October 10, 2022

Dear Investor,

Last quarter, we started our letter with the point that we may well be wandering through our own volatile chapter in history, like many other countries, but not fully appreciating it.

This quarter, we bring the view local, covering 'the House Price' tracking calculation since homes are typically the largest asset owned next to retirement accounts and we can relate to home purchases. That analysis is found on the next page. Please look it over carefully.

In the meantime … since 2022 'market' performance just set an unfortunate record where it is the first time in history that **both** stocks and bonds have declined together for 3 straight quarters, let us reiterate that you first saw in Q4 2018 the central bank prove that its money printing hi-jinx cannot be removed from the system without crushing asset prices. 2022 has thus far shown quite clearly that money printing must continue or prices of stocks, bonds and real estate all dive. If you don't like 2022, key in on the two key points:

If a central bank, the Federal Reserve in our case, prints money, asset prices rise.

If the central bank removes money from circulation, asset prices fall.

That is basically it. That is pretty much all there is to it. The unelected group of people at the central bank (confirmed by your 'representatives' in DC) decided that in 2022 your asset values will decline (until they decide to print money once again). Most Americans assume that 1) the Fed will print again, and 2) it will work again.

The Fed has decided not only that Americans will have asset values decline, but many need to lose their jobs too … so they won't spend money … because there will be less of it, you see. They have stated both 'needs' (for the greater good), verbatim: 1) they will force asset prices down, and 2) people will lose jobs. The Fed has been **categorically wrong** about the **many** asset bubbles they have blown, **categorically wrong** about inflation being 'transitory' … and they will potentially be categorically wrong when they choose to print money once more.

We expect 'markets' to be tricky for some time to come. As the Fed withdraws from markets, the 'real' markets adjust. Real participants clearly do not like what the Fed is doing. Caution continues to be warranted, despite the furious 'short-squeeze' market rally that started October. Signs suggest more room to run through October, **but** that is Fed dependent and other signs have us on high-alert for further downside, perhaps substantial. The next pages convey the negative wealth-effect the Fed has on houses and some more color. Call us if we can review allocations and strategy at (614) 698-0333 (FFF) or e-mail info@f3advisors.com.

Best Regards,

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Detail

2022 is the **second monetary incident** (the first was Q4 2018), in which the Fed has shown asset prices flat out dive without relentless money printing and interest rate suppression. These concepts are not without consequence to your long-term financial well being.

Remember, our money is *backed by debt*. Everything printed that makes us happy today as asset prices climb, is taken from the future. That is how debt works, at least the debt that you and I have to deal with. What you borrow, you must pay back. The Fed pretends there will be no price to pay, ever. History books reveal that claim to be as **categorically wrong** as the many claims the Fed has made. Have you noticed that they have been wrong about most major claims? It is ironic that the jobs that will be lost do not include theirs, sad really.

On to housing, then we'll move on to the Fed's impact on retirement and investment assets.

Assume your child, recently out on their own, is house shopping. Paychecks, being relatively firm across the length of each year of work create your child's financial path. Anything not spent can of course be saved or invested. Your child, like most Americans, will park the majority of their wealth in two key places: 1) a home, and 2) retirement accounts.

Assuming they will pursue the goal of owning a home (and we know many who have recently bought them), the retirement savings will take the 2nd seat … anything left over goes there.

Below is what just happened ***in 9 months*** to the house your child is purchasing. Assume your child can afford roughly $1,900 per month for the house (other associated expenses like property tax, electricity and high speed internet not included):

Payment	Date	30 Yr Mtg Rate	Home Price	% Chg	Added Interest
$1,909	1/1/22	4.0%	$400,000	N/A	N/A
$1,909	4/3/22	5.0%	$355,500	-11%	+$43,542
$1,909	6/3/22	6.0%	$306,000	-24%	+$93,586
$1,909	**9/28/22**	**7.0%**	**$287,000**	**-28%**	**+$113,051**

You are seeing that correctly. In nine months, the Federal Reserve, in an effort to unwind the inflation **they primarily caused**, has moved to drive a simple mathematical equation that will severely punish anyone who has to borrow money from its banking empire, the one that pays you 1.0% (maybe) at your bank and charges you 25% on your credit cards.

Your child, as of September 28th, based on payment affordability will only be able to buy that same $400k house ***if the price drops*** -28%, bringing that house price down to **$287,000**. AND, in buying the house, instead of paying $287k interest, he/she will pay $400k interest, **$113,051** more **to banks**. People react 'that can't happen', but they likely ***just watched*** that same house price rise just that much over roughly six quarters into 2021 year end! The Fed was printing then, with low rates, now it is removing money and raising rates. Very simple.

That is where we are headed. And, yes, the **game** will be to try to buy the house at a lower price, as the Fed drives rates back down, the trick the Fed always uses once it smacks asset prices downwards again, and people lose jobs, and the quality of life lowers for many. The quality of life for those who do not own assets has suffered due to the inflation the Fed

primarily caused, and quality of life is reducing now for those who own assets; but much moreso for those who lose their jobs on top of it all. Greater good, you know.

On the plus side, US Treasuries, which have long been a 'safe investment' as we assume Uncle Sam can make good on repayment of the bonds (loans), are yielding in the **4%** area. Shorter term Treasuries (2-5 Year) are at that level. Longer Treasuries actually yield less than that, which reflects that bond investors think the Fed may indeed keep raising rates (as they have expressed), ***but*** by doing so they will collapse stock and real estate prices so they will then have to turn around and lower rates later (and no doubt print money again).

For 2018 context, the Fed last tried to lift rates above their long-term down-trend (which signifies the asset prices can only rise with low rates and printed money being endlessly supplied) in Q4 2018. The 10 Year Treasury that drives mortgages like those listed above, breached 3.15% and everything promptly fell apart. So … the Fed reversed course. Today, the 10 Year Treasury bond is yielding 3.9%, well above 2018's tipping point. **That rate** may well break everything, so do pay attention.

A rather reasonable assumption is that the preceding years of rising asset prices (since Fed Chairman Bernanke unleashed 'Quantitative Easing' in 2008-09) will not repeat, at least not without ***more*** money-printing and interest rate suppression, and perhaps not even with it. Again, this assumes 1) the Fed ***will*** try it again, and 2) **it will work** … IE it will not shake people's confidence, but rather will entice them to pile right back into a stock-chasing game.

The start to October had the stock chasing game going full-tilt, with the narrative being the Fed will back off on rate hikes. The rally was fueled by a 'Short-Squeeze', one of the many games Wall Street's larger players run in the short term while markets are open.

The early October Squeeze presented numerous technical indicators that painted the surge as a possible near-term low: TICK and breadth readings, oscillators, etc. The days since then question whether that is possible. We know that the market is very over-sold leading into the November election, making more gains possible. But risk is simultaneously quite high now.

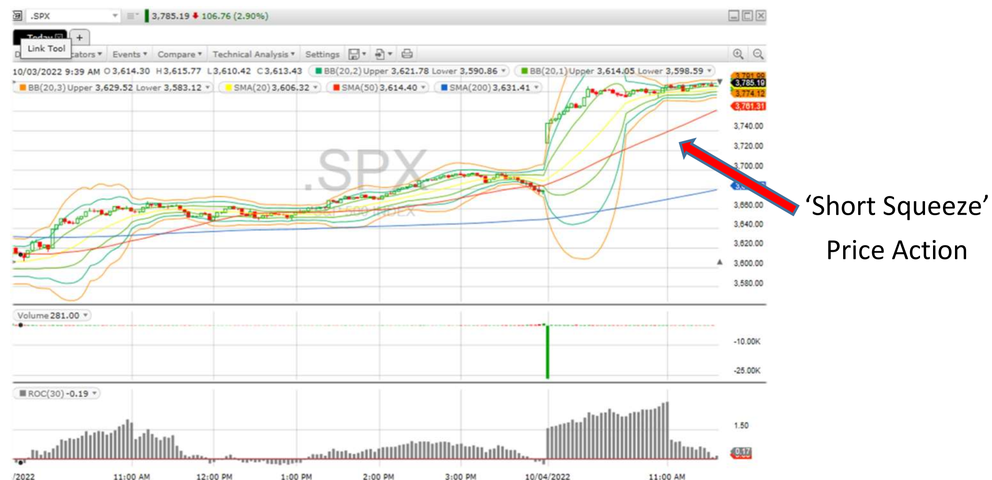
The 'Short-Squeeze' game, is fueled by furious one-way trades. A Squeeze is preceded by strong market declines during which prices are pushed relentlessly downward by some traders, Group 1. Group 1 sells stocks 'short' themselves … which means they borrow shares then sell them … expecting to later buy them back lower to return the shares to the lender. Prices drop even further as other Group 2 traders (who had purchased the stocks higher) panic-sell their shares too, right into the jaws of the decline. Group 3 introduces traders who also borrow shares so they too can sell them 'short', but they do this late in the decline.

If prices rise, anybody who sold borrowed shares late in the decline loses money as prices lift, because they will have to buy those shares back at higher prices to return them to the lender. The higher the shares move, the more they stand to lose. So they panic-buy.

Group 1 buys shares aggressively after banking profits from the original beat-down, and now trades in the opposite direction: up. Group 3 buys aggressively to reduce their losses. Group 2 just watches forlornly as they just bought high and sold low. Group 3 is thus being Squeezed by shorter term traders who are simply working their daily Profits and Losses game.

This is a long-standing game markets play; a ***short-term*** game, not long-term.

A Short Squeeze looks like this screenshot of intra-day trades in the S&P 500 index:



Stock market futures lift markets into the open, (futures of course are driven by large firms), and when the markets open for normal retail trading, prices are lifted further non-stop by Group 1, then held at the highs, executing the squeeze. This game happens with relative frequency during volatile markets, and it changes not only price but **investor psychology.**

Following the brutal Q3 which sold off through the last day, stocks soared to start Q4. If you yourself were paying attention at the abysmal close to Q3 and the furious rally the first few days of October, you likely felt sizable distress on Friday, September 30th, then had it replaced by hope and greed just two short days into October. That is how it works.

The close of Q3 undoubtedly involved another Wall Street game known as 'window-dressing' where traders and investment funds do not want to show that they owned the stocks of companies that had been pounded down. So, they sell them to remove them from their positions reports. Markets then opened for Q4 on the 3rd up 1%, and kept trucking to a nearly 3% rally. The 4th opened with the second 3% Squeeze, shown above. Anybody 'short' shares the last day of Q3 (Group 3) was down nearly 6% in two days, with no chance to buy shares back lower to return to their lender without losing money. The window-dressing gang buys them back from the opening bell (1% higher than the 9/30 close), and everybody buys (except Group 2 which dumped shares in a panic), … hence the term 'Squeezed' applies to Group 3.

This game has little to do with fundamentals and long-term stock trajectories. A case can easily be made that stocks of good companies had fallen too far. So an increase in those stock prices makes sense for both fundamental reasons and for short-term stock gamesmanship.

The narrative to which the October rally was attributed of course was the Fed backing off more rate hikes. While we know it needs to, doing so just confirms that 2022 matches 2018 for monetary policy futility. Earnings begin next week and we will see the impact that the historic rate hikes have already placed on the economy. While there is no doubt rates have impacted companies and customers negatively, we'll find out if stocks dropped too far.

Following are the 2022 Q3 results. Whereas formerly, bonds would receive the money that rotated out of stocks in Bear Markets, the Fed ***removed itself as the 'buyer' of bonds*** because of the inflation they did not see coming (as they printed the $120B per month throughout 2021 that flowed into stocks, real estate *and* bonds). When 'buyers', including the (artificial buyer) Fed disappear, the prices of those assets go down. Here are the Fed's sculpted Q3 results, while they keep ***their*** jobs:

INDEX	TYPE	Q3	YTD
Standard & Poor's 500	US Based Large Stocks (500)	**-5.3%**	**-24.8%**
Dow Jones Industrials	US Based Large Stocks (30)	**-6.7%**	**-20.9%**
Nasdaq Composite	US Based Large Stocks	**-4.1%**	**-32.4%**
Standard & Poor's 400	US Based Mid-Cap Stocks (400)	**-2.9%**	**-22.5%**
Russell 2000	US Based Small-Cap Stocks (2000	**-2.5%**	**-26.0%**
Dow Jones Transports	US Based Transportation Stocks	**-8.3%**	**-26.8%**
Dow Jones Utilities	US Based Utility Stocks	**-8.3%**	**-9.4%**
EAFE International Index	International Large Cap	**-10.4%**	**-28.8%**
MSCI Emerging Markets	Diversified Emerging Markets	**-13.0%**	**-28.9%**
Commodities	Bloomberg Commodity Index	**-2.8%**	**14.7%**
7-10Y US Treasury Bonds	7-10 Y Us Treasury Bonds	**-6.0%**	**-16.5%**
3 Month T-Bill **YIELD**	Cash Equivalent	**3.3%**	**–N/A –**

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

Bullet point highlights for Q3 follow:

- Almost every traditional asset got whacked again, energy excluded (it did *great*).
- The Nasdaq index hit its 200 Week Moving average the last two days of September, something it had not visited since 2008. (We are near there again today)
  - As is normal on Wall Street, it reversed there at the green arrow , pulling price back up as panic sellers and new 'short' positions were picked up by traders.
  - The 'market' loves to make as many people wrong as possible. That old Wall Street saying exists for a reason!

- 2008 is when the Quantitative Easing (QE: money printing) program was unleashed.
- 2022 has the Fed now removing money to quash inflation from QE. QT: Quantitative Tightening is happening now, and markets have crushed the entire uptrend since QE.
- Difference between 2008 & 2022? The Fed maintains it *will not* bail us out again here
  - The Fed is saying 'no', not this time, more rate hikes are coming, ***and***
  - They will continue to ***remove*** $95 Billion per month from markets.
- The early October rally is saying it thinks they're lying. But the retracement back to 200 Week Moving Average today is worried again that they are not.
- Several generations of investors have been conditioned to believe the Fed will bail them out of course, always. It is all we have known, in particular since 1987.

We trust everyone can see the difference this time. We will soon find out whether the Fed caves, or market players just ran a Short-Squeeze short term, but prospects for companies and their stocks will continue to worsen. Without the Fed caving, odds favor worsening will be the case and the market will move lower again. If the Fed does cave, and we strongly believe they have to unless their goal is to force a long-term Bear Market, we may have bottomed for a while.

The Fed does not live in a vacuum. High rates have also caused the US Dollar to soar. The impact of a surging US Dollar causes other countries to see their currencies weaken which aggravates inflation in their own lands and causes problems with their own local populations.

Crises now exist in the UK, Europe, China, Japan and many smaller nations. Those nations all know the Fed is causing big problems for them, their global neighbors. That is not good for the Fed, nor for the US and the Dollar long term, nor is it good for Americans that depend upon it.

We have written about the BRICS (Brazil, Russia, India, China and South Africa) and their banding together to form an alternative to the US and its Allies, the G7. The G7 includes those who live under the 'western central bank' money-printing regime, dominated by the US Dollar.

The BRIC countries last year had global Gross Domestic Product of nearly $28 Trillion. The G7 countries cranked out roughly $34 Trillion. See the gap narrowing? The BRICs are romancing Iran, Argentina and most recently Saudi Arabia. The G7 and the US Dollar have competition.

Saudi Arabia is of massive importance because of their oil production. It was Saudi Arabia that led OPEC to agree in the early 1970's that all oil would be sold in US Dollars, a concept known as the 'Petro-Dollar' when Nixon detached the Dollar from its Gold backing. The Petro-Dollar (US Dollars backed by oil) has enabled the US to print endlessly without any negative consequence (yet) to America. The volatility you have seen since 2018 shows the Dollar's jeopardy. And the architect of the jeopardy is the Fed.

During the Russia/Ukraine fiasco (which like most issues is nothing remotely close to what the US worthless mainstream media portrays), not one of the BRICS backed the sanctions the western central bank G7 countries levied against Russia. **Not one of them.**

The Biden Administration chose to boot Russia from the SWIFT system which 'clears' global trade transactions. By doing so, it jettisoned the supply of Russian oil that gets backed by dollars. Russia is now selling its oil in Russian Rubles, and the BRICS countries are more than happy to buy it that way. Thus, Biden kicked a leg out on the US Dollar's oil-backed stool.

So, we find ourselves in a position where the Fed is in the corner, once again **categorically wrong** on their stance that they will successfully continue interest rate hikes (as the Bond Market is clearly telling them) and the Fed will either hold to their guns in which case things could get quite a bit messier, or they will fold, backing off the rate hike schedule. That leaves investors with the same three scenarios we had last quarter, all possible:

1. Bear Market Rally: designed to entice investors back into 'buying' mode where they will then be sold shares of stock at higher levels before the market rolls back over and declines further.
2. Weimar Republic: That chapter in history where prices accelerate upward, in a blow-off top, where everyone fears getting ravaged by inflation so they panic-pile further into stocks.
3. Healthy Rally: arrival of decent earnings ***with decent forecasts***. Supply chain issues and cost inflation will shed light on forecasts which have cooled overall. We'll see how much. And 'healthy' automatically assumes the monetary system and health of the Dollar stay intact.

Note we ***did*** get #1 during Q3, a Bear Market Rally (BMR) that ran into August only to topple when the core inflation caused largely by the Fed in the first place, came in very hot again at +8.3%. The Fed was forced to commit to more and more rate hikes, still admitting no responsibility. Are we in another BMR now? Will there be more? We will find out soon enough.

We could get our own version of #2, a Weimar rally, if the Fed caves and prints (hence the term 'one-trick-pony'). We believe that in the end, math will win. Money printing causes short term relief at the cost of long-term pain. The Fed does not escape math by using the same tricks all of its predecessors failed using. Their hubris does not beat math, not long-term anyway.

The Fed did prove in Q4 2018 it could not stop printing and raise rates, and the amount of money printed since then is truly beyond comprehension. They have thus proven it again in 2022. If we are paying attention, we can see that now. We are very likely in that pivotal time. Whether we print our ways out of it again successfully or not remains to be seen.

You may find yourselves in the camp in which many investors reside, trained through decades of interest rate suppression and endless money printing, to conclude:

1. They …
2. … Will Make It …
3. … Go Up Again

Note first the above mindset automatically acknowledges 1. There is a 'They', and 2. **They** will do something to push prices in a particular direction, and 3. The rest of the world will display confidence it will work again and thus respond accordingly … IE buy stocks and other assets.

Monetary history is littered with examples that prove #1 and #2 are facts: there is a group (central banks) that will take action. History is also littered with examples of #3 where it works, but alas, there is a 4th component for other countries in history books: #4: It Won't".

We again acknowledge that these observations are less than cheery. Nonetheless, the asset price action of 2022, like that of 2018, is accompanied by Federal Reserve monetary manipulations and the consequences are overtly observable. That is what causes a loss of confidence which in turn causes ultimate failure. We should not ignore that.

So … what do we ***do*** about it? Well, investment wise, we acknowledge our place in history and presume the risks in our paper investment allocations are higher than they have been in the past, assess how that risk affects our allocations and importantly our timelines. Shorter time frames require more urgent attention than longer time frames perhaps? We also should acknowledge the potential limitations in the Fed's 'tool box' are more evident than they have been over the course of our investing lifetimes. Aggressive positioning should be taken with an eye on the risk/reward picture. The reward may be substantial, but so is the risk given the backdrop. More moderate positioning accepts that this period in time may be a bit different than days gone by, and is willing to forego some potential furious rallies like this start to October for some less downside potential. High inflation and increasing threats to the Dollar's status as Reserve Currency are new variables we have not seen in most of our lifetimes.

Treasuries yielding 3.5% - 4.0% is as an attractive rate as we have seen in sometime, a decent 'defensive play'. Even that too, however, assumes Uncle Sam will make good on his debts! And while that sounds very good (and it is), 8% inflation means we're losing **-4%** purchasing power.

This is a lot to think about, but do think about it. Each person individually chooses their own risk exposure and the strategy to deploy if their assets reside in these 'paper' markets.

We will be glad to discuss it with you and assist you in arranging allocations you deem best to either seek appreciation in subsequent up cycles, or to protect your assets from any further declines. We can be reached at (614) 698-0333 (FFF) or info@f3advisors.com .

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