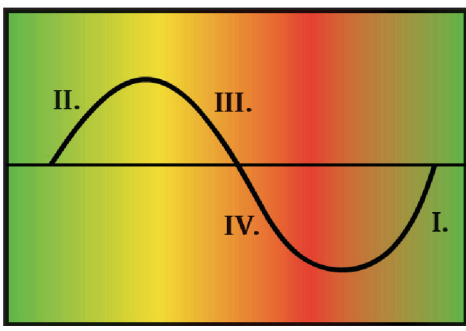


Month in Review

The S&P 500 lost 0.83% in November as worries over a new Covid variant slammed the markets on Black Friday and hawkish comments by Federal Reserve Chairman Jerome Powell derailed a powerful relief rally the following Monday. It's time to check our indicators to see how the month-end volatility has affected them.

I. CREDIT CYCLE

PHASE III: LATE CYCLE



There has been a shift in tone from Jay Powell since he was reappointed to a new 4-year term as Federal Reserve Chairman. All year long, he has played down elevated inflation levels, calling them “transitory” and implying that they would soon dissipate without the Fed needing to take any action. That changed abruptly when Powell told a Senate Banking Committee that it was “a good time to retire that word [transitory]” to describe inflation, and that the Fed would consider speeding up its timetable for reducing its monthly bond purchases at the next FOMC meeting. Faster tapering means tighter liquidity, shifting the Credit Cycle from **PHASE II: EXPANSION** to **PHASE III: LATE CYCLE**. **PHASE III** is a more difficult but still positive environment for stocks and other risky assets. Focus on quality and low leverage and buckle up for a bumpier ride.

II. RISK LEVEL INDICATORS



US STOCKS: Guarded

The Risk Level for **US STOCKS** is **GUARDED**. The path of the pandemic continues to dictate the course of the markets. After a strong start in November, new Covid-19 restrictions in Europe weighed on the reopening sectors as investors once again rotated back to the Covid era tech/secular growth stocks. That proved to be just a small foretaste of what was to come on “Black Friday” when the Dow tumbled 900 points for the worst day of the year. WHO officials spooked the market with news of a highly mutated strain of the virus found in Africa that may be more resistant to vaccines. With faith in the reopening trade fading fast, investors were unnerved by Fed Chair Jay Powell’s about-face on inflation in the face of the “downside risk to employment and economic activity” posed by the Omicron variant. The **SWING INDICATORS** are negative but extended, raising the odds of a short-term rally. We will be watching the market internals for clues as to the health of the bull market and our strategy going forward.

INTERNATIONAL STOCKS: SEVERE

INTERNATIONAL STOCKS have failed the “Bogey Check” for the first time since March 26, 2020. That raises the Risk Level to **SEVERE** and suggests a minimum allocation at best until the Risk Level improves. Liquidity growth drives the economy, and international markets are especially sensitive to global liquidity. As liquidity growth decelerates risky assets derate, starting with China, South Korea, Japan (most cyclical) ending with the US (most defensive). China and South Korea are already in bear markets and Japan appears to be rolling over. Stay on the defensive until the rolling correction runs its course and a new cycle has begun.

US FIXED INCOME QUALITY: LOW

The Risk Level for **US FIXED INCOME QUALITY** has dropped to **LOW**. At the time of our last report, the direction of interest rates was hanging in the balance. The surge in cases of the Delta variant had delayed a full reopening of the economy causing the yield curve (i.e., the difference between the yields on 2-year and 10-year Treasury bonds) to flatten suggesting weaker economic activity ahead. As the Delta wave abated, the yield curve began to steepen and stock markets enjoyed their best performance since November 2020. Unfortunately, it was not to last. Since peaking in October, the yield curve has collapsed sending shockwaves across markets. The bond market is telling us the economy is slowing and the Fed is making a mistake to tighten into it. Bonds hate growth and inflation and if both are about to slow this may be a good time to invest in them. The **BOND INDICATORS** are positive suggesting further gains ahead.

III. LOOKING AHEAD

FED PUT

Monetary policy seems about to make a major shift after a long period of holding rates on the floor. Investors are wondering if the long-standing “Fed put”, or the belief that the Fed has the market’s back, is fading. The Omicron variant of the coronavirus has markets worried about slower growth, and Powell’s diminished dovishness comes at a particularly uncomfortable time. The weight of the stock market in terms of the economy has never been greater, at a time when valuation measures are off the charts and investor complacency rivals the dot.com era. The next serious correction could have an out-sized impact on both confidence and the economy. Powell already played “The Grinch Who Stole Christmas” once on his watch. Here’s hoping he learned from the experience and will take care not to repeat it.

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