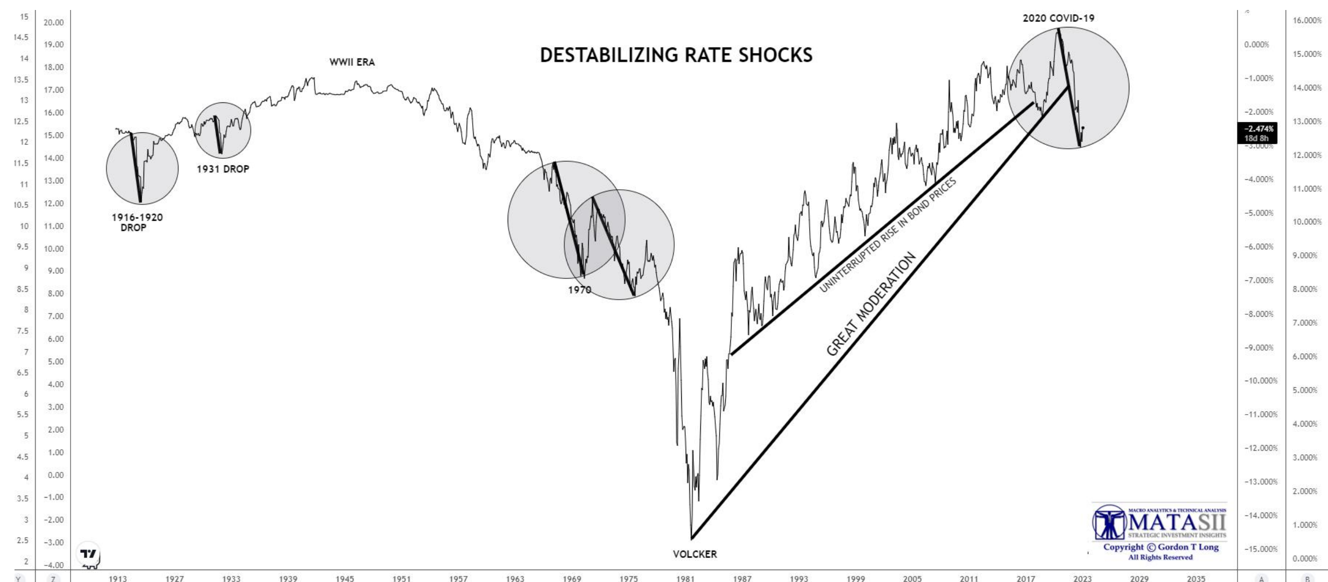
When we look back over the history of the financial markets, what is clearly evident is that unexpected shocks occur within every generational cycle (see previous "Cycles" section) which ends one era and sets the stage for a new era. We believe this has again occurred globally as a result of Covid-19.

Below is a historical view of US 10Y Treasury Prices going back prior to WWI. As prices rise in this chart, remember that yields correspondingly fall. US Treasury prices were the highest during the WWII era and most recently as the Covid-19 pandemic shock occurred. They were the lowest (highest yields) during Fed Chairman Paul Volcker's inflation fight in 1980.

This benchmark has become accepted since the post WWII Bretton Woods conference as the yardstick from which to measure Financial Risk. Risk from the Black-Scholes model is at its core about the pricing of volatility.

What is clearly evident is the sudden drop in prices highlighted by circled periods shown below: i) 1916-1920 drop, ii) 1931 drop, iii) 1966-1970 drop, iv) 1971-1975 and today beginning with Covid-19 in 2020.



For simplicity we might consider this historic period as having 5 eras:

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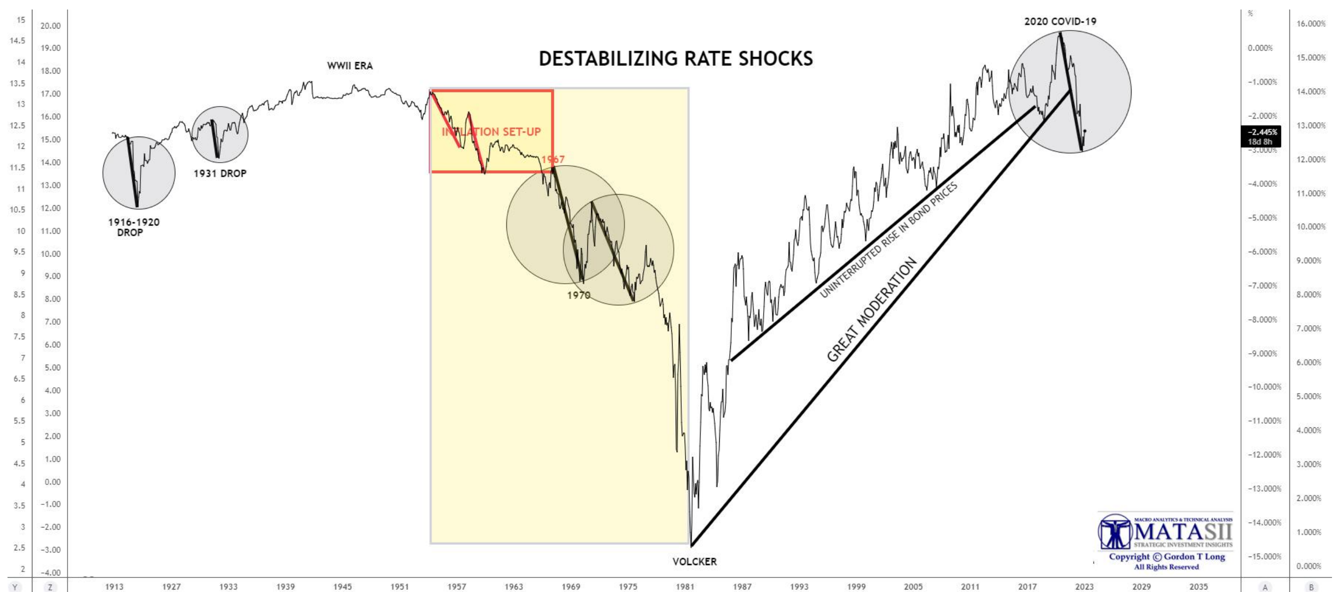
1. The WWI Shock: Post Spanish Flu / WWI through the Great Depression,
2. The WWII Era
3. The Inflation Era from 1964 (Vietnam War not paid for by War Bonds but by Credit & Energy Shock) to 1980
4. The Great Moderation from 1981 until 2020
5. Since the 2020 Covid-19 Shock

THE INFLATION ERA

Let's first consider what we think of as the Inflation Era from 1964 to 1980. Though Inflation is thought to be about the 1970's, it actually took root beginning in 1964 with the Vietnam War. This was the first War not financed as it was fought in the form of primarily War Bonds. It was financed by debt. This along with President Lyndon Johnson's Great Society launched debt (red box), which further accelerated debt with the Energy Crisis Inflation shock in the early 1970.



If we just look at the 1964-1980 Inflation era above and add what was going on with CPI inflation (orange line), we see some distinctive trend lines (in black). Initial rising inflation matched what we referred to earlier as the set-up period. This then lead to surging inflation beginning in 1967 at the height of the Vietnam War and Johnson's Great Society spending programs. It all ended with Inflation at 14.7% and Volcker having the 10Y Treasury rate at 12.4%.

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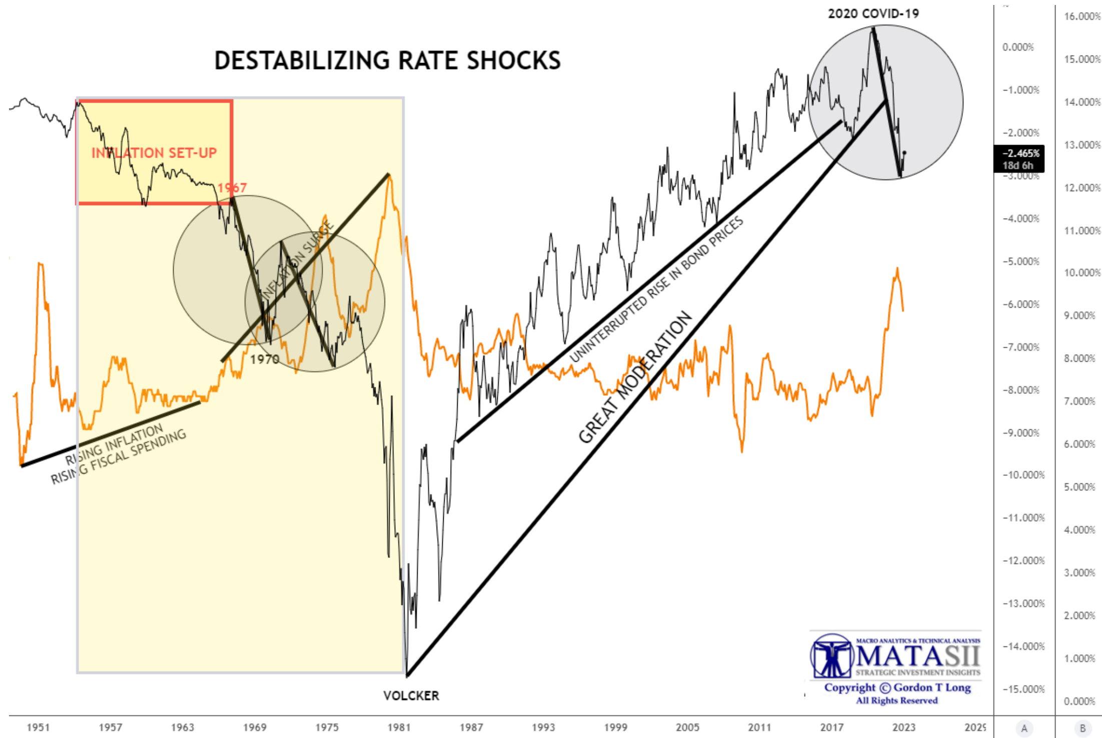
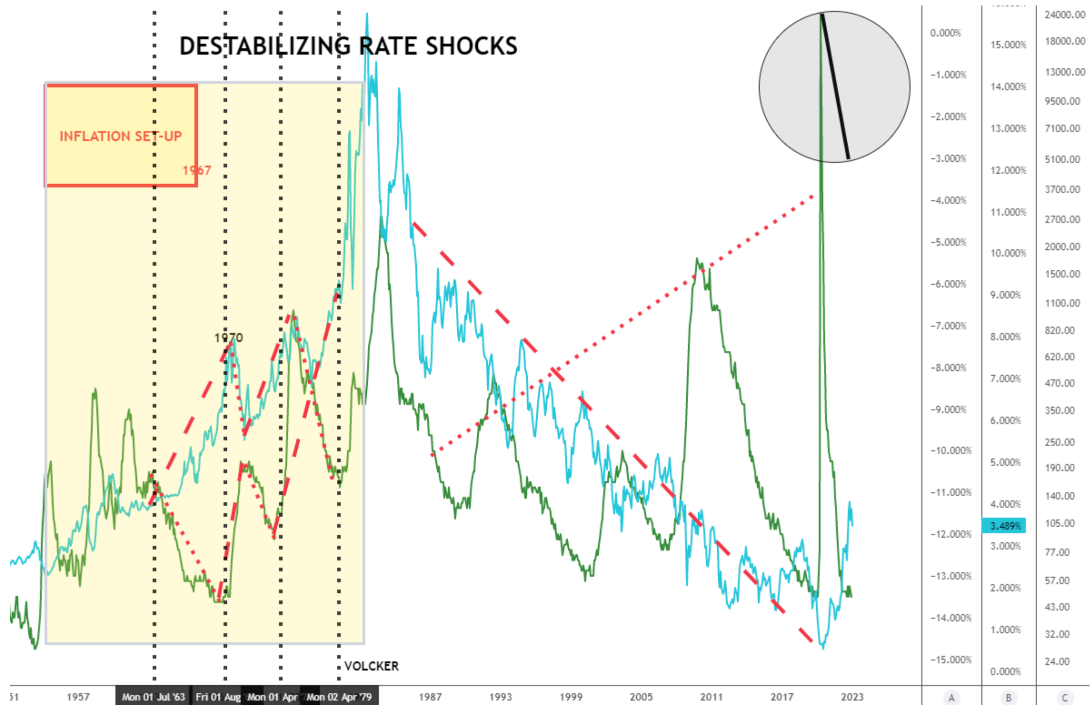


Comparing that Era to today we are highly likely to be in the very early innings of rising inflation which will be punctuated with high volatility associated with episodes of crushing deflation countered with fiscal "Stimulus" spending, energy and food inflation, higher taxes reducing disposable income and dollar devaluation raising import prices.

We have added below the Unemployment Rate during this period of time.



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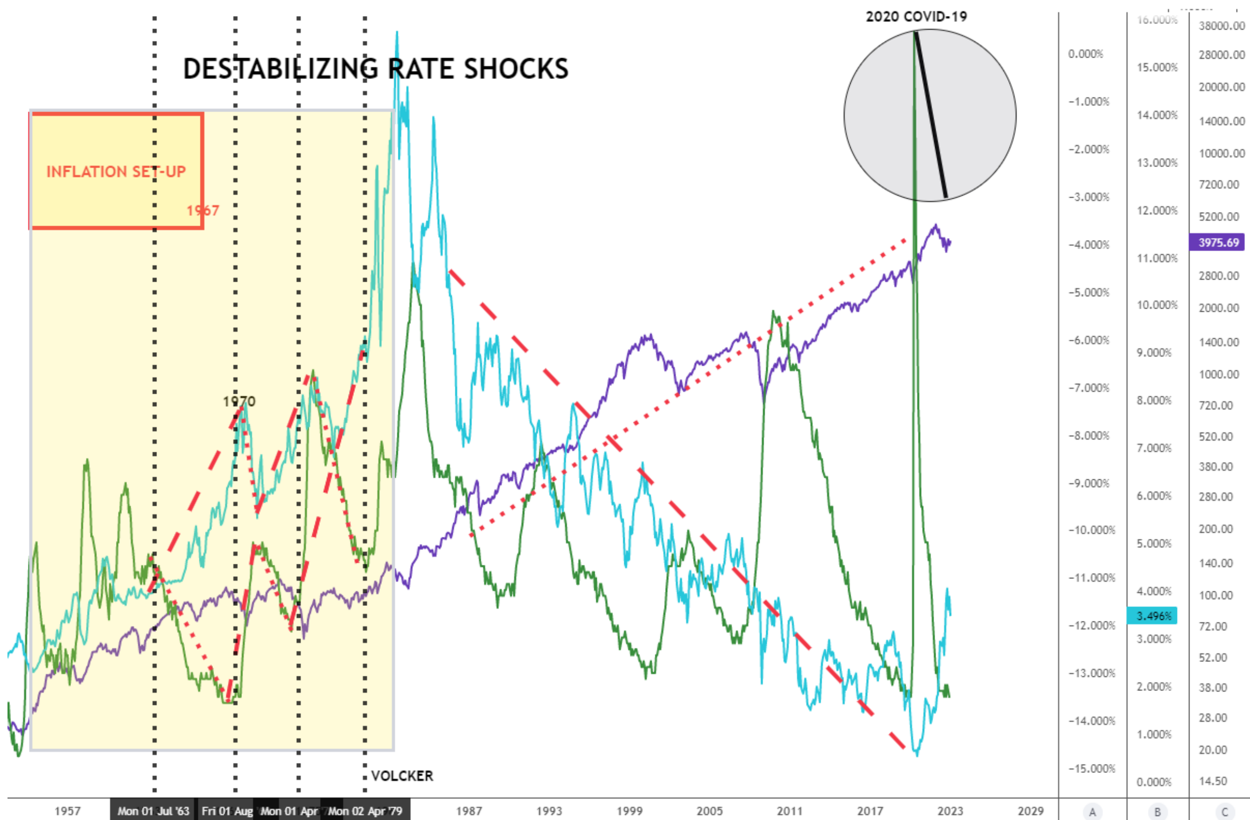
What stands out here is that during the Inflation Era there was a continuous offsetting of higher rates (dashed red line) with a falling Unemployment rate (dotted red line). This resulted in a well behaved and performing market.

Today on the right in the above chart we see the **OPPOSITE** occurring and on a much larger secular time frame. We see on the Unemployment peaking trend rising (dotted red line), while lower rates have continued trending lower (dashed red line) – until the Covid-19 shock.

This does not bode well for the future, because rising rates today can only mean layoffs and bankruptcies within our indebted and over leveraged corporations.

Through all this we have seen equity markets continue to perform (purple line below). Though since the 2008 Financial Crisis, it has taken unprecedented policies like Quantitative Easing and exploding central bank balance sheets to achieve this. We will explore the increasing challenges and problems in later sections.



THE WWI & SPANISH FLU SHOCK

Clearly Jobs and Employment are going to be a central economic problem in the coming era of Stagflation.

What about timing and duration? Is there anything history can tell us about here?

We found a number of important similarities when we considered the WWI & Spanish Flu Shock. Let's go back to that era highlighted on the left of the chart to the right.

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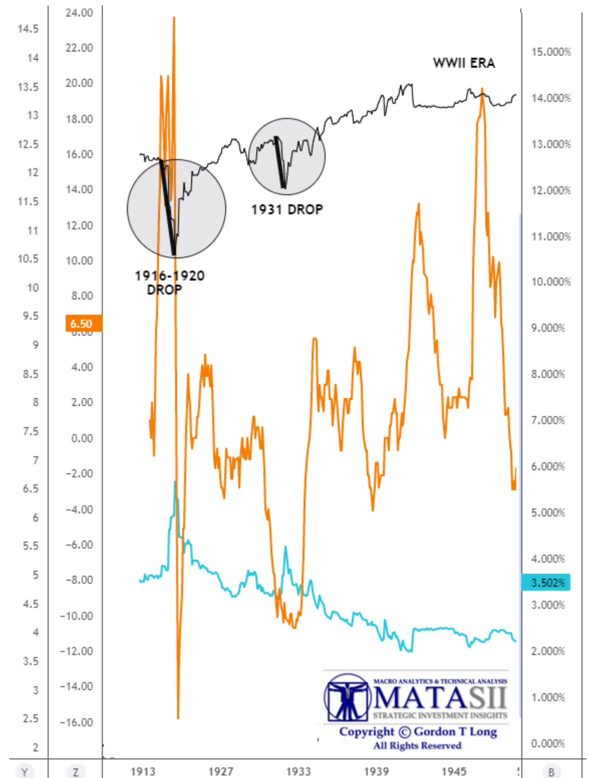
In the chart to the right we see the two circled bond price drops (1916-1920 and 1931) operating much as the two separate circled drops in the Inflation Era.



The added orange line is the CPI inflation rate and the turquoise line at the bottom is the US Treasury 10Y Yield (the reverse of the US 10Y Price [black line at the top] to make it easier to understad what was transpiring).

We immediately see that between 1916 and 1920 the Fed was raising rates rapidly with inflation raging from the fallout from the Spanish Flu and WWI at ~14.5%. The Fed had been complacent too long while inflation had been quite elevated. The Fed suddenly raising rates rapidly immediately triggered a massive deflationary shock, which saw the inflation rate abruptly plummet to a contraction of ~ -15.8% within two years.

The Federal Reserve was then forced to abruptly reverse again and start lowering rates to fight deflationary pressures. They were somewhat successful and managed to get the inflation rate back in the range of a high of ~+4.7% and contraction low of ~-3.4% between then and 1928, when they started raising rates again.

This subsequently led to the 1929 stock market crash and serious deflation once again.

The Fed then made a serious plunder by raising rates which caused the 1930 Great Depression to last longer than it had to, even with the Fed steadily reducing rates to get the economy going again.

If any of this sounds familiar you are right!

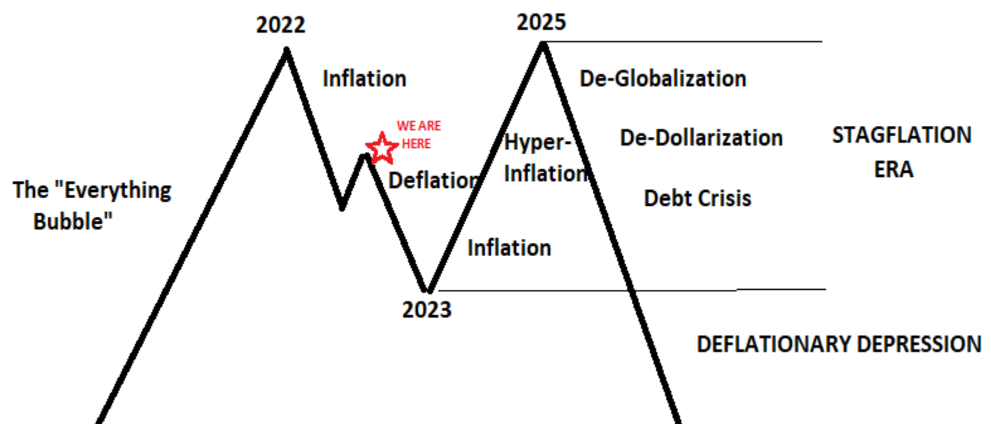
Today the fed waited too long to raise rates, letting inflation quickly get out of control (aided and abetted by historic government spending, stimulus and government transfer payments). This was a shock not only to the demand side, but coupled with global supply problems, have de-stabilized an over-leveraged and over - valued global financial assets market.

As you will see in the next three sections, the US economy will be unable to deal with this shock as volatility increases. We are facing the Beta Drought Decade. No one knows how this will play out, because there are just too many factors in a highly complex and inter-related world to know what decisions will or will not be taken.

Our best guess is it will look conceptually look something like the generalized schematic to the right.

A Classic "M" Top.

We will come back to our expectations in the Conclusion at the end of this paper.



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INFLATION PLUS DEFLATION

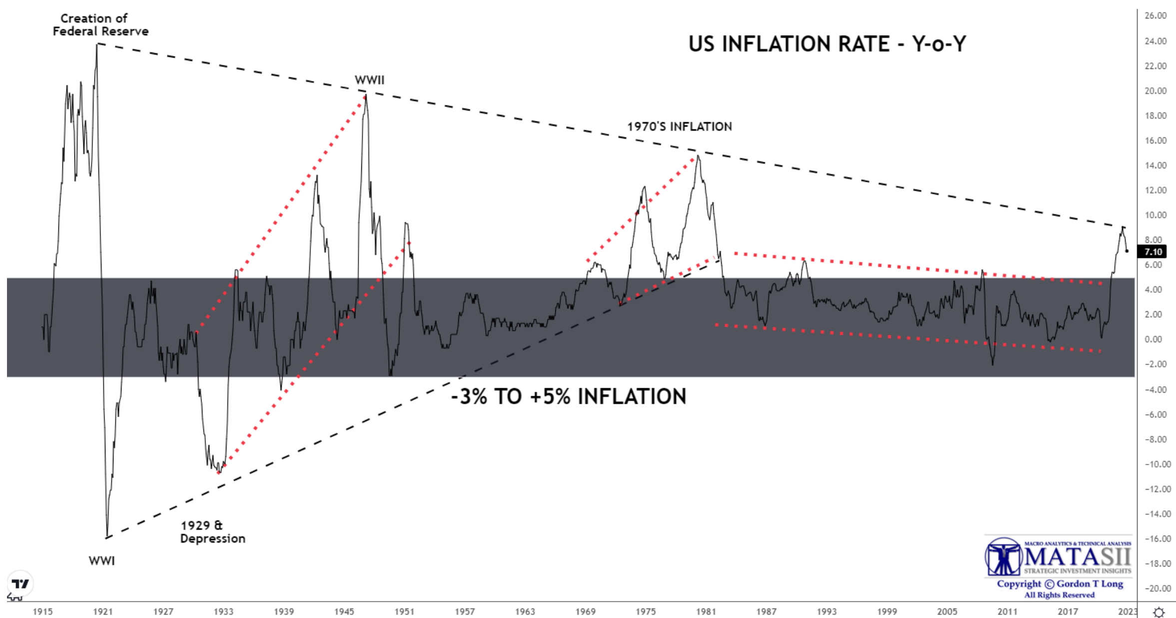
KEY MESSSAGES

- We should expect increasing instabilities with both rising Inflation and Deflation. These will occur concurrently but in different economic and financial areas.
- According to research by Deutsche Bank, history shows that once inflation rises above 5% in developed economies, it takes at least a decade to bring it down to 2%.
- In 2023 we are highly likely to see major deflationary pressures associated with a potential Federal Reserve hard landing and recession.
- Inflation will be with us for the next decade. It may fall based on "official" numbers to ~4-5%, but it will be there nevertheless. We will be in an era of continuous policy initiatives to rein in inflation to manageable levels.
- We are now only in the first phase of what is likely to be a three phase process before we see inflation being possibly contained.
- Inflation fighting is about Politics as much as it is about Economics!

CONCURRENT INFLATION & DEFLATION

According to research by Deutsche Bank, history shows that once inflation rises above 5% in developed economies, it takes at least a decade to bring it down to 2%.

Even the OECD expects persistent inflation in 2023 against a backdrop of weakening growth.



I have written extensively about the reality that we have both Inflation and Deflation concurrently. They exist concurrently in different areas of the economy and both continue to shift into focus. What shifts in a much larger manner however is public perception, media narrative and market focus.

In 2020 as Covid-19 hit, I produced a video entitled "Inflation PLUS Deflation" specifically reinforcing this point.

UnderTheLens - 09-23-20 - OCTOBER - Inflation PLUS Deflation?

Inflation can only be expected to trend higher as we inevitably head towards a final hyperinflationary blow-off of fiat currencies.

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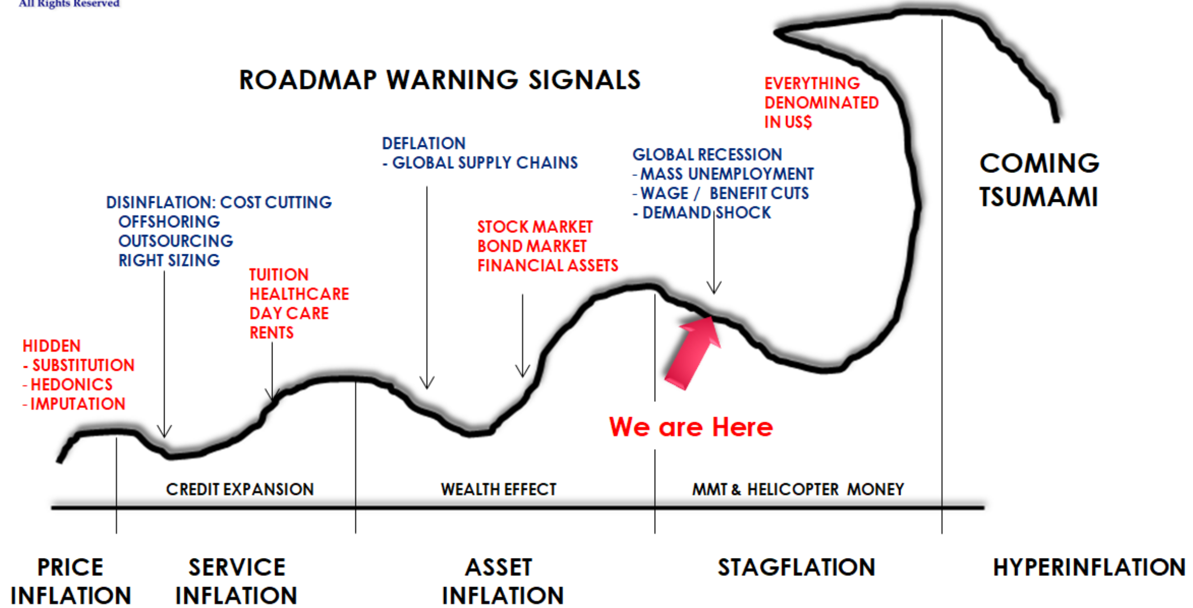
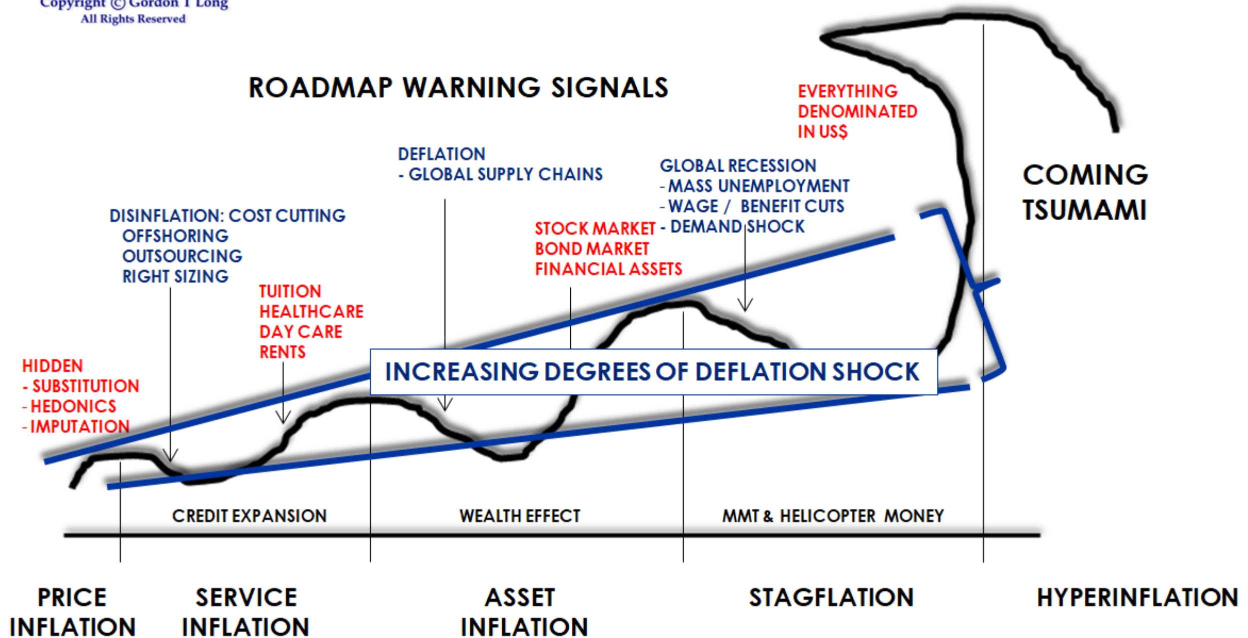


Meanwhile we can expect Deflationary pressures to increase. It is highly likely the next major Deflationary pressure will soon come from Recessionary pressures.



We are likely very near that pivot point now

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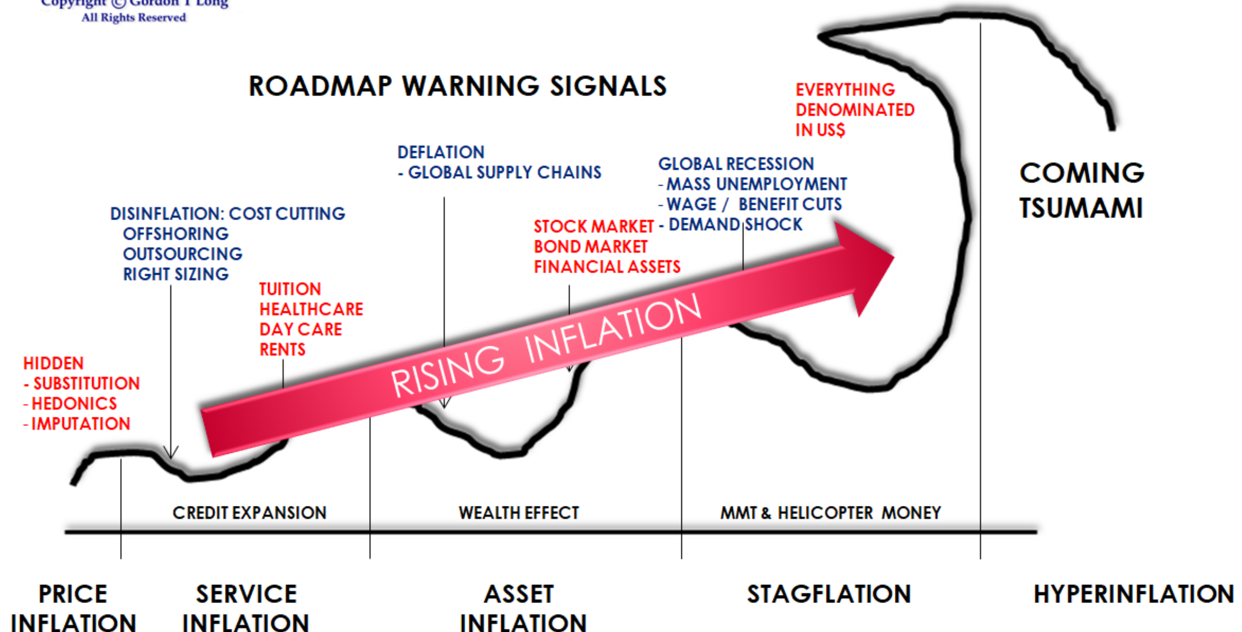
In 2023 we are highly likely to see major deflationary pressures associated with a potential Federal Reserve hard landing and recession. As we publish this Thesis Paper at the beginning of 2023 we are in the midst of the following unfolding cycle.

However, don't be misled!

Inflation will be with us for the next decade. It may fall based on "official" numbers to let's say 5%, but it will be there nevertheless. We will be in an era of continuous policy initiatives to rein in inflation to manageable levels.

However with the size of global debt the opportunity to inflate away some of that debt is not going to be missed.



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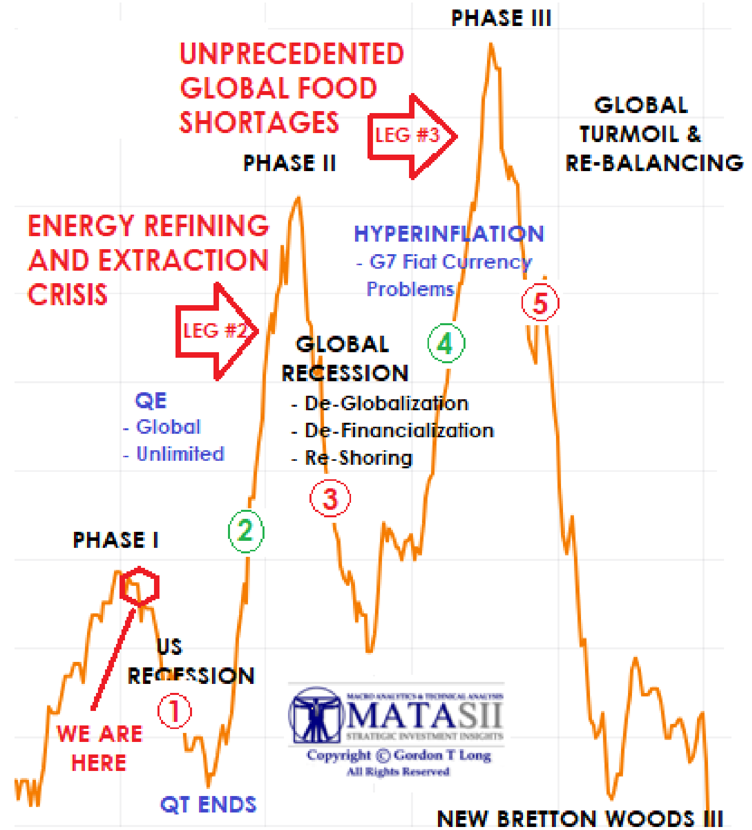
EXPECT THREE INFLATION CYCLE PEAKS

We are now only in the first phase of what is likely to be a three phase process before we see inflation being possibly contained. We are now in the midst of an Energy refining & extraction Crisis that will last minimally through 2023 if not much longer.

In 2023, energy will likely be the only thing that matters to investors. Everything else, including the Fed will be a side-show. Who's ready for the insanity wave??

We just had a half-year pause in my oil thesis, now it's potentially about to resume with vigor!

Soon we will see a global food crisis which is already being felt in many emerging countries. It is likely to be a prime inflationary fire in 2023-2024.



This matches prior longer periods of Inflation where we have seen similar three cycle stages (below).

US DOLLAR G7 FIAT CURRENCIES GEO-POLITICAL GLOBAL GROWTH

DOMINATE CONTROLLERS

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INFLATION FIGHTING IS AS MUCH ABOUT POLITICS AS ECONOMICS

The current Federal Reserve Chairman, Jay Powell, does not want to repeat the mistake of Paul Volcker who also fought inflation with rate hikes, but cut rates too early and came to regret it.

When Paul Volcker was appointed Fed Chair in 1979, he immediately set about ending the worst inflation the U.S. has seen since the end of World War II by raising rates.

Then the U.S. was hit with a recession in January 1980.

Unemployment rose to 7%. Inflation was still 14.7% in April 1980, but Volcker was under intense pressure to cut rates in the face of a recession and layoffs.

The Fed blinked. Volcker lowered the fed funds target rate by 7 percentage points.

The recession was over by July 1980, but inflation was not. Inflation at the end of 1980 was still over 12%. The Fed and Volcker had damaged their credibility as inflation fighters. **This became known as the infamous Volcker Mistake.**

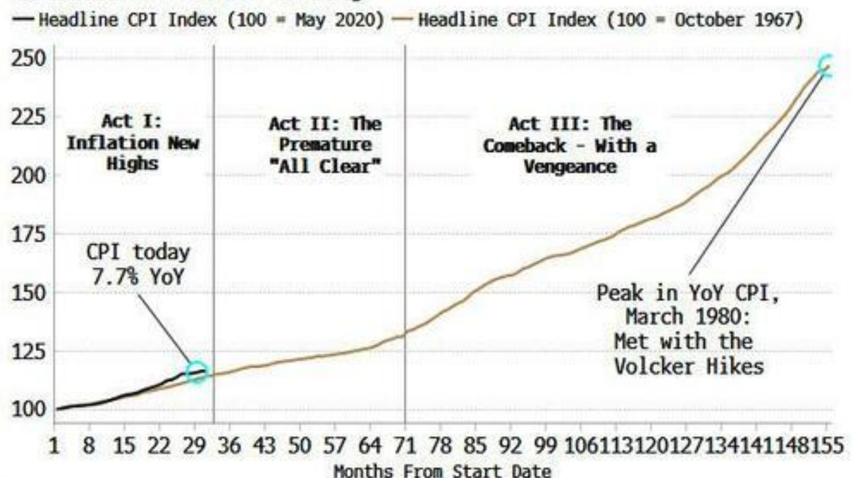
From there Volcker doubled down. Because of the credibility damage from the Volcker Mistake, interest rates had to go even higher. It was in this stretch that the fed funds target rate hit 20% in June 1981.

This extreme level triggered another recession in July 1981, the second in two years. The 1981 – 1982 recession was the worst since the end of World War II, and interest rates were still 15% in the middle of 1982.

The severity of that recession was not surpassed until the global financial crisis of 2008.

The point is that when Volcker lowered rates in 1980, the job of beating inflation *was not done*. Inflation went even higher and Volcker had to take even more extreme measures finally to get it under control.

WE CAN EXPECT THE THREE INFLATION PEAKS AGAIN … FROM AS MUCH POLITICAL, AS ANY ECONOMIC CONSIDERATIONS



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MACRO ANALYTICS & TECHNICAL ANALYSIS
MATASII
STRATEGIC INVESTMENT INSIGHTS

DEVELOPMENTS IN THE KEY ELEMENTS OF STAGFLATION

KEY MESSSAGES

KEY ELEMENTS OF STAGFLATION AHEAD

ELEVATED INFLATION (+4%)

SLOW GROWTH (<1%)

MAJOR UNEMPLOYMENT (+10%)

INFLATION ELEMENT

- In the 2020's, we are likely to find ourselves in a radically different situation to the 2010s. Inflation will always be a little too high (as opposed to too low). With both monetary and fiscal policy pivoting a full 180 degrees, we will again have a "tug of war", but this time a battle that pushes firmly in the direction of higher interest rates, rather than the disinflation and NIRP of the post-GFC era.
- The US may now be entering another Beta Drought. US returns are now at risk from both the prospects of higher inflation AND the headwinds to returns from high starting-point valuations.
- We fully expect a major crisis within the $2.2 Quadrillion derivatives complex to ignite yet another government money printing episode of even more egregious new government policies.
- The broken Credit Transmission Mechanism is now fractured for many reasons, but most of all because of a shortage of unencumbered collateral.
- We have reached the point where Credit growth can no longer sustain over-indebted and over leveraged systems. The US and most developed economies debt are quickly becoming unfundable without dramatic actions being taken.
- If this is not enough – US productivity is now in free fall because of a decade of mal-investment and under investment in productive assets. It will take the next decade (or possibly more) to clear the monetary mal-practice, fiscal excessive and global imbalances from the system. It will be a Beta Drought Decade.
- The coming decade will likely be referred to as the Great Stagflation. This is similar to the 1930s' which was labeled the Great Depression. There is all likelihood it may be worse and eventually be labeled the Great Stagflationary Debt Crisis.
- Inflation and Deflationary pressures will come at us increasingly from major shifts in the World Order as do domestic problems.
- Those discussions match with what we have already experienced in 2022 with regard to the results of the "60:40 Bond Total Real Return Index".
- Expect to see:
    - De-Globalization / De-Growth / De-Financialization / Re-Balancing / Re-Shoring,
    - Declining Productivity,
    - Falling Purchasing Power of US$ & Fiat Currencies,
    - De-Dollarization.

GROWTH ELEMENT

- US Economic growth is seen be extremely strong even when plotted on a log scale. However careful analysis shows it briefly leveled off near the end on the 1970's (red circle above).
- This closely aligns with the beginning of the Great Moderation when once again economies continued to steadily advance.
- We can see this was preceded with over a decade of rising Inflation (three peak cycles) that began with spending to financing the Vietnam War (the first War financed by credit), President Lyndon B. Johnson's Great Society (financed with fiscal deficits) and in 1971 when the US Dollar officially becoming a fiat currency when President Richard took the US off the Gold Standard.

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- Banks Are Worried About Something?
  - Banks and holders of cash are dramatically increasing their holdings of Reverse Repos (RRP) Balances at the Fed instead of lending it out.
  - Commercial banks are significantly increasing their Loan Loss Reserves which always is a clear sign that they see defaults and loan delinquencies ahead.
  - Loan & credit officers are steadily tightening lending Standards.
  - The Federal Reserve has been steadily tightening Financial Conditions as seen by the Financial Conditions Index.
- We have serious problems arising in the areas of Liquidity, Credit, Debt, Collateral & Lending Risk.
- IMF and World Bank Economic projections have been abruptly and significantly reduced for 2023. The World Bank is warning of a Global Recession.

UNEMPLOYMENT ELEMENT

- The Unemployment rate has been steadily rising over a longer period of time, despite a rapidly rising Participation rate, as the US effectively de-industrializes with over 54 thousand manufacturing facilities having left the US for China and more competitive Asian locations.
- An upper limit of 10% Unemployment rate recently broken by Covid-19 reached during the 1980-1982 Volcker created Inflation fighting recession.
- We have additional problems associated with:
  - Growing hidden costs of unemployment,
  - Exploding Disability roles and funding costs,
  - The ranks of Medicaid recipients and funding costs,
  - Over $90 Trillion in unfunded liabilities for Social Security and Medicare for unemployed elderly.

CONTSRAINED BOUNDARY CONDITIONS

- If inflation stays elevated (above 5%), then there is a strong possibility that the official unemployment rate will surge through the 10% range.
- This is particularly likely if the Fed Funds Rate remains elevated in the Federal Reserve's fight against inflation. This is highly likely since the rate is still very low versus Inflation and what it will likely take to effectively fight it.
- The commonly understood perception is that the US has shifted over the last 5 decades from being the dominant global manufacturer, to becoming a Service Economy. Few take that point further by pointing out that this has meant destruction in high paying jobs with fewer Service Jobs that in aggregate pay less than the lost manufacturing jobs. Additionally, in aggregate the export revenue of the shift is a significant net loss to the US Economy.
- It has taken a continuous reduction in interest rates to effectively avoid bankruptcy by financing employment in Zombie corporations, job creating mal-investment in Unicorns and high failure rate start-ups to keep unemployment from rising further than an already longer trend that has been rising despite this.
- Precarious US employment rates have become increasingly dependent on low rates to sustain mal-investment and poorly capitalized employers. Any de-stabilizing financial stress has the potential to send unemployment through the roof!

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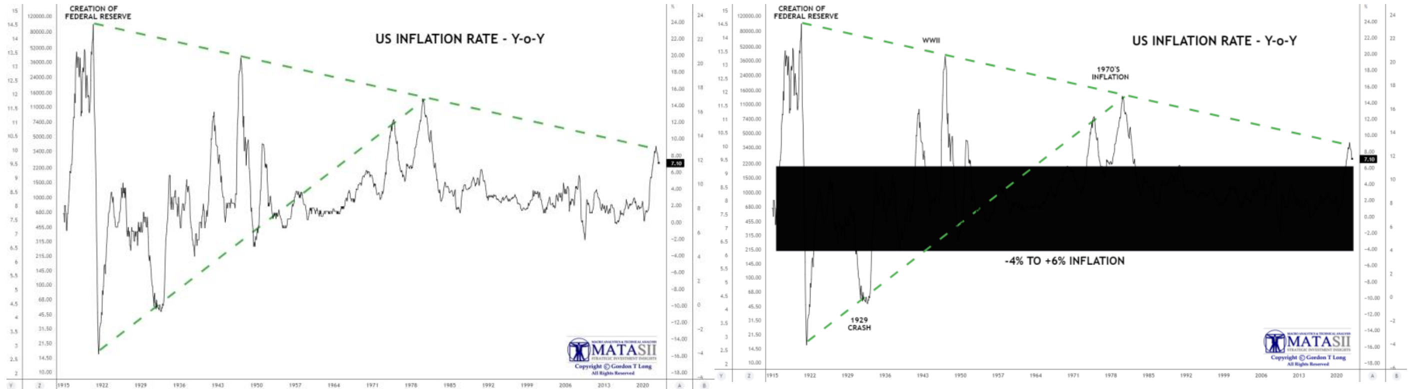
THE INFLATION ELEMENT

We discussed the following two historical inflation charts in the prior "Great Moderation" and "Inflation PLUS Deflation" sections, which highlighted the secular significance of Inflation breaking through the 5% Inflation threshold barrier.

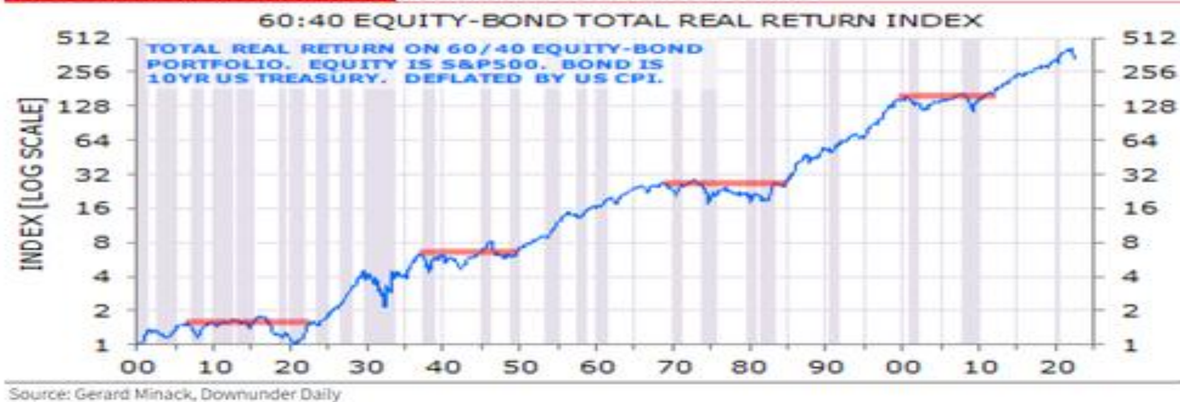


5% REGIME

In the 2020s, we are likely to find ourselves in a radically different situation to the 2010s. Inflation will always be a little too high (as opposed to too low). With both monetary and fiscal policy pivoting a full 180 degrees, we will again have a "tug of war", but this time a battle that pushes firmly in the direction of higher interest rates, rather than the disinflation and NIRP of the post-GFC era.

Inflation and Deflationary pressures will come at us increasingly from major shifts in the World Order as to domestic problems.

Those discussions match with what we have already experienced in 2022 with regard to the results of the "60:40 Bond Total Real Return Index" (shown below).



We need to be fully aware that US investors have enjoyed historic beta for a dozen years. A 60:40 equity/bond portfolio generated a 10½% annual average return between March 2009 and January 2022.

There have been four Beta Droughts since 1900: extended periods of little or no beta return.

- Three of the four historical beta droughts – in the 1910s, 1940s and 1970s – were caused by rising inflation - typically decade-average CPI inflation of over 5%.
- Those three inflation episodes were associated with WW1, WW2, and the 1970s oil shocks.

The US may now be entering another Beta Drought. US returns are now at risk from both the prospects of higher inflation AND the headwinds to returns from high starting-point valuations.

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Larry Fink, the Founder, Chairman & CEO of BlackRock recently emphasized the following numbers:

> *Just a year ago, the US 2Y Treasury Notes were yielding 25 basis points. Today, they're earning 4%, with corporate bonds over 5% and high yield above 9%.*
>
> *If we go back to 1995, before congress repealed the Glass-Steagall Act (brought into being as a result of the 1929 stock market crash of 1933), you could get a 7.5% yield, with a portfolio of simply 100% RISKLESS bonds.*
>
> *If you fast forward 10 years, in 2005, it had to be 40% equities, 50% bonds, and 10% alternatives. Then move another 10 years, and in 2016 you needed 60% equities, 15% bonds, and 25% alternatives.*
> *This describes the growth of several markets with investors having to take on significantly more risk for even a shot at the same return.*
>
> *Today, to get that same 7.5% yield, a portfolio could be 85% bonds, and the 15% equities and alternatives.*

We are not far from returning to potentially 1995 benchmark levels.

What this suggests is that the increasing risk that investors have accepted over the last decade will likely to be purged over the next decade or at least lowered.

S&P 500 real prices and Cyclical Adjusted PE Ratios are more than likely to regress to more normalized levels represented by the dotted exponential plots.

The famous George Soros' lieutenant, *Stanly Druckenmiller believes* that could be the case. I quote him:

> *"There's a high probability in my mind that the market, at best, is going to be kind of flat for 10 years, sort of like the '66 to '82 time period."*

Druckenmiller added that with inflation raging, central banks raising rates, de-globalization taking hold, and the war in Ukraine dragging on, he believes the odds of **a global recession** are now the highest in decades.

He points out that globalization has a "deflationary" effect because it increases worker productivity and speeds up technological advancement. However, that tailwind is now fading.

To quote Druckenmiller again:

> *"When I look back at the bull market that we've had in financial assets really starting in 1982. All the factors that created that boom not only have stopped, they've reversed."*

We fully expect a major crisis within the $2.2 Quadrillion derivatives complex to ignite yet another government money printing episode of even more egregious new government policies.

The broken Credit Transmission Mechanism is now fractured for many reasons, but most of all because of a shortage of unencumbered collateral.

We have reached the point where Credit growth can no longer sustain over-indebted and over leveraged systems. The US and most developed economies debt is quickly becoming unfundable without dramatic actions being taken.

If this is not enough – US productivity is now in free fall because of a decade of malinvestment and under investment in productive assets. It will take the next decade (or possibly more) to clear the monetary mal-practice, fiscal excessive and global imbalances from the system. It will be a Beta Drought Decade.

The coming decade will likely be referred to as the Great Stagflation. This is similar to the 1930s' which was labeled the Great Depression.

There is all likelihood it may be worse and eventually be labeled the "Great Stagflationary Debt Crisis".

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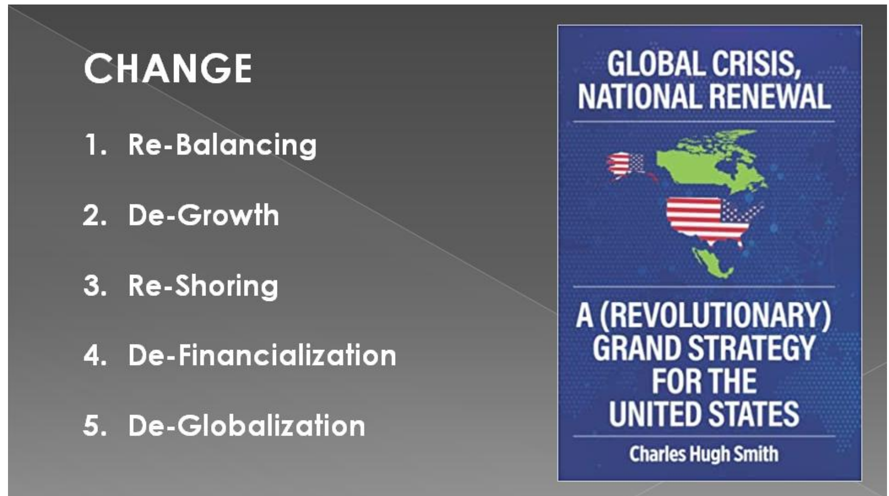
DE-GLOBALIZATION / DE-GROWTH / DE-FINANCIALIZATION / RE-BALANCING / RE-SHORING

Above I said:

> *"Inflation and Deflationary pressures will come at us increasingly from major shifts in the World Order as to domestic problems".*

What I was additionally talking about by World Order is the change in trend in the items outlined to the right.

My colleague, Charles Hugh Smith and I have done three 45 minute videos in 2022 on exactly the importance of these shifts.

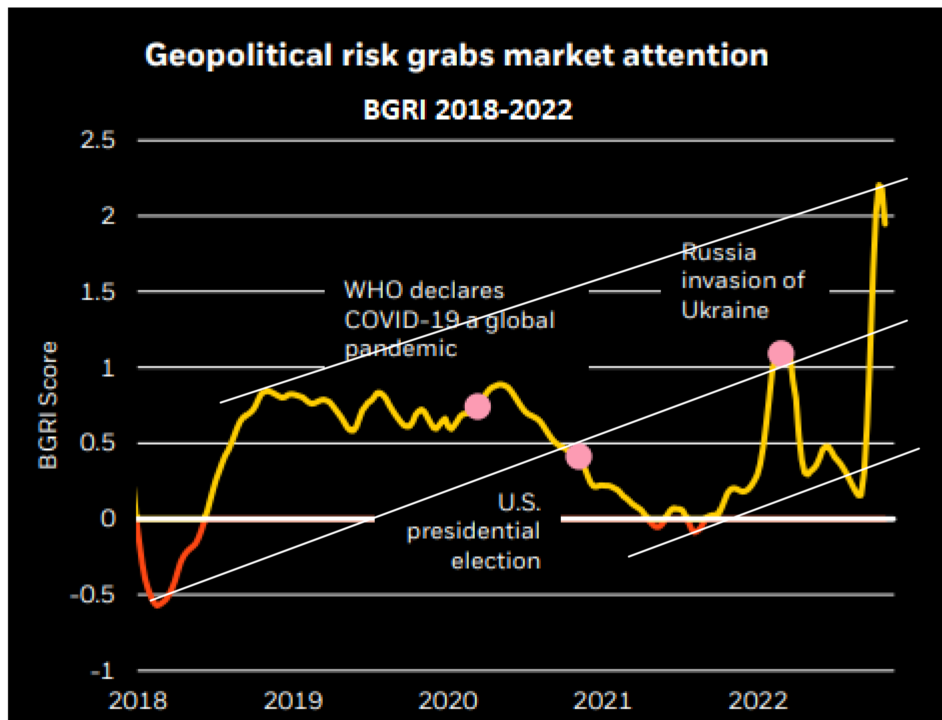


MACRO ANALYTICS - 03-31-22 - MARCH - The Dam Has Cracked!

MACRO ANALYTICS - 06 16 22 - JUNE - Tectonic Shift of Mercantilism Revalued

MACRO ANALYTICS - 09 29 22 - The Plundering Of Productive Assets

Geo-Political issues will increasingly dominate and complicate domestic Monetary and Fiscal approaches to solving US economic problems.



In many ways this will be similar to the 1969 to 1980 era when the US economy was for the first time being subjected to problems within re-emerging, developing and new economies.

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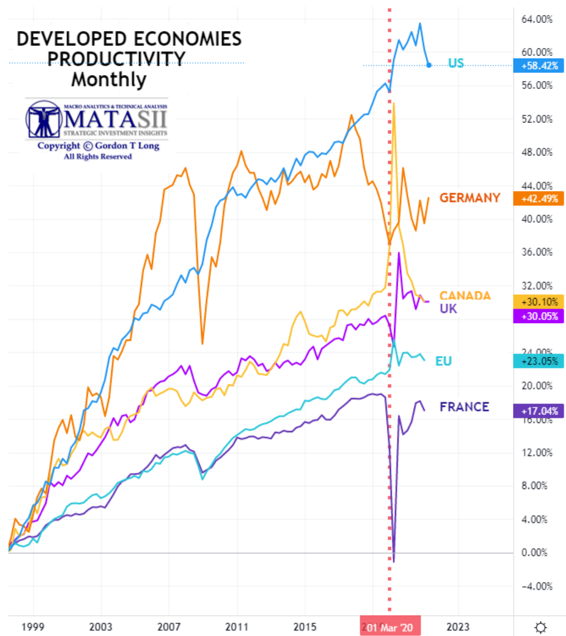
DECLINING PRODUCTIVITY

We studied this problem in detail in 2022.

> See: UnderTheLens - 08 24 22 - SEPTEMBER –
> US Labor Market In Productive Decline

Nonfarm productivity declined at a 4.6% annualized rate in the second quarter 2022, marking the second consecutive decline. The trend in productivity growth has worsened compared to prior to the pandemic, and the surge in unit labor costs makes the Fed's challenge of getting inflation back down to its 2% target all the more challenging. Frankly, I don't recall seeing Productivity charts going **NEGATIVE before?**



The 2022 second quarter's contraction comes on the heels of the sharpest decline in 74 years, which was negative 7.4% in Q1. Smoothing through the see-saw ride of quarterly productivity growth the past year suggests it has worsened compared to before the COVID-19 pandemic.

Productivity growth was down at an annual rate of -0.4% over the past four quarters compared to the pre-pandemic average increase of 1.3%. Weak productivity growth makes the Fed's inflation challenge even harder. If workers are more productive, companies can afford to pay them more without pressuring profits or fueling a wage-price spiral. This isn't what we're seeing today.

The Fed simply can't get to 2% inflation with this sort of productivity and wage growth.

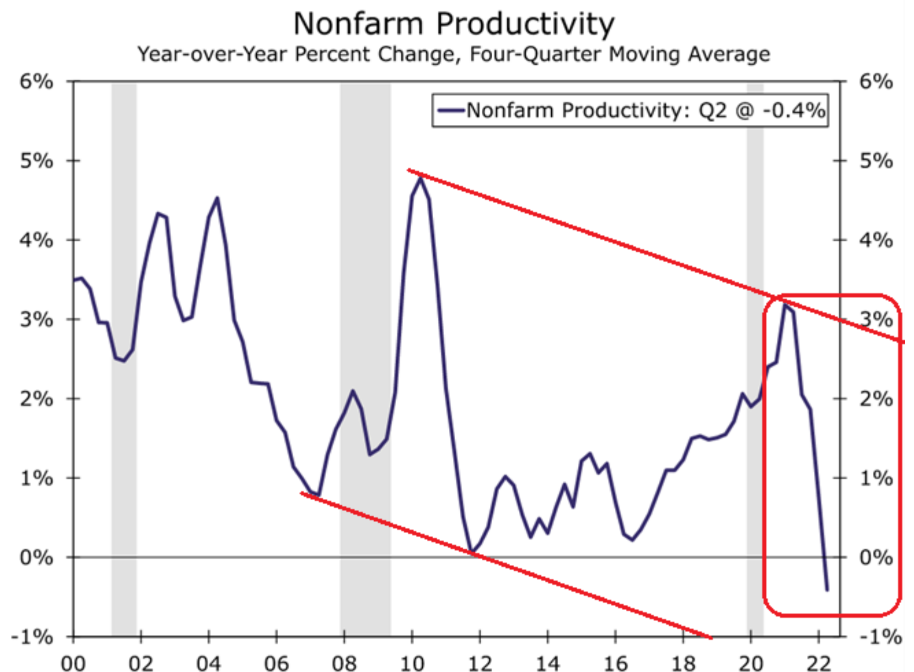
Labor costs tend to be a stickier contributor to inflation, thus the Q2 productivity data position forces the Fed to continue on its tightening path until it sees wage growth subside and inflation moving meaningfully lower.

The reasons labor productivity has collapsed range far and wide. But they all come back to a few critical elements:

1. Over Regulation,
2. Over Taxation,
3. Monetary Expansion,
4. Credit Market Manipulation, and
5. A near total intervention of economic and business life by a grossly out of control "Tax & Spend" Regulatory State.

Remember, production determines consumption. Production has collapsed.

An extended period of economic decline will follow.



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FALLING PURCHASING POWER OF US$ & FIAT CURRENCIES

In 2022 we witnessed one of the largest surges in the US Dollar in decades. It was driven by:

- The Federal Reserve's aggressive monetary tightening of the Fed Funds Rate (March) and launching Quantitative Tightening (QT – June),
- A perceived flight to safety as most major currencies suffered against the US$ for economic slowing reasons.

However, in late September 2022 the US began retracing the rise quite rapidly.

We believe we are now beginning to experience some of the elements we laid out in the video:

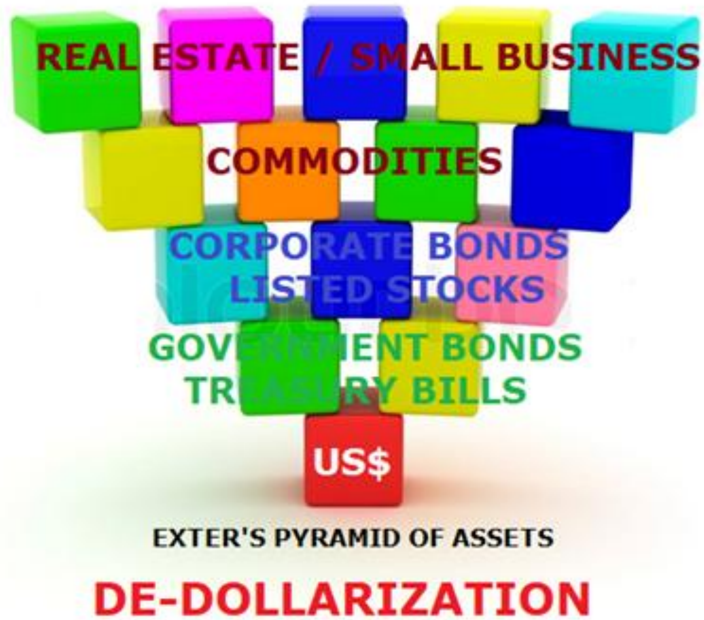
07-22-20-UnderTheLens-August-
The Coming US Dollar Devaluation

In that video produced as Covid-19 began to take hold and before Supply Chain shortage began making an inflationary impact, we warned of the fallout being a shift towards "De-Globalization". We believed this would eventually involve the reduction of dependency on foreign supply chains and growing De-Financialization. This would lead to a weakening US Dollar when coupled with a growing De-Dollarization, as the need for US Dollar denominated global reserves would be reduced.

DE-DOLLARIZATION

The weaponization of the US Dollar through its use as a foreign policy weapon in the form of sanctions has put in a motion a global shift away from the US Dollar. We spelled this out in:

2019 THESIS PAPER – DE-DOLLARIZATION



Since then the sanctions against Russia in response to the Ukraine War were a serious financial blunder accelerating what we warned of in our 2019 Thesis Paper.

By using the SWIFT system to cripple the Russian Central Bank, global central banks began to believe that the use of the US Dollar for their FX Reserves left then exposed to US hegemony.

With Saudi Arabia's shift away from the 1970 enacted rules around the creation of the Petrodollar and an increasing move towards settling Oil imports in non US dollar funds (i.e. PetroYuan) the die has been cast for a highly likely falling dollar during this decade.

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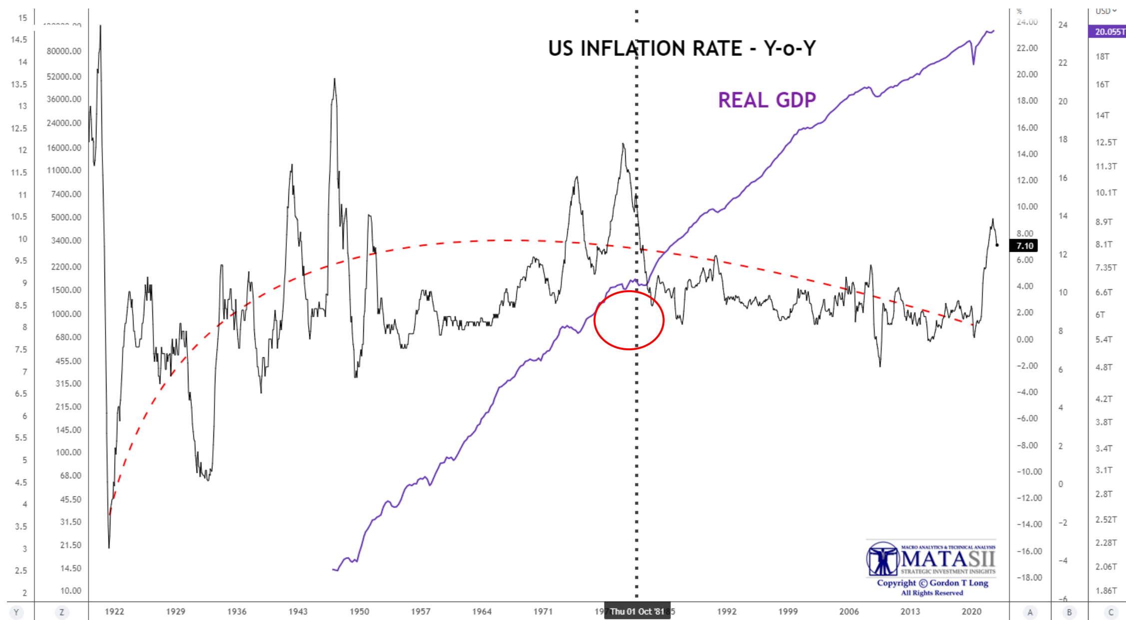
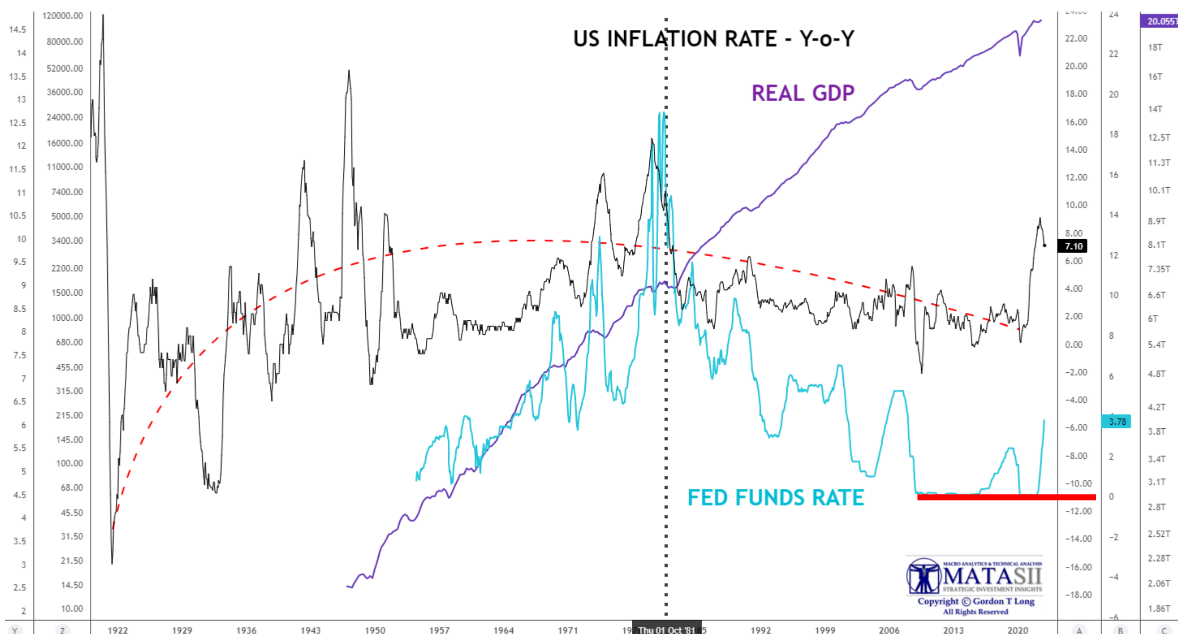
THE GROWTH ELEMENT

Two of the three key elements of Stagflation are Inflation and Economic Growth. When we compare them over a long period of time, a number of observations can be made.



- US Economic growth is seen to be extremely strong even when plotted on a log scale. However careful analysis shows it briefly leveled off near the end on the 1970's (red circle above).
- This closely aligns with the beginning of the Great Moderation when once again economies continued to steadily advance.
- We can see this was preceded with over a decade of rising Inflation (three peak cycles) that began with spending to financing the Vietnam War (the first War financed by credit), President Lyndon B. Johnson's Great Society (financed with fiscal deficits) and in 1971 when the US Dollar officially becoming a fiat currency when President Richard took the US off the Gold Standard.

When we overlay the results of Fed Chairman Paul Volcker's Inflation policies we see the following:



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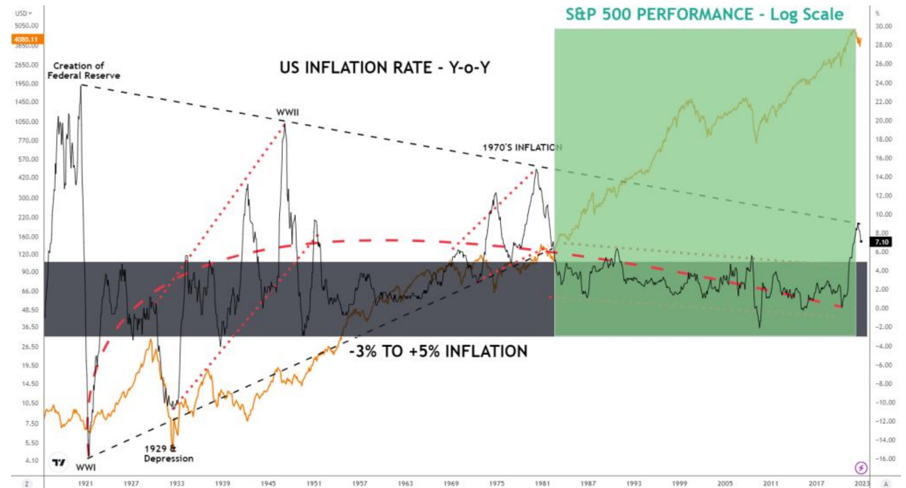
- US Economics Real GDP growth continued its upward trajectory as the Fed Fund Rate and US financing rates steadily continued to fall for the next 40 years.
- Zero Bound rates for over a decade starting as a solution came to an end at the end of 2021 when Inflation suddenly surged and the Fed Funds Rate was forced into increasing (see red bar).

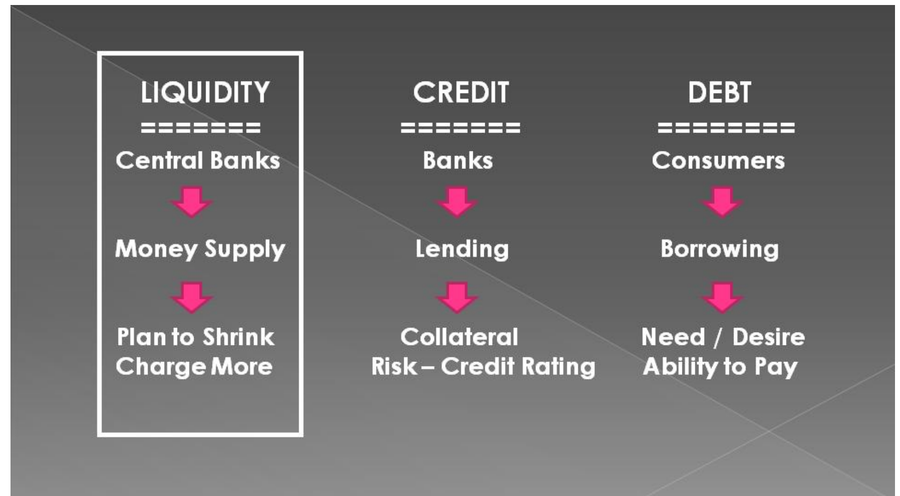
LIQUIDITY, CREDIT, DEBT, COLLATERAL & LENDING RISK

The Green area in the chart to the right shows the sustained rise in real US GDP during the era of the Great Moderation. This was the direct result of a financial environment that drove liquidity, credit, debt and accessible collateral while containing perceived lending risks.



1- LIQUIDITY, CREDIT & DEBT GROWTH

According to Morgan Stanley, the world's top central banks are embarked on "the largest quantitative tightening in history", estimating that $2.2 trillion worth of support would disappear over the 12 months ending in May 2023. A surge in global inflation is forcing the European Central Bank, Bank of Japan and Bank of England (BoE) to reel in the support measures used during the corona virus pandemic. Morgan Stanley further pointed out that G4 central bank by reducing their balance sheets by a further $2.2 trillion would be 4.5 times larger than that in 2018 when ~$500 billion was lost.



Through Quantitative Tightening the Fed's current plan calls for the destruction of $1.25 trillion or 14% of all Dollars by the middle of 2023. That would reduce the size of the Fed's Total Assets from $8.9 trillion now to around $7.7 trillion by June 2023.

It is currently expected that the European Central Bank's (ECB) balance sheet will actually shrink faster than the Fed's from May 2022 to May 2023, given less liquidity via TLTROs. This is because of the ECB's ultra-cheap and unlimited funding provision to euro zone banks. The monthly net purchases under the APP (Asset Purchase Program) of Corporate and Covered Bonds from banks will decrease significantly.

In the 21st century, Liquidity determines the direction of asset prices.
However, CREDIT growth drives economic growth.

Much tighter Monetary Policy will cause Credit Growth to slow sharply and contract. Therefore, the chances of many countries, including the US, falling into Recession in 2023 are now significant. The recent dramatic inversion of the yield curve (5s30s right) supports this view as it is normally a precursor of a Recession.

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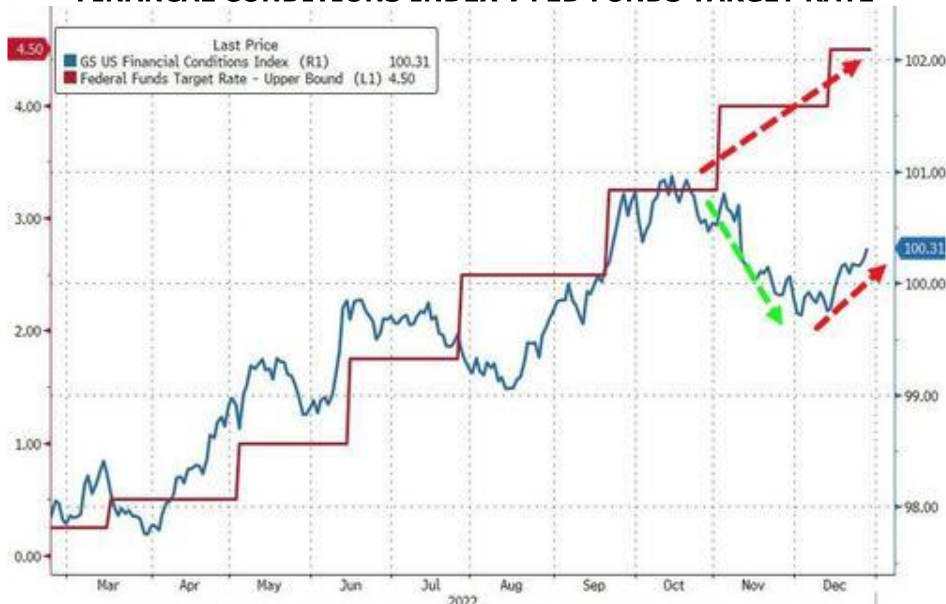
BANKS ARE WORRIED ABOUT SOMETHING!

- Banks and holders of cash are dramatically increasing their holdings of Reverse Repos (RRP) Balances at the Fed instead of lending it out.
- Commercial banks are significantly increasing their Loan Loss Reserves which are always a clear sign that they see defaults and loan delinquencies ahead.
- Loan & credit officers are steadily tightening lending Standards.
- The Federal Reserve has been steadily tightening Financial Conditions as seen by the Financial Conditions Index (below).

FINANCAL CONDITIONS INDEX v FED FUNDS TARGET RATE



2- COLLATERAL

There is an increasing problem with available unencumbered collateral to secure credit and debt. Additionally, there is a growing worry of the quality and reliability of the collateral because of the broad use of Rehypothecation.

> **REHYPOTHECATION:** A practice whereby banks and brokers use, for their own purposes, assets that have been posted as collateral by their clients. Pledging a valuable asset as collateral for the loan gives the lender security in the event that the borrower does not adhere to the terms of the loan agreement. In a hypothecation agreement, the borrower retains ownership of the pledged asset while the lender places a lien on the asset.

3- LENDING RISK

Lending Risk is the potential loss arising from a bank borrower or counterparty failing to meet its obligations in accordance with the agreed terms. This is increasingly showing itself with; i) Rising Credit Default Swap (CDS) rates, ii) OIS-FRA spreads, iii) the Ted Spread, iv) HY Spreads, v) Covlite tightening and vi) Derivative pricing. This signals lenders don't trust third parties, other banks or other lenders.

Expect the US and Global Economies to slow dramatically in 2023 and coming years, **barring a dramatic resurgence in central bank liquidity or government credit creation (though credit guarantees).**

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IMF PROJECTIONS

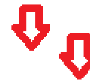
International Monetary Fund Managing Director Kristalina Georgieva warned on [CBS's 'Face the Nation'] in an interview aired on Jan. 1 that a third of the global economy will be in recession this year and investors must prepare for "a tough year, tougher than the year we leave behind." Kristalina explained recession risks are elevated "because the three big economies, US, EU, China, are all slowing down simultaneously." She added that some countries will avoid recession, though "it would feel like a recession for hundreds of millions of people."

"Our big worry is that with the economy slowing down globally, we are projecting global growth to go down to 2.7%, maybe even lower next year," she said. In 2021, global growth was 6%. It slumped to 3.2% in 2022 and continues to decline as central banks worldwide unleash the most aggressive monetary policy tightening scheme in a generation to get inflation under control.

Georgieva added the US might avoid a recession, but the situation looks bleaker in Europe, which has been hit hard by the war in Ukraine, she said. "Half of the European Union will be in recession," she warned.

Latest World Economic Outlook Growth Projections

SERIOUS REDUCTIONS!



(real GDP, annual percent change)	2021	PROJECTIONS 2022	2023
World Output	6.0	3.2	2.7
Advanced Economies	5.2	2.4	1.1
United States	5.7	1.6	1.0
Euro Area	5.2	3.1	0.5
Germany	2.6	1.5	-0.3
France	6.8	2.5	0.7
Italy	6.7	3.2	-0.2
Spain	5.1	4.3	1.2
Japan	1.7	1.7	1.6
United Kingdom	7.4	3.6	0.3
Canada	4.5	3.3	1.5
Other Advanced Economies	5.3	2.8	2.3
Emerging Market and Developing Economies	6.6	3.7	3.7
Emerging and Developing Asia	7.2	4.4	4.9
China	8.1	3.2	4.4
India	8.7	6.8	6.1
ASEAN-5	3.4	5.3	4.9
Emerging and Developing Europe	6.8	0.0	0.6
Russia	4.7	-3.4	-2.3
Latin America and the Caribbean	6.9	3.5	1.7
Brazil	4.6	2.8	1.0
Mexico	4.8	2.1	1.2
Middle East and Central Asia	4.5	5.0	3.6
Saudi Arabia	3.2	7.6	3.7
Sub-Saharan Africa	4.7	3.6	3.7
Nigeria	3.6	3.2	3.0
South Africa	4.9	2.1	1.1
Memorandum			
Emerging Market and Middle-Income Economies	6.8	3.6	3.6
Low-Income Developing Countries	4.1	4.8	4.9

Source: IMF, *World Economic Outlook*, October 2022

Note: For India, data and forecasts are presented on a fiscal year basis, with FY 2021/2022 starting in April 2021. For the October 2022 WEO, India's growth projections are 6.9 percent in 2022 and 5.4 percent in 2023 based on calendar year.

INTERNATIONAL MONETARY FUND IMF.org

NOTE:
The IMF has a record of always being overly optimistic in their Economic Outlooks. For them to call this degree of slowdown is unprecedented in my years of following them.

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"For the first time in 40 years, China's growth in 2022 is likely to be at or below global growth. That has never happened before. And looking into next year for three, four, five, six months, the relaxation of COVID restrictions will mean bushfire COVID cases throughout China," she said.
Georgieva warned the world is "more shock-prone" than ever before. An energy crisis is plaguing the world -- national security issues in Europe and Asia and liquidity issues in the banking system. The shocks of Covid are still not over though global supply chain congestion is receding.

Georgieva's comments are alarming for investors hoping for a soft economic landing this year. The latest figures over the weekend pointed to more weakness in the Chinese economy.

The official purchasing managers' index for China's factory activity shrank for the third consecutive month in December despite reopening efforts. The downturn is also visible in the purchasing managers' index for manufacturing worldwide, slipping into a contraction in September.

WORLD BANK PROJECTIONS

In mid-year 2022 the World Bank slashed its global growth outlook for 2022 and 2023 to +2.9% and +3.0% respectively blaming "the war in Ukraine, lockdowns in China, supply-chain disruptions, and the risk of stagflation" for hammering growth.

In January 2023 in its latest report on global economic prospects, The World Bank has slashed its growth forecast for 2023 by almost a half to just +1.7%, led by weaker growth in all the world's top economies — the United States, Europe and China.

"Global growth has slowed to the extent that the global economy is perilously close to falling into recession," World Bank.

That would mark the third-weakest pace of global growth in nearly three decades, overshadowed only by the 2009 and 2020 downturns.

The World Bank called on global central banks to remain alert to the risk that aggressively tightening monetary policy to fight inflation could spill across borders. The new report called for discussions between central bankers to "help mitigate risks associated with financial stability and avoid an excessive global economic slowdown in the pursuit of inflation objectives."

"Weakness in growth and business investment will compound the already devastating reversals in education, health, poverty, and infrastructure and the increasing demands from climate change," said David Malpass, president of the World Bank.

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*For now, those central bankers are facing their nemesis... **Stagflation...***

Though the United States might avoid a recession this year - the World Bank predicts the U.S. economy will eke out growth of 0.5% - global weakness will likely pose another headwind for America's businesses and consumers, on top of high prices and more expensive borrowing rates.
The United States also remains vulnerable to further supply chain disruptions if COVID keeps surging or the war in Ukraine worsens.

And Europe, long a major exporter to China, will likely suffer from a weaker Chinese economy, projecting that the EU's economy won't grow at all next year after having expanded 3.3% in 2022.

It foresees China growing 4.3%, nearly a percentage point lower than it had previously forecast, and about half the pace that Beijing posted in 2021.

"The risks that we warned of six months ago have materialized and our worst-case scenario is now our baseline scenario. The world's economy is on a razor's edge and could easily fall into recession if financial conditions tighten." Ayhan Kose, the World Bank economist responsible for the report

If the World Bank's gloomy prognosis was realized, the current decade would become the first since the 1930s to experience two global recessions.

The report follows a similarly gloomy forecast a week earlier from Kristina Georgieva, the head of the IMF, the global lending agency. Georgieva estimated on CBS' "Face the Nation" that one-third of the world will fall into recession this year.

BLACKROCK

BlackRock, the world's largest investment manager, has also warned a recession is imminent due to central banks aggressively boosting borrowing costs to tame inflation. According to a team of BlackRock strategists, their actions will ignite more market turbulence than ever before.

"Recession is foretold as central banks race to try to tame inflation. It's the opposite of past recessions," the team wrote in their 2023 Global Outlook, which said that the global economy has already exited a four-decade period of stable growth and inflation, and has now entered a period of heightened instability.

And when things get bad, BlackRock said, "Central bankers won't ride to the rescue when growth slows in this new regime, contrary to what investors have come to expect. Equity valuations don't yet reflect the damage ahead."

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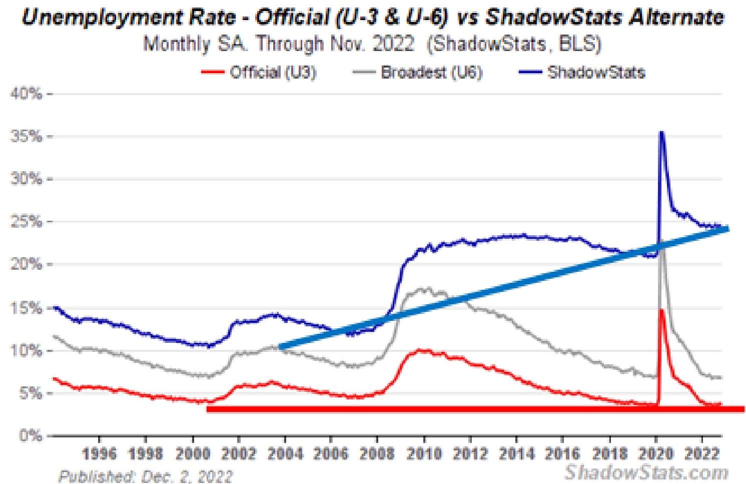
THE UNEMPLOYMENT ELEMENT

Full employment is one of the Federal Reserve's primary mandates. There are a number of measures for the US Unemployment Rate that is artfully used to hide harsh realities of what is going on from public scrutiny.

Shadowstats reports the chart to the right as reality. It has the unemployment rate at approximately 25% if the US government was consistent in its classifications over a multi-decade period of time.



Even pro-government players like Blackstone *(leading spokesperson for government's policy of ESG)* suggest a proper view of the US unemployment rate is as shown below (bottom right).

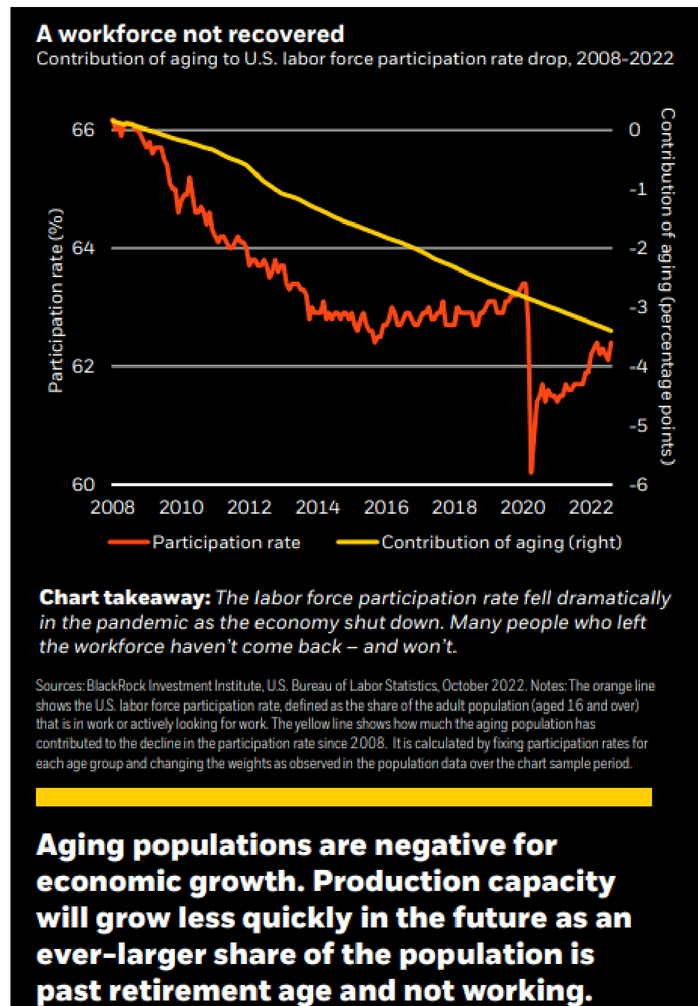
We examined US demographics fairly closely in 2022 when we studied the reasons for plunging US productivity data.

UnderTheLens - 08 24 22 - SEPTEMBER – [US Labor Market In Productive Decline]

It became clear during the research investigation that the US Labor market is under profound change:

- Gen X, Y (Millennial), and Z (Zoomer) have significantly different views and expectations of work,
- Pervasive attitudes like Quiet Quitting, demands to be able to work from home or limited hours worked as a professional are all increasingly under attack,
- Mismatch of the practical skills of college graduates versus what the labor market requires,
- Shortage of certified trades personnel,
- Companies' lack of investment in training coupled with employee turnover,
- The impact of an experienced Baby Boomer Generation without trained backfills,
- Lost skills as the manufacturing worker pool in the US has effectively been "gutted",
- A "Living Wage" with the burden of student loans, unaffordable shelter, limited medical and retirement coverage etc.,
- Immigration policy restrictions,
- Toxic work environments from poorly trained management,
- Burn-out and frustration from being expected to do more and more with less and less.

These and many other factors are increasingly making it difficult for US based corporations to compete globally. The US is quickly losing its competitive edge as educated workers are available in many lower paying countries.



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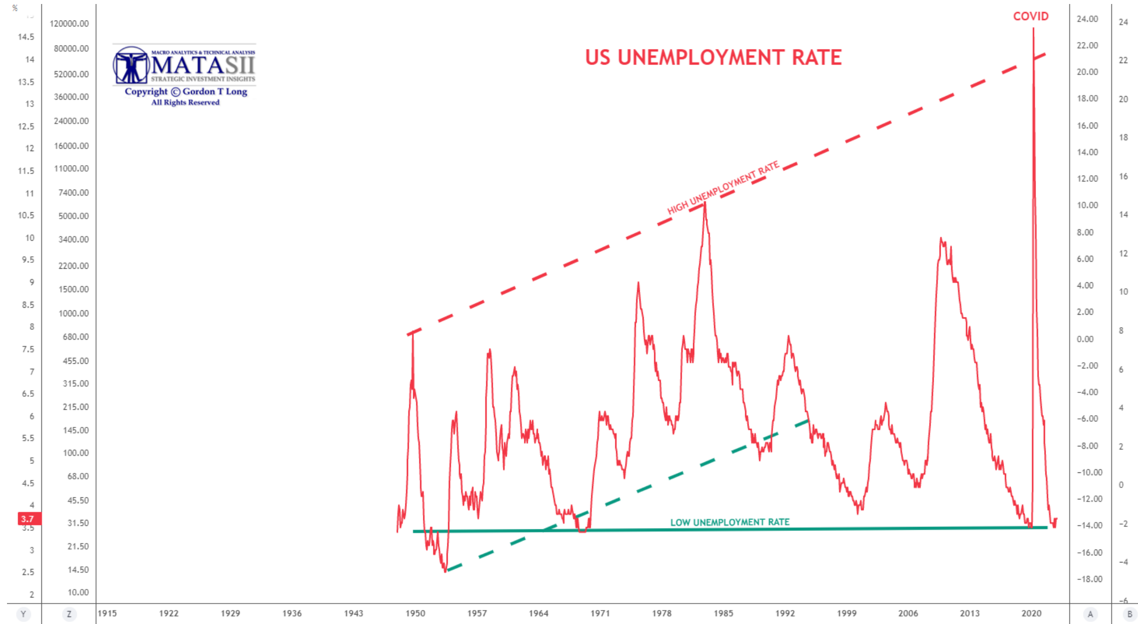
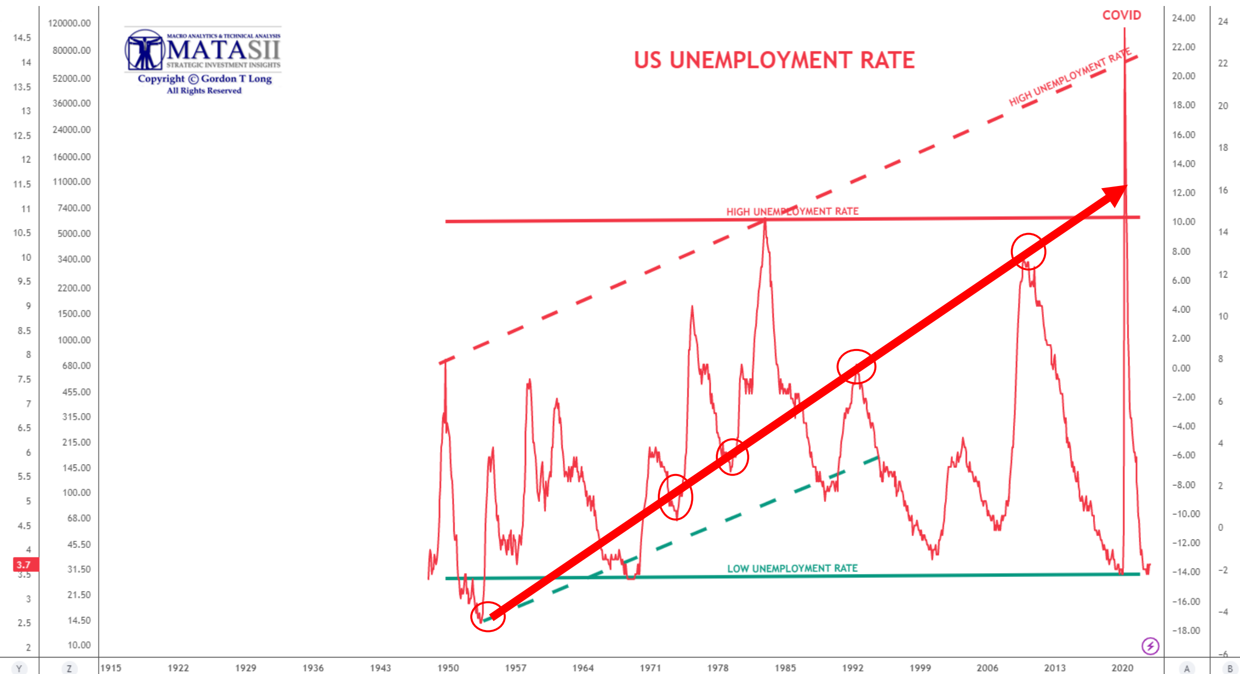
The following graphics use the officially 'messaged' US unemployment rate. It still can't hide the realities of what is happening in the US labor market.

We see the following:

- The Unemployment rate has been steadily rising over a longer period of time, despite a rapidly rising Participation rate, as the US effectively de-industrializes with over 54 thousand manufacturing facilities having left the US for China and more competitive Asian locations.



- The red bar below shows an upper limit of 10% Unemployment rate, recently broken by Covid-19, reached during the 1980-1982 Volcker created Inflation fighting recession.
- The red arrow below shows the actual trend underway and actual levels achieved during the 2008 Financial Crisis and assuming Covid-19 to be an "outlier".



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GROWING HIDDEN COST OF UNEMPLOYMENT

The Labor Force Participation Rate is defined by the Current Population Survey (CPS) as "the number of people in the labor force as a percentage of the civilian non-institutional population […] the participation rate is the percentage of the population that is either working or actively looking for work."

Participation Rate means a stealth drain on liquidity in circulation because **their cost of living and survival must be financed somehow**. Not necessarily through government transfer programs (like the additional massive growth in Disability payments by the government), but through their families' disposable income or savings.

Nothing compounds this stealth bleed faster than rising inflation costs.

EXPLODING US DISABILITY GROWTH

In the year 2019, an estimated 12.7 percent (plus or minus 0.05 percentage points) of non-institutionalized, male or female, all ages, all races, regardless of ethnicity, with all education levels in the United States reported a disability.

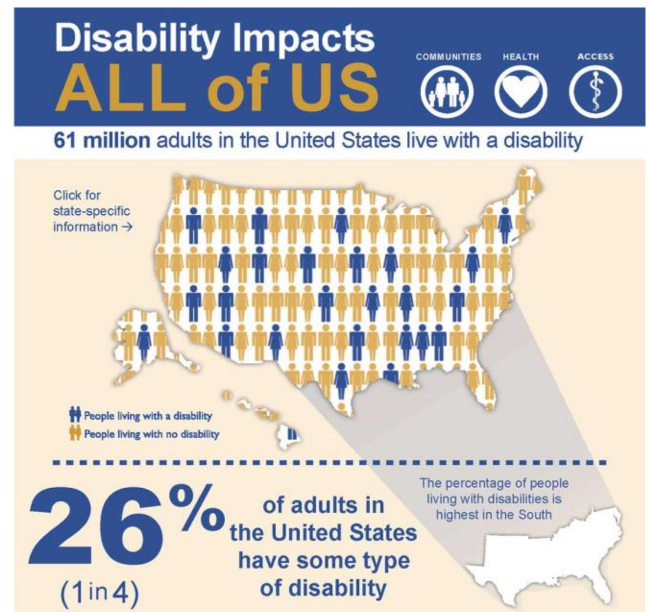
In other words, 41,207,700 out of 324,371,500 non-institutionalized, male or female, all ages, all races, regardless of ethnicity, with all education levels in the United States reported a disability.

It has been my personal observation that the fraud in disability claims is epidemic across the US with little to no discovery or media coverage.

MEDICAID

Nearly one-third of the country will soon be on Medicaid. The Foundation for Government Accountability (FGA), a think tank focused on welfare and health care policy announced it estimates that the number of Americans enrolled with Medicaid will cross the 100 million mark by March 2023. 21 million people would have previously been disqualified from the health care program prior to Biden Administration changes.

The employed US work force is now simply too small relative to those not working and living off the employed or government required deficit spending.



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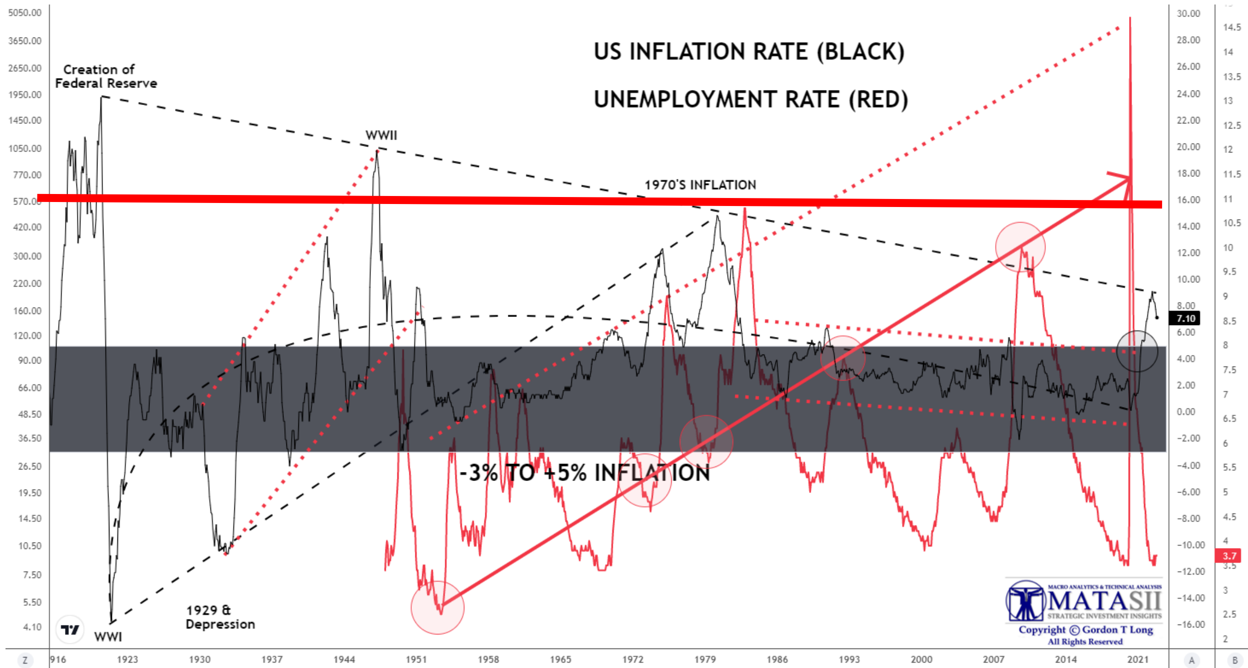
CONSTRAINED BOUNDARY CONDITIONS

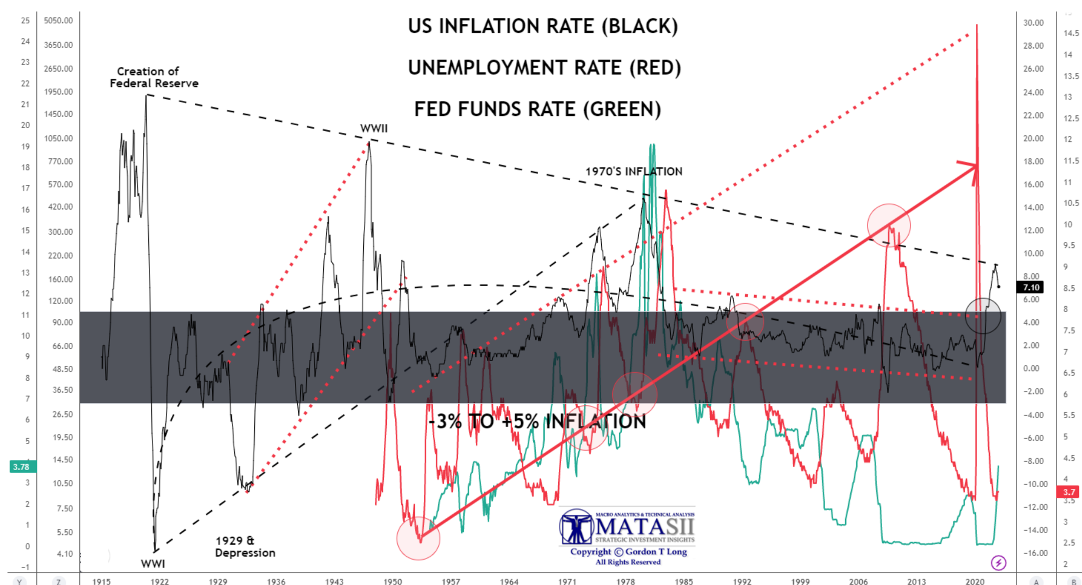
INFLATION + UNEMPLOYMENT

- When we overlay inflation (black lines) with the unemployment rate, we begin to see some strong correlations and shown by the red unemployment trend arrow.
- If inflation stays elevated (above 5% black shaded area), then there is a strong possibility that the official unemployment rate will surge through the 10% range.



INFLATION + UNEMPLOYMENT + FED FUNDS RATE

- This is particularly likely if the Fed Funds Rate (Green line) remains elevated in the Federal Reserve's fight against inflation. This is highly likely since the rate is still very low versus Inflation and what it will likely take to effectively fight it.



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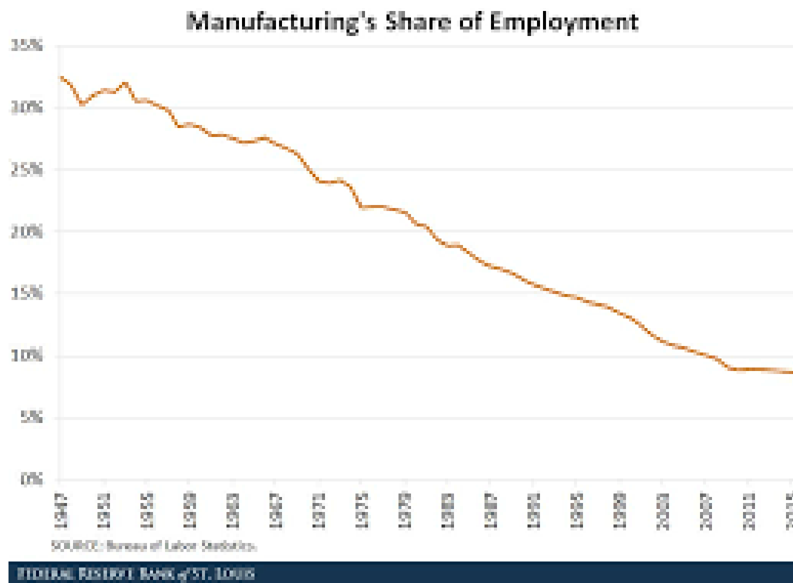
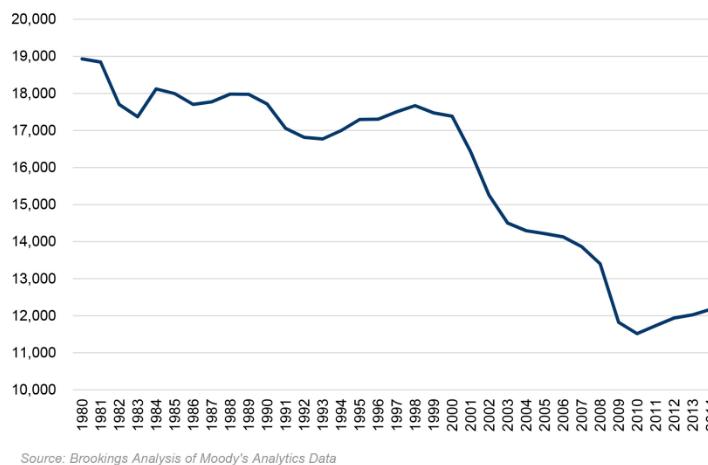
THE COST OF LOST EXPORT MANUFACTURING & SELLING SERVICES TO EACH OTHER

The commonly understood perception is that the US has shifted over the last 5 decades from being the dominant global manufacturer to becoming a Service Economy. Few take that point further by pointing out that this has meant destruction in high paying jobs with fewer Service Jobs that in aggregate pay less than the lost manufacturing jobs. Additionally, in aggregate the export revenue of the shift is a significant net loss to the US Economy.

It has taken a continuous reduction in interest rates to effectively avoid bankruptcy by financing employment in Zombie corporations and job creating mal-investment in Unicorns and high failure rate start-ups to keep unemployment from rising further than an already longer trend that has been rising despite this.

Precarious US employment rates has become increasingly dependent on low rates to sustain mal-investment and poorly capitalized employers. Any de-stabilizing financial stress has the potential to send unemployment trough the roof!





B | Metropolitan Policy Program at BROOKINGS

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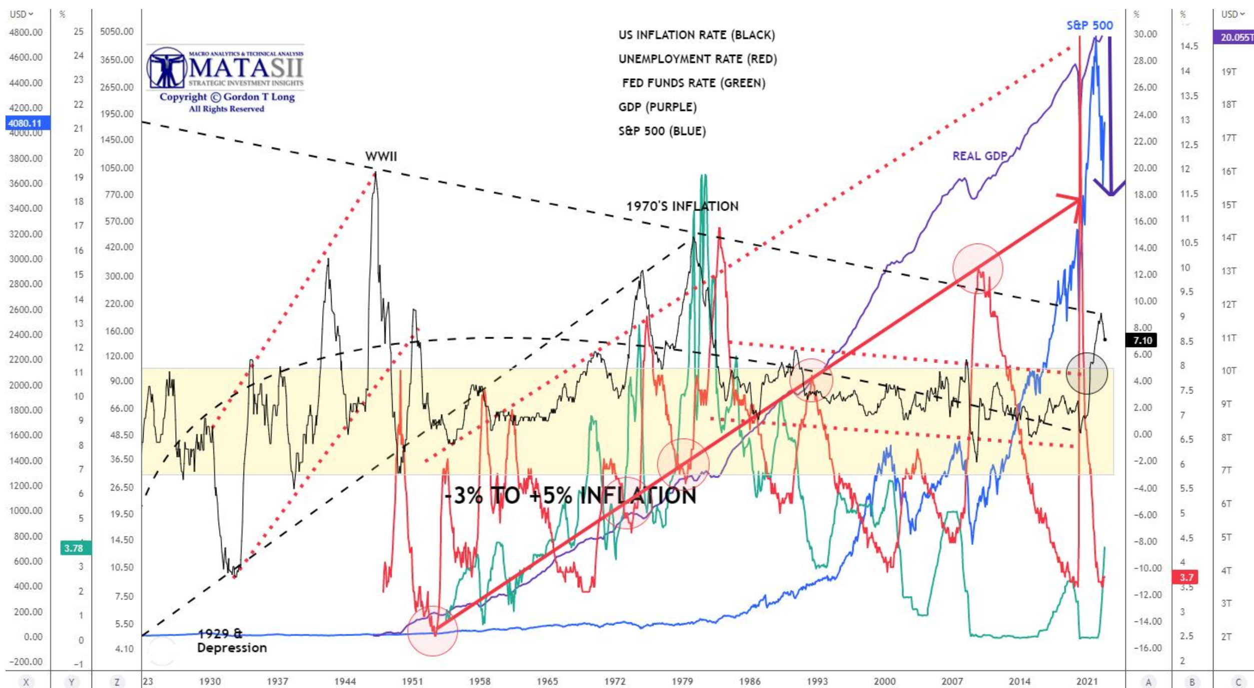
MACRO ANALYTICS & TECHNICAL ANALYSIS
MATASII
STRATEGIC INVESTMENT INSIGHTS

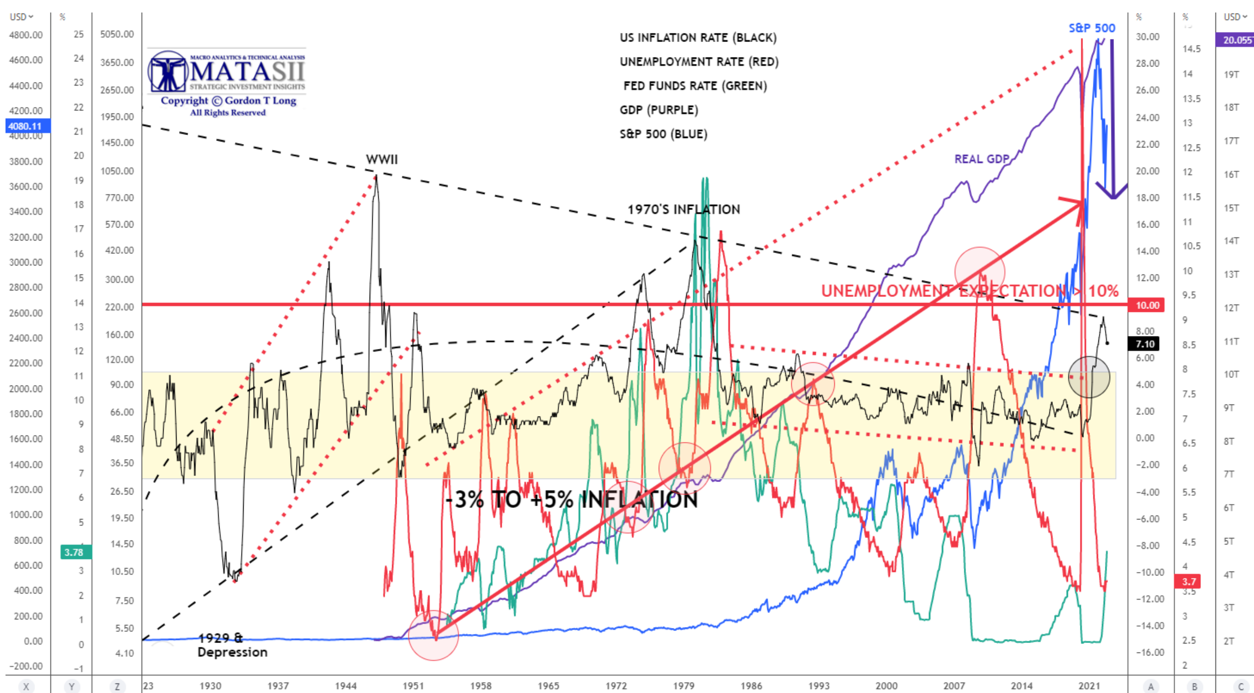
INFLATION + GROWTH + UNEMPLOYMENT

Dramatic drops in Fed Funds Rate to Halt Surging Unemployment Rates (Circled Spikes)

Precarious Employment has become increasingly dependent on low rates to sustain mal-investment and poorly capitalized employers.

Expect 7.5 to 9.5% Unemployment Rate.





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KEY ELEMENTS OF STAGFLATION AHEAD

ELEVATED INFLATION (+4%)

SLOW GROWTH (<1%)

MAJOR UNEMPLOYMENT (+10%)

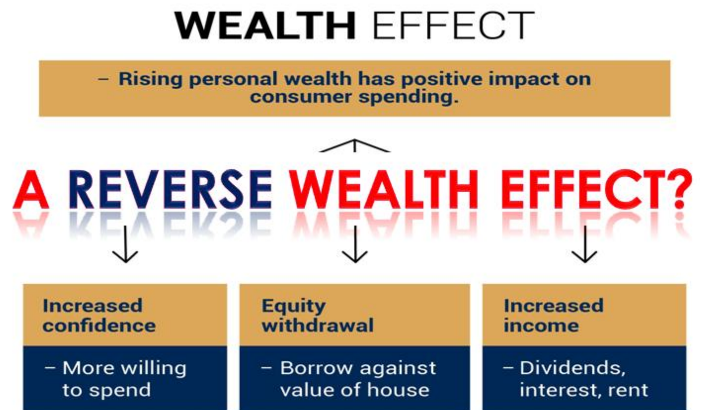
REVERSE WEALTH EFFECT

My colleague, Charles High Smith and I released a video in June of 2020 entitled: "A Reverse Wealth Effect".

When the Wealth Effect begins to crumble (falling equities and bond prices) within a weak economy, unemployment will eventually soar.

This is what will trigger a recession and the beginnings of real Stagflation. Presently, as we issue this paper in January 2023 the focus is presently on Inflation and Growth.

The real bellwether to watch is unemployment as layoffs are announced, because earnings will then being falling rapidly. That is likely to not be seen before mid 2023.



It will take ALL THREE – Inflation, Economic Growth and Unemployment to deliver the Great Stagflation.

There is likely to be a lot of confusion at that point, because it is highly likely the US Federal Reserve will soon after pivot its policy at that point and reduce rates rapidly. The drawdown of QT will be considered complete at that point as the Fed Balance Sheet will have been reduced by its targeted amount.

Expect a new QE program to commence in 2024 with the markets already pricing it in by the summer of 2023.

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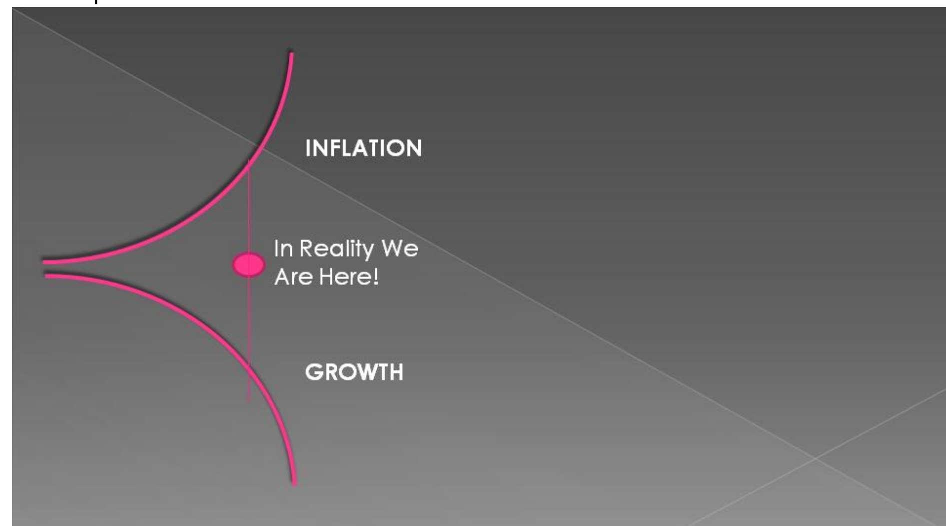
THE REALITY OF THE STAGFLATIONARY EVENT HORIZON

KEY MESSAGES

- A potential Stagflation problem is much bigger and much more intractable than most yet fully realize!
- The way to visualize what is occurring is to think of Stagflation as a potential Black Hole. It is easy to unwittingly and unsuspectingly get into, but extremely if not impossible to get out of once trapped in it.
- The hidden problem is that the distortions and reporting games we have been playing for a very long time, have let us get much too deep in the Black Hole than we understand, because our measures have failed to alert us of the reality of the situation.
- The political "Kick-the-Can-Down-the-Road" policy approaches have only fostered "tweaking" the warning measures to buy time and make it someone else's problem!
- Inflation through statistical distortions such as Hedonics, Substitution, Imputation and others which I have previously chronicled, have distorted Inflation as measured by the CPI to such a degree that Inflation, Inflation Breakevens and Real Rates are ineffective measures.
- Economic Growth is also seriously distorted by an obsolete formula that is based on sound money and adopted during the era of the gold standard and fails miserably to adequately describe real growth in an era of massive government debt, transfer payments and debt financed consumption now being nearly 70% of the economy.
- The creators of the simple formula never imagined an economy like the one we operate in today.
- The central problem and difference with what occurred in the 1970's is important to understand. We not only have an order of magnitude worse "black hole" problem, but our tools are dull and our thinking seriously obsolete. Our politically polarized governance is also a big problem!
- The intractable problems we are highly likely to face during the Great Stagflation can be laid at the feet of poor and ineffective political leadership within a blatantly corrupt political process. Decades of "Kicking-the-Can-Down-The-Road" to future elected leaders by altering reporting and distorting hard realities in the central problem will soon have to be faced!
- The continuous avoidance of reality has only made the problem much bigger than it ever needed to be. The delay may in fact unfortunately possibly lead to the economic and financial collapse of America as the world presently knows it!



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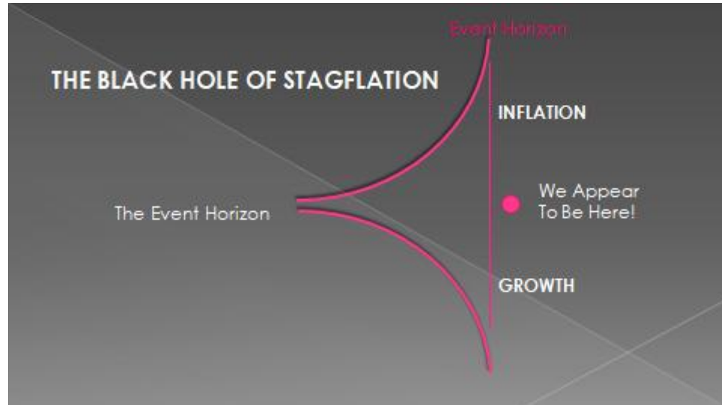
Stagflation may in fact soon be felt throughout the developed economies! There is little doubt a Recession is on the horizon, but the question of an era of Stagflation is not too many – at least yet!

To me what is centrally important is to understand that today a potential Stagflation problem is much bigger and much more intractable than most yet fully realize!

The way to visualize what is occurring is to think of Stagflation as a potential Black Hole. It is easy to unwittingly and unsuspectingly get into, but extremely if not impossible to get out of once trapped in it.

The secret is to avoid it with sound economic policies before you reach the "Event Horizon"!

Many knowledgeable money managers perceive we are potentially entering such a situation.



The reaction by central bankers and those in control of Monetary Policy is to apply traditional Keynesian thinking to the problem. But in this case it doesn't work!

What must be done to control Inflation crushes growth.

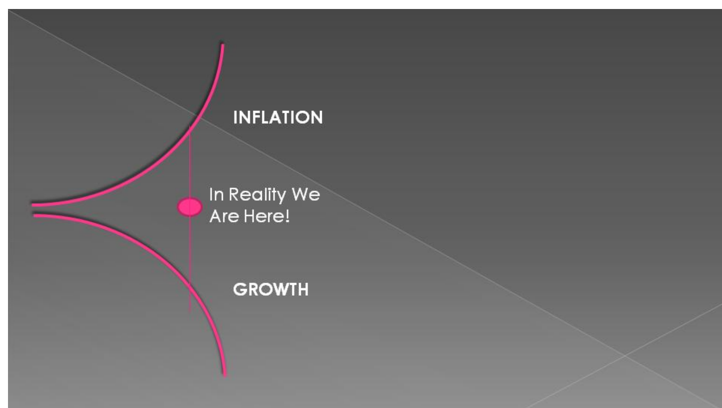
What must be done to foster growth inflames Inflation!

It is the proverbial "Catch 22".

The solution therefore is you must identify it early and act aggressively.

The hidden problem is that the distortions, and reporting games we have been playing for a very long time, have let us get much too deep in the Black Hole than we understand, because our measures have failed to alert us of the reality of the situation.

The political "Kick-the-Can-Down-the-Road" policy approaches have only fostered "tweaking" the warning measures to buy time and make it someone else's problem!



Let me be specific.

Inflation through statistical distortions such as Hedonics, Substitution, Imputation and others which I have previously chronicled have distorted Inflation as measured by the CPI to such a degree that Inflation, Inflation Breakevens and Real Rates are ineffective measures.

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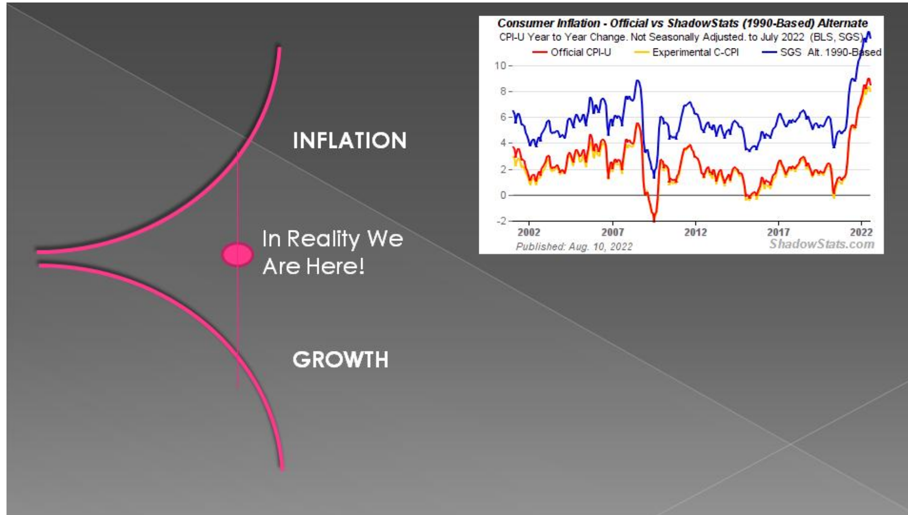
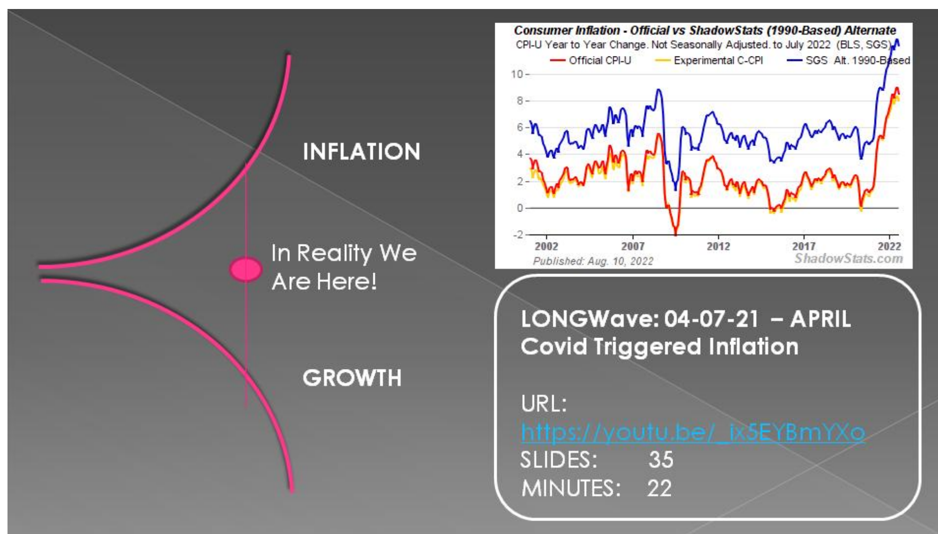
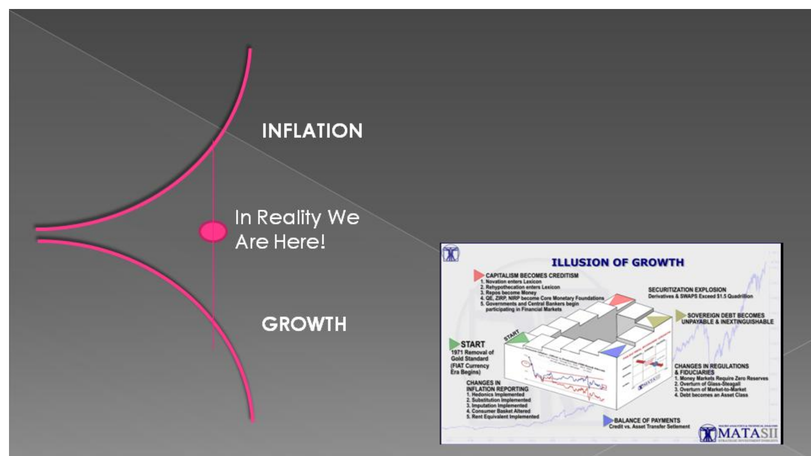


I laid out how the new world of Inflation Swaps has exploded in an attempt to protect the more sophisticated institutional investors from these mirrors and mirages.



Economic Growth is also seriously distorted by an obsolete formula that is based on sound money and adopted during the era of the gold standard and fails miserably to adequately describe real growth in an era of massive government debt, transfer payments and debt financed consumption now being nearly 70% of the economy.

The creators of the simple formula never imagined an economy like the one we operate in today.



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Our 2017 Thesis paper entitled "The Illusion of Growth" lays out the indisputable reality of the facts in its 111 pages of detailed analysis.

The central problem and difference with what occurred in the 1970's is important to understand. We not only have an order of magnitude worse "black hole" problem, but our tools are dull and our thinking seriously obsolete. Our politically polarized governance is also a big problem!

INFLATION
In Reality We Are Here!
GROWTH
2017 ILLUSION OF GROWTH
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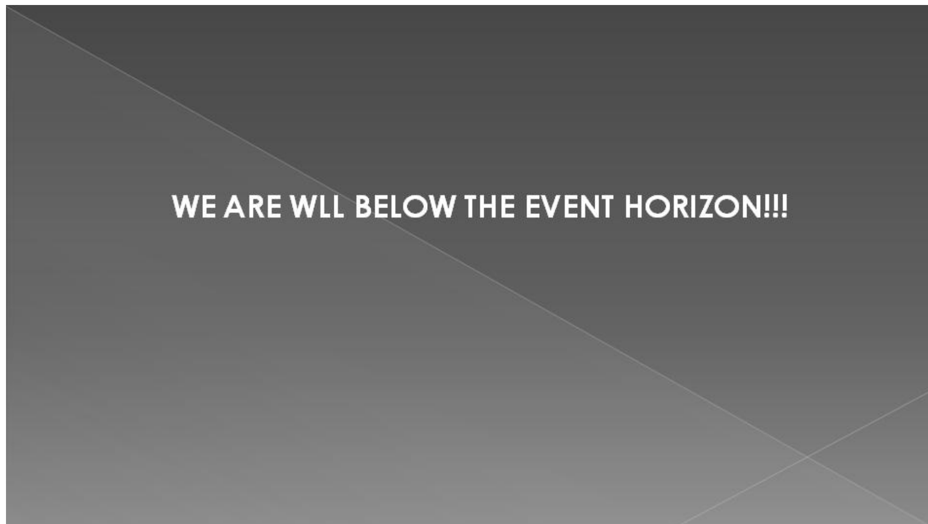
111 Pages
ILLUSION OF GROWTH

The simple truth and reality is that the US is highly likely to already be well below the event horizon!



POLICY FAILURE

The intractable problems we are highly likely to face during the Great Stagflation can be laid at the feet of poor and ineffective political leadership within a blatantly corrupt political process. Decades of "Kicking-the-Can-Down-The-Road" to future elected leaders by altering reporting and distorting hard realities in the central problem will soon have to be faced!

The continuous avoidance of reality has only made the problem much bigger than it ever needed to be. The delay may in fact unfortunately possibly lead to the economic and financial collapse of America as the world presently knows it!

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CONCLUSIONS

"A Republic If You Can Keep It!"
Benjamin Franklin

KEY MESSAGES

- Though the rest of this decade will be challenging and fraught with political, economic and social changes continuously disrupting the stability of the financial markets it must be viewed in the proper context! It is what is required to resolve a historic global debt crisis and anchor fiat currencies as part of the required process of returning to a global platform of Sound Money.
- The US Standard of Living is likely to mirror the S&P 500 equity markets as measured by Household Net Worth as a Percentage of Disposable Personal Income during the next decade.
- Equity markets are headed lower primarily driven by slowing US consumer demand which initiates **a Reverse Wealth Effect**. A 70% consumption economy as over leveraged as the US has become while consuming more than it produced is finally testing the bounds of the global economy willing to continue to finance this massive world imbalance.
- In the short to intermediate term equity markets are likely to face a **major counter rally** when the Fed pivots and reverses Monetary Policy by; initially stopping rate hikes somewhere around a 5% terminal rate; then begin lowering the Fed Funds Rate as unemployment increases. By this time the QT target will have been met and halted (June 2023), at which time the Fed is likely to have already once again opened the liquidity spigots by increasing the Fed's balance sheet.

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THE HURDLE: A CONSUMPTION ECONOMY WITH A FALLING STANDARD OF LIVING

Over the next few years our analysis firmly indicates that:

1. LONGER TERM: Equity markets are headed lower primarily driven by slowing US consumer demand which initiates **a Reverse Wealth Effect**. A 70% consumption economy, as over leveraged as the US has become while consuming more than it produced, is finally testing the bounds of the global economy willing to continue to finance this massive world imbalance.

2. SHORT TO INTERMEDAITE TERM: In the short to intermediate term equity markets are likely to face a **major counter rally** when the Fed pivots and reverses Monetary Policy by initially stopping rate hikes somewhere around a 5% terminal rate; then begin lowering the Fed Funds Rate as unemployment increases. By this time the QT target will have been met and halted (June 2023), at which time the Fed is likely to have already once again opened the liquidity spigots by increasing the Fed's balance sheet.

This roadmap is likely to look something like the following for the S&P 500:

When we couple this with valuation projections in this document along with prior videos:

LONGWave-07-13-22-JULY-An-Earnings-Recession-Newsletter-3
URL: [MATASII'S Q2 EARNINGS GUIDANCE TRANSLATOR]

We should expect the following:

1. A US Consumer Led Recession,
2. The rapidly rising US$ will create a Global Credit Event,
3. When the Fed signals a shift to Rate Hikes, then the US Dollar will weaken,
4. US$ weakening will improve US Earnings & Exports, which improves an EPS Reversal.

Yield Curve Inversion Is Currently Signaling:
1. Fed Policy IS Wrong.
2. A Recession is occurring or close at hand.

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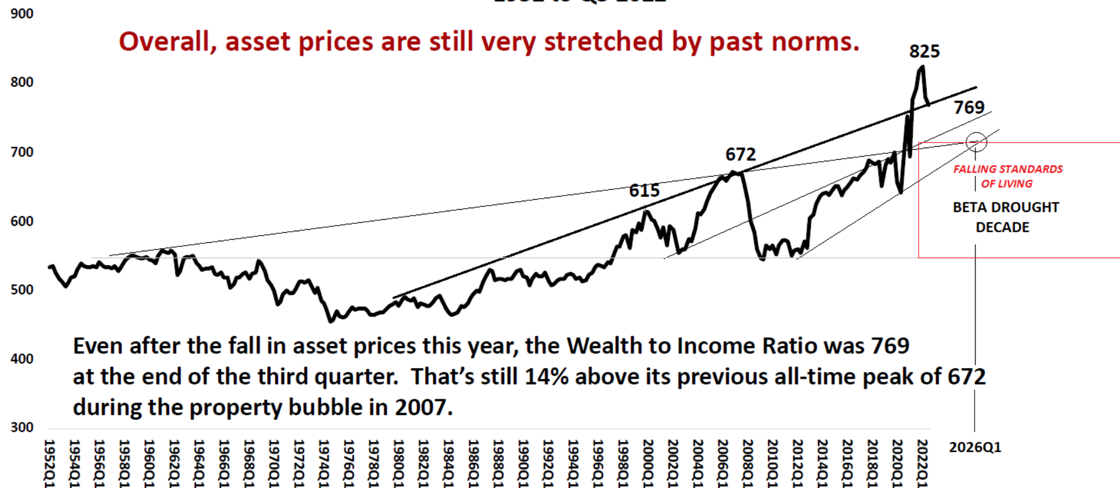
REVERSE WEALTH EFFECT

Charles Hugh Smith and I did a 42 minute video in 2020 on the strong possibility of an approaching "Reverse Wealth Effect". It appears that is what we should expect in 2023, but to be even more pronounced in 2024.

MACRO ANALYTICS - 06-04-20 - A Reverse Wealth Effect?
URL: https://youtu.be/_4ZXQzmabsc



The US Standard of Living is likely to mirror the equity markets as measured by Household Net Worth as a Percentage of Disposable Personal Income.

Technically, the impact is likely to look something like the following:

THE CORE PROBLEM: A DEARTH OF REAL LIVING WAGES

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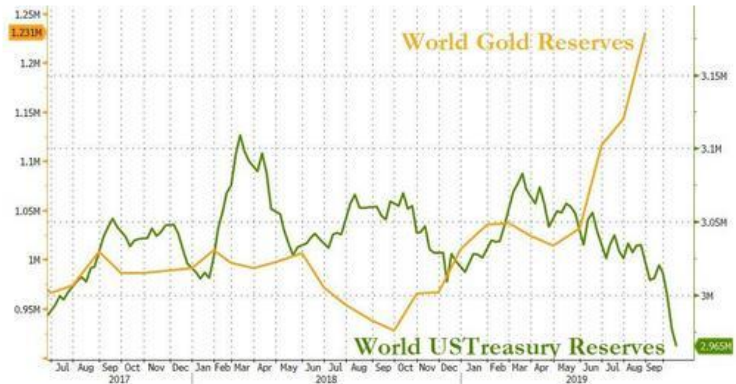
When we start getting "a lot less for more" (to be expected with larger governments) and jobs are increasingly lost with living wage jobs becoming hard to find, we are highly likely to see changing attitudes.

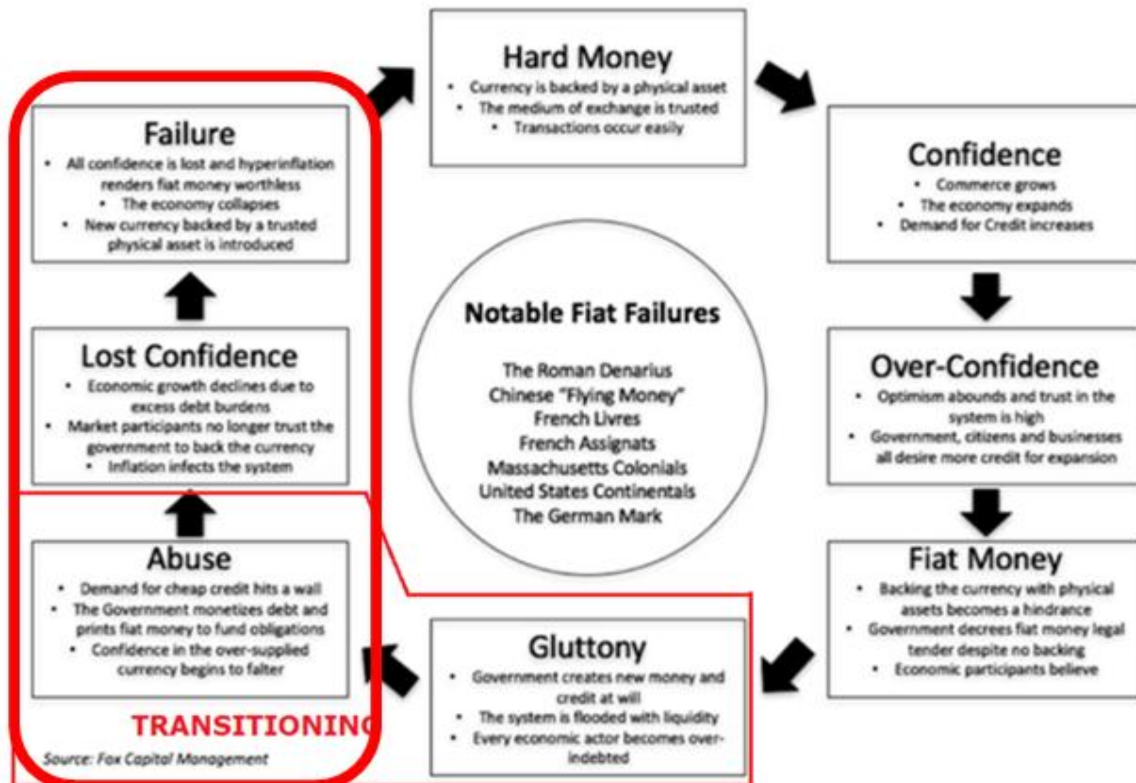
When I read that surveys of the Gen Z generation feel they need $171K to live the lifestyle they want and expect, it is clear we have labor problems ahead. This may be the one of the most serious problems the US will face as times get tougher. We could see a rebellion by the youth to pay for the Social Security and Medicare benefits of an aging and more affluent older generation.

THE TRANSITION BACK TO SOUND MONEY

Though the rest of this decade will be challenging and fraught with political, economic and social changes continuously disrupting the stability of the financial markets, it must be viewed in the proper context!

It is what is required to resolve a historic global debt crisis and anchor fiat currencies as part of the required process of returning to a global platform of Sound Money.





What will save the US and continue to make it a sought after place to invest and prosper?

- The US Constitution,
- Being a Republic with Separation of Powers &
- The Rule of Law.

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ALWAYS KEEP THIS IN MIND WITH MARKET PROJECTIONS

Extracted & edited from: *The Global Financial System Is A Rube Goldberg Machine by Bruce Wilds via Advancing Time blog,*

The global financial system is not a well-designed efficient machine. Instead, it is a cobbled-together mess all glued together in a haphazard way to get the job done. To make matters worse, this system is greased by the greed of those who benefit from stealing a little from here and there. In the real world, things are usually not intentionally designed to be complicated but the reality is that they just are.

This means that more often than we would like to admit, systems thrown together with various parts or pieced together haphazardly are prone to be unreliable. When we try to explain events in terms of cause and effect the bigger picture has a way of getting lost. Often hidden away is the risk that results when complex poorly built systems become codependent upon other poorly built systems. Bestselling author Nassim Taleb who wrote, "The Black Swan" detailed in his book how when something is highly complicated highly improbable and unpredictable events can and do occur.

History shows we often have no idea what is driving events until long after they have transpired and even then the picture is blurred by interpretation.

The lens by which we peer at events is firmly controlled by those with an agenda. These people control our government, big business, and mainstream media. When we look at the individuals leading these various factions we should feel little reason for faith or calm.

The Direction In Which Things Fall Matter

The problem with getting a good handle on what is about to happen is complicated by the massive number of variables built into events. For example, guessing what a central bank might do is one thing, however, how do you make allowances for the money created to stimulate the nation's economy rushing out of the country at the tap of a button or companies using the money to buy back stock or pursuing a leveraged hostile takeover rather than investing in a new plant and equipment. The argument could be made that central banks can stack the deck but when it gets too high and begins to fall they may not be able to control the direction or who it will crush.

Just because a market or investors have reacted in a certain way in the past is no guarantee that faced with a similar situation their response will be the same or that once we hit a tipping point a self-feeding loop will not develop and take control. We have become very complacent and accepted the idea those in power will continue being creative enough to keep the economy moving forward. This includes thinking they can prolong current trends. Like a complicated Rube Goldberg machine with many moving parts, the failure of just one piece to perform as expected can alter the way events unfold.

History is littered with many caution signs as to just how difficult it is to interpret current events and their possible impact on tomorrow. This makes it clear that looking in the rear-view mirror gives us a better image of events than predictions as to what might happen in the future. Part of this contraption that controls our world is the huge but hidden world of high-frequency trading algorithms, payment for order flow & dark exchanges. This coupled with such things as stock buybacks destroy true price discovery. My point is, it might be wise not to have a great deal of faith in our global financial system because not only is it highly leveraged but it is severely flawed.

In short, because of corruption and other issues, our current system does not even meet the criteria of a well-designed Rube Goldberg machine.

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