

# September 30, 2022

**We have a molecule crisis. We've had 40 years where all the money went into broadband, or internet, or Netflix or the cloud and no money went into basic productive capacity of metals. - Robert Friedland**

**Inflation is the symptom, not the illness. Investors should remember that Fed-induced slowdowns are simply a short-term abatement of the symptom-inflation- and not a cure for the problem-underinvestment in physical production capacity - Goldman Sachs**

## **Doom Loops - And A Little Good News**

### **It's Getting Real**

**Big, very important changes are occurring rapidly, now. Consider: The Norstream pipelines were sabotaged. There is not the option of gas to Europe from Russia other than through Ukraine, no matter what anyone wants. Beyond changing the geopolitical game, infrastructure in international waters is now fair game - we are now playing at a different level.**

**The financial system of the UK was this close to collapse. It's complicated, but a combination of QT, interest rate hikes and other steps taken by the government sent the system into a doom loop. The Bank of England had to take extraordinary steps to save the system. This is the canary in the coal mine. Look for more things to head for collapse.**

**Russia is using conscription to add hundreds of thousands of men to the military. Basically, they want to throw bodies at the war. This also has the effect of increasing political instability inside of Russia.**

## **Markets**

**(Graphs updated)**

Not much to say. No change in thoughts in any of the markets. We have a bear market in essentially everything, however with a nice bounce in here just in time to make people feel better about the Democrats before the election.

## **Something Broke**

You may recall that my base case is that the Fed will raise rates until something breaks.

Well, something broke - in the UK.

It has to do with rates and collateral and pension funds, probably too much to go into here. But the bottom line is that the UK financial system was on the verge of a doom loop when the Bank of England stepped in. Coming to a country near you.

## **Recession**

Are we in a recession or not? What is it going to look like? Inflation or deflation or both? Is depression possible?

This issue will contain a lot of charts and discussion.

You know the context - too much debt and deficits, the Fed is in a corner and now has to choose between inflation and austerity. For now, it has chosen inflation as the way to erode away the debt.

In the meantime, deficits are not going away and politicians are spending without restraint.

IMO, the Fed will raise rates until something breaks. And something will break - soon. The global financial system is coming unstrung and mini-crises are popping up everywhere.

I'm not just talking about attacks on the British pound, I am talking about social upheaval. Much social upheaval.

In the background, relentlessly approaching, is a supply cliff. We have underinvested in commodities, particularly oil. Commodities deplete and need continual new sources. We have not been doing that. This process is compounded by deglobalization, supply chain disruptions and the war in Ukraine.

Demand must be destroyed to match the destruction of supply.

So, simplistically, if we are running out of oil, grains and copper, why are their prices going down? If housing is booming, why has the price of lumber crashed.

This is the major theme of this issue. My answer to that question is that the markets are forecasting a dramatic decrease in demand - a deep recession - to bring supply and demand into balance.

The challenge is that fixing the problem takes years in the case of grains and around a decade for oil, copper and the building of nuclear energy capability. And we haven't started yet.

The coming decade could turn out to be a real bitch.

And, even though the inflation monster may be tamed by the recession - I think stagflation is more likely - it is probable that the Fed will not finish the job and that inflation will rear its ugly head, later.

Because the world's financial system is breaking down. Too complicated to go into here, but the plumbing is leaking and beginning to rupture.

It has long been my thesis that the entire system must be completely reset. We have taken things too far and they are basically unfixable. The Fed and the rest of the world are fighting mightily to take a series of steps to cure the most egregious ills of the current system. This will be a fascinating soap opera in which we are all participants.

So, I will briefly flesh out some of these statements, below.

Hang on, we have entered the end game.

## It's Really Not That Complicated



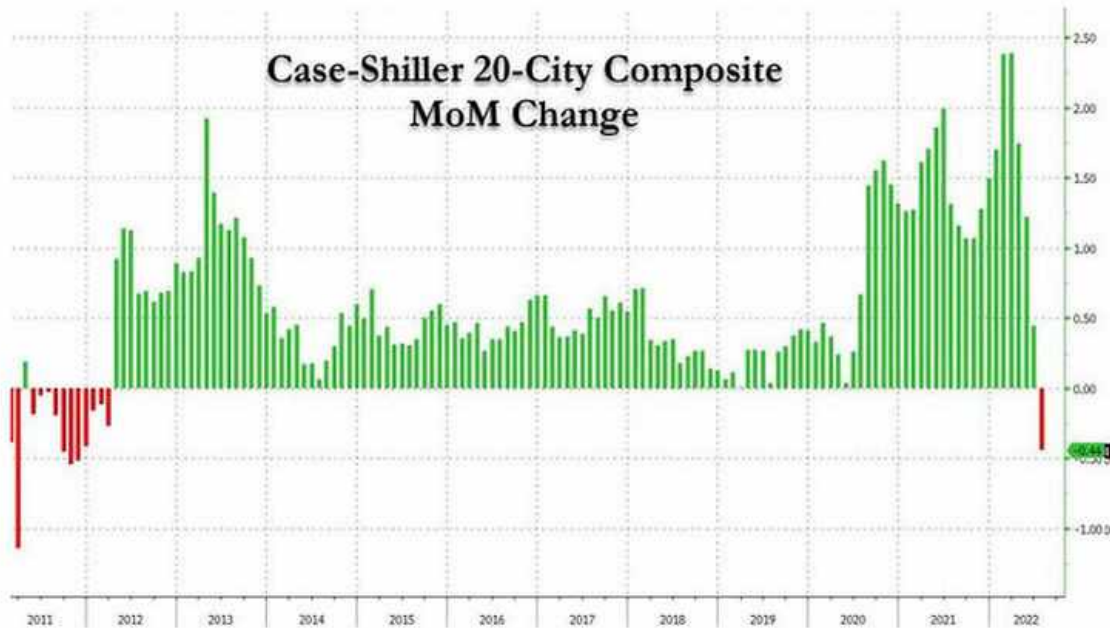
## A Quick Overview



As a broad overview, commodities are in a long-term bull market, but we are in a bear market retracement phase. So in the short term, b will be going down for a while, before turning back up. Which means that commodity inflation should be constrained for a while.

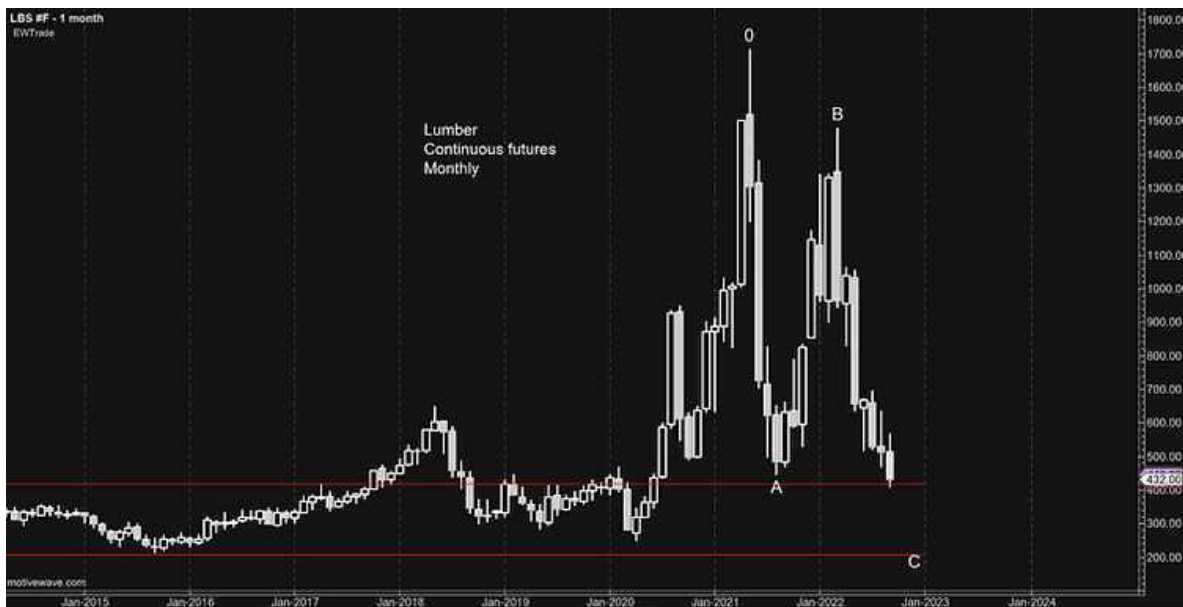
For several months, I have been saying that the economy, including housing, is decelerating rapidly. I have also said that the graphs of various commodities, particularly oil, are telling me that the recession is under way. Following are some of those charts and some thoughts.

## The Housing Bubble Has Officially Burst : Case-Shiller Records First Drop In Home Prices Since 2012



The -0.23% difference between the July and August rates of annual increase in the National Composite Index was the largest deceleration in the history of the index.

**Housing is collapsing. As construction ramps up and as mortgage rates increase, housing is changing at the fastest rate on record.**



This graph of lumber prices (linear, not semilog as are the rest of the graphs in this presentation, to make the changes more dramatic) gave us a good indication that the housing market was topping. Supply problems were being resolved, and demand was not keeping up with supply. If  $C=A$ , a common, but not required relationship, then the price of lumber is heading to the bottom of its historical range. It went up 6 times its "normal" price and then reverted, all in the space of around 3 years.



Obviously, my Elliott counts could be wrong. But this is the chart that really, really scares me. Very bearish, although there should be a rally in our future. I don't know how high (b) will go, but if I am in the ballpark, oil could be heading to around 60. Now THAT'S demand destruction.





**"Doctor" copper has the same count as oil. Definitely a forecast of economic weakness.**



**In the midst of a food crisis, why would the price of grains be going down? Way down?**

**One obvious answer is that I am just wrong. Who the hell can tell the future, anyway?**

**And I hope I am.  
Because the alternative is just scary.  
But, we will track it here, blow by blow, whichever way it goes.**

## **Lacy Hunt and Recessions**

**Lacy Hunt is just a treasure.  
I listened to a presentation he gave that is behind a paywall.  
He does not think we are in a recession now, but sees it coming.**



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## Pre-Recessionary Indicators

1. Real retail sales have declined in six of the last nine months and is down 6.7% a.r. in the last 3 months.
2. Average hourly earnings slowed to a 5.2% annual rate in the latest three months down from a 6.1% three month growth rate at the end of 2021.
3. Rail and trucking freight has lost significant momentum in 2022.
4. Mortgage purchase applications are down 43.2% from the 2021 peak and mortgage refinancing applications are down 91.3% from 2021 peak.
5. 1/22-8/22 average vehicle sales are down 21.6% versus Q4 2019.
6. New home sales are down 50.7% from the 2020 peak and existing home sales are down 27.7% from the 2021 peak.
7. The composite index of the NFIB Small Business Survey sank to 91.8 in August, the lowest since the May 2013.
8. Manufacturing PMI is down 17.1% from the 2021 peak. Services PMI is down 16.8% from the 2021 peak.
9. New York Fed's weekly economic index is down 70.9% vs the peak in 2021.
10. Productivity declined by a record amount in the last four quarters.

## My Bottom Line?

**Nasty recession - maybe depression.**

**Financial systems on the verge of collapse - perhaps collapsing.**

**Underlying inflation dueling with the deflation caused by debt and a recession - I will take stagflation as a win.**

**Civil unrest everywhere.**

**War more than possible.**

**I very much hope I am wrong.**

## **A Little Simplistic, But Definitely The Straw ...**

Former Obama economist Larry Summers: “We basically had inflation under control for forty years,” but “we lost the thread...about a year and a half ago” with Biden’s \$1.9 trillion stimulus

## **Oh, Well, Nevermind**

The CDC just updated its Covid advisories:

"Updated to note that vaccination status is no longer used to inform source control, screening testing, or post exposure recommendations."

My translation - vaccination helps keep you from getting very sick or dying, and those are good things. However, that's about it. Doesn't keep you from getting sick or from transmitting the disease.

## **It's All Good**

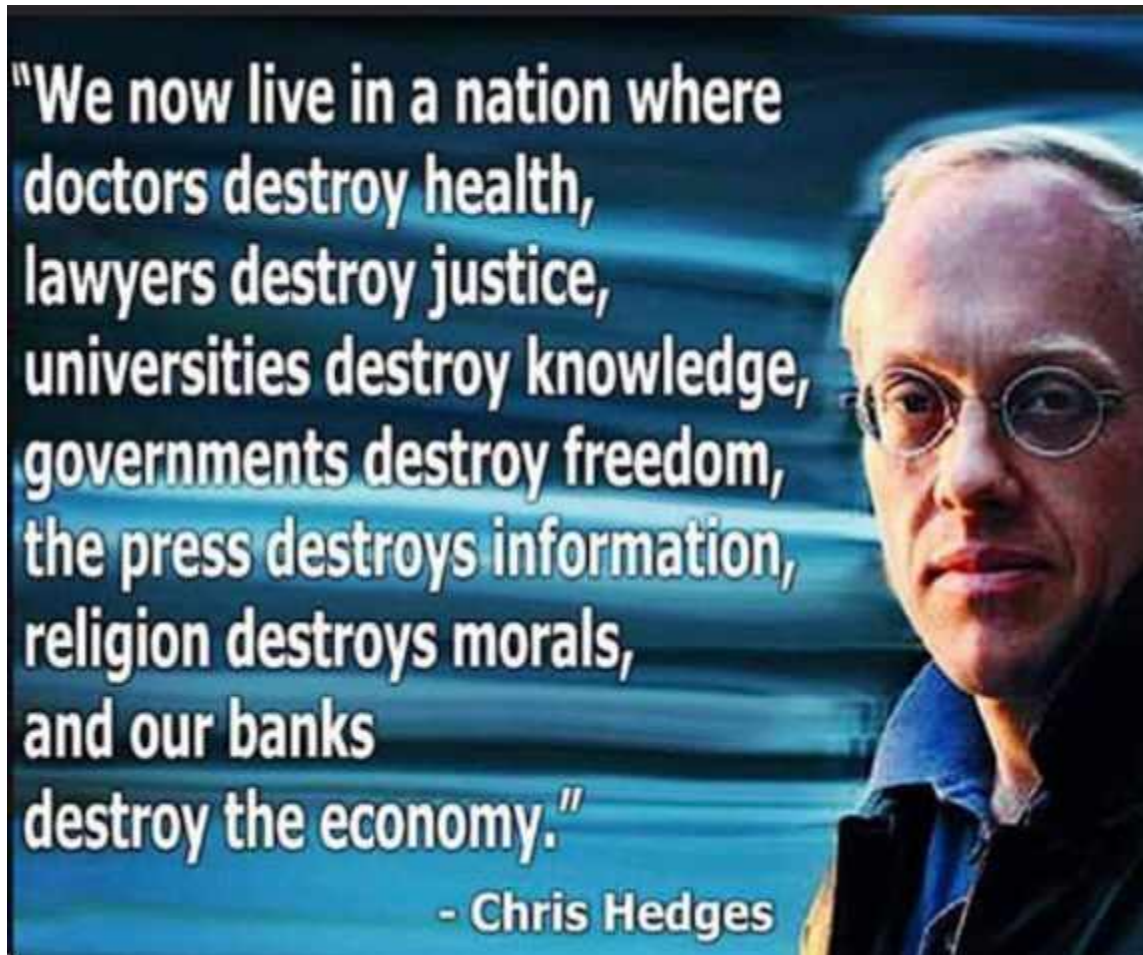


## **The Student Loan Wars**

The Department of Education announced Thursday it was scaling back the scope of President Biden’s student loan cancellation plan, now excluding borrowers with federal student loans held by private entities—including Federal Family Education Loans or Federal Perkins Loan Program loans—from accessing the debt forgiveness. The tweak is expected to affect millions of borrowers otherwise eligible for the

program, and is almost assuredly an effort to head off mounting legal challenges.

### **Naw, It's Not That Bad**



### **The Mormons Were Just Ahead Of Their Time**

A judge in New York has just ruled that polyamorous relationships - in this case a 3-person married unit living together in an apartment - are entitled to the same legal protection as opposite-sex or same-sex 2-person marriages. (Kit) It has been clear to me for a while that polygamy and polyandry were heading into the mainstream.

## This Is Bee-Level Good



**Max Fras** @maxfras · 10h

Meanwhile, in Russia

(via @wowhotshots)

