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Market Forecast – October 7, 2021

Note: I posted to LinkedIn on 11/5/2021 that we had reached the early November date for the second window.

Market Expectations:

For those that just want the forecasts without reading the commentary:

US Equities: I anticipate lower equity prices through early December, and through mid-2023. We just entered a time window to try establishing a short position. For the S&P 500, try shorting at the 4422 level if the market gives another chance through Monday, October12. A clear break below 4389 would indicate additional confidence on a short position. All equity markets will move sharply lower. Potential turning points during this time will be shared in future commentaries. If, instead, we move higher than today's high of 4429.97, the next window to establish a short position will be in early November.

US Fixed Income: US Treasury bonds futures prices have traded in a well-defined channel since 1981. This channel was briefly pierced on the up-side in March 2020, and has broken through the low side recently, too. If US Treasury bond futures decisively break through this channel, prices are likely to move even lower. While many people believe bonds move opposite in direction to equities, this inaccurate, as there have been several instances where they both moved in tandem. Bond futures closed today at 158-13, down from 191-22 in March 2020. The chart accompanying this commentary shows the position of the bond market. If we make a break lower, and out of the channel, 135 is a reasonable first expectation over time as the downtrend continues.

Broad Market Commentary: It's been awhile since my last forecast, but we are entering what should be active 4th and 1st quarters. Decades of irresponsible spending and deficit creation will finally start to unravel and cause challenges for the US. These irresponsible policies come from both of the political parties, as they don't worry about the long-term consequences of their actions because they don't think they will be in office when things go wrong. Unfortunately, these policies have decreased the dollar's purchasing power significantly over time, acting as an unseen tax. This is becoming more apparent as we have seen price increases across our economy, including, most visibly for the public, paying more for gas and for smaller portions at the grocery store. These costs will hit consumers hard.

I do not buy into new monetarist theories that say you can print unlimited dollars without there being an economic impact. If interested, *The Creature From Jekyll Island* by G. Edward Griffen is an excellent book on this subject, which also outlines the creation of the Federal Reserve Bank and the impact of large deficits and past bailout packages. While I realize massive dollar printing helped stabilize the economy during the 2008 market crash, the negative impact from these policies over time is real.

The government is buying treasuries and even corporate bonds to help support the markets. While this may help prop the market up and act as easy money along with historic near zero percent short-term interest rates, has kept things afloat for some time. But this manipulation will not work forever. An excellent example of this is when currency traders knocked the British pound out of the exchange rate

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mechanism in the early 1990s because the fundamentals of their economy did not support the artificially high price. The book *The Vandals Crown* by Gregory Millman is an excellent book on this topic.

Additional headwinds for the economy that will be mentioned in the news as causing lower equity prices include higher prices for just about everything, and the massive amount of new spending that may be coming from the Democrats currently controlling all branches of government. The amount of spending, on top of all the money already spent to provide support to the country during the Covid pandemic is simply not sustainable without it impacting the capital markets. In fact, the move higher in stocks is related to these inflationary pressures and the expectation of massive additional spending. This spending will be much higher than the headline $2 trillion to $3.5 trillion dollar spending bill. To fit the final dollar amount the Democrats decide on, additional spending on new entitlement programs, which are nearly impossible to take away once enacted, will be shortened to just a few years instead of the ten the budget purports to be for. This will result in new spending programs that are not budgeted past these few years, but that will cost much more over time as the new benefits will likely be permanent and require much more funding moving forward. In short, a bait and switch related to the true costs of these programs is underway. Please know that I am not making any political judgment, but merely discussing the impact these programs and policies will have on US markets.

While the stock market has been rallying from the uptick in inflation and the expectation of the new spending bill, our forward looking markets have already priced this in. So, we are looking at the old market saying "buy the rumor, sell the fact," or a downward market adjustment in response to a smaller stimulus package than currently priced in.

The idea that these new spending programs will pay for themselves, through taxes on the rich and businesses, are simply ludicrous. In fact, businesses will pass the additional costs on to consumers, resulting in even further inflation. If people have to pay more for everything, whether through taxes or higher prices, it is essentially a tax on everyone that will reduce discretionary income and, hence, economic activity. Further, these programs will eventually require more taxes, which will increasingly impact the middle class; there is simply not enough money from the top income producers to pay for all of this new spending. Further, additional fees, such as higher gas taxes and other new revenue items that will be in the more than 2,000 page spending bill will be regressive and impact low and middle income people, too. Supply disruptions, the impact of inflation, and declining stock prices will also contribute to an unhappy electorate through the holidays. Another significant risk is the impact higher interest rates would have on the economy, as just one basis point increase in yields on $30 trillion of debt is a staggering $3 billion dollars. When rates move higher interest payments on the national debt will crowd out and put pressure on other discretionary spending programs.

Higher taxes on wealth creators and businesses, and higher capital gains taxes, will result in less investment, which will further hurt the economy. Also concerning is the moral hazard of Washington

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providing benefits to people that don't pay anything for them; it's very easy to be for a benefit if there is no cost, but this leads to bad policy, further friction between classes, and irresponsible spending.

Unfortunately, this may be the beginning of what I see as a very difficult road ahead for America through the rest of the decade. Two key things to keep watching over the next several years is the US-China relationship and the increasingly wide split between political parties. To use a simple football analogy on the domestic front, both parties have shifted their positions from the 35 yard line to the ten yard line, so instead of 30 yards between them, there are now 80 yards, making it increasingly difficult to find common ground. In fact, moderates on both sides of the aisle are dwindling. Media sources untrusted on both sides further add to the rift, and social media and each parties' echo chamber of ideas is further radicalizing both sides of the electorate; even those that were once moderate. This is a very combustible dynamic threatening America, and it will grow worse throughout the 2020s.

Some charts follow for US equities and US Treasury Bond futures.

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S&P 500 – Daily Chart:

S&P 500 Index - SP500 (SPI) - 1 Day Bar Chart - USD - No Layout

4,239.9278

3,592.4181

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Mar May Jul Sep Nov 2021 Mar May Jul Sep Nov

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Market Forecast – October 7, 2021

US Treasury Bond futures – Daily Chart:

Thirty-Year US Treasury Bond Futures Volume Spot - USVolSpot (CBOT) - 1 Day CandleStick Chart - USD - No Layout

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My Approach to the Markets and disclaimers

Some of you are familiar with my work on financial market cycles, but others are not, so a quick word and disclaimer. I am not soliciting or suggesting any trades or market activity, and take no responsibility for any financial decisions you may choose to make. I am simply sharing my insights and offering possibilities based on years of specialized research and hard work. The commentaries are written for a wide audience.

I work to identify windows of time where risk/reward ratios are favorable in certain markets. I typically look for a handful of good trading opportunities each year, when specific markets are active. My work is best utilized by professional traders or speculative capital with a clear understanding of how to manage positions, and enter and exit the market in a way that controls risk. The work to identify the cycles and timing points is an entirely different skill set than the talents needed to effectively monetize this information in the markets. Because of the timing nature of my work, it should be of particular interest to sophisticated investors and options traders familiar with multiple strategies for controlling risk.