

Likes/Dislikes – December 10th, 2021

Below are Evergreen Gavekal's Likes/Dislikes for December 10th, 2021.

One of the main themes of last week's much longer than normal text section of our positioning recommendations was that Omicron fears were overdone. Related to that was my suggestion to accumulate positions in sectors that had been particularly slammed by the news of its rapid spread.

The expert intel I relayed was that this latest virus variant was likely to turn out be highly transmissible but not nearly as harmful as Delta.* Fortunately, as more information has come out, that appears to be the case. However, with anything Covid-related negative surprises are entirely possible. However, again, I do believe most countries are adopting an attitude similar to Sweden's of protecting the most vulnerable citizens while avoiding draconian lock-downs, as I've written in prior EVAs. In other words, the world is learning to live with a pandemic that is slowly morphing into endemic, though Covid still clearly has a global reach.

Because of reduced Xi—sorry, Omicron—fears, the economically-sensitive stocks have, for the most part, seen the strongest rallies this week, as I'd hoped. It's fair to note, though, that some of the momentum has faded as the week has progressed. Part of the waning upside might be a function of on-going tax-loss selling due to the price declines seen in most cyclical stocks since Delta became a problem back in late spring. Another factor could be fears that the Fed is about to tighten far faster and more aggressively than was believe just weeks ago.

On that topic, it continues to be my view that the Fed is massively behind the inflation rate. Based on today's CPI number, it is increasing at nearly a 10% annualized rate. Admittedly, it's unlikely to continue to run this hot over the next 12 months. But even assuming US inflation recedes to 4%, the Fed needs to essentially raise 16 times to merely get up to that level (based on the quarter-point rate hikes it typically does when it is tightening). If the Fed bumps rates every quarter, its usual interval, we're talking about four years before it can get rates up to a 4% inflation rate, much less above the CPI, typically what needs to happen to qualify as truly restrictive.

Then, there is the Fed's distended balance sheet which is loaded with around \$8 trillion of bonds and mortgages it has acquired since the Great Recession (and about \$5 trillion in the last two years alone). Of course, these assets were all acquired via the Fed's Magical Money Machine, basically, a modern-day printing press. Some pundits believe this is equivalent to a *negative* Fed funds rate of 10%. The Atlanta Fed estimates this is around negative 2% but that seems far too low to me. Perhaps reality is somewhere in between at around -6%. Regardless, this means the Fed has to clamp down even more than 16 or so rate increases, quite possibly a lot more.

The odds are very high that we will see extreme market turbulence and, possibly, a panic before the Fed can catch up to the inflation rate. Past history has repeatedly shown that the Fed will cave in once the market turmoil becomes severe. Based on all of this, I don't see how it won't be in a stimulative stance for years to come, even if less easy than it is presently. If I'm right, something else will have to curtail inflation rather than Fed action.

Accordingly, to the extent that stocks which benefit from economic growth get hit due to Fed fears, that would represent another buying opportunity, similar to what happened with Delta and then Omicron. Most of these types of issues qualify for the value categorization that has long trailed growth names. Thus, they are way overdue for a major reversal of fortune per today's main *EVA* section. Speaking of which...

Another key point of last week's *EVA* was the remarkable breakdown in a plethora of growth stocks. As noted in that edition, the pain has thus far spared the mighty FAANGM stocks like Apple and Microsoft. In fact, they appear to be beneficiaries of growth money fleeing the hundreds of smaller (though, in many cases, far from small) issues that have been hit so hard of late. At some point, however, even Apple—which is now worth more than the entire German stock market—may come under pressure.

Growth stocks have bounced a bit this week but it's been a far from impressive snap-back. In fact, the once screaming meme stocks, like AMC Entertainment and GameStop, continue to crack. Consequently, there does seem to be a paradigm shift underway that is setting the stage for a long-lasting period of value sectors outperforming those of a high-growth and high P/E nature. There undoubtedly will be back and forth action but, over the years to come, I believe we will see value dominate growth. Persistent inflation is likely to play a starring role in that performance inversion.

*In case you are wondering why Omicron wasn't given the next-in-line Greek name, per fellow newsletter scribe Ben Hunt, the World Health Organization switched out what it should have been, Xi, because it didn't want to offend China's dictator whose name, coincidentally, is Xi Jinping. Isn't it considerate of them to be so sensitive?)

Positioning Recommendations

(Note: Market prices haven't fluctuated enough this week to warrant making recommendation changes; however, some of the statistics, such as percentage declines, have been updated.)

LIKE

- Large-cap growth. (Avoid those that are beneficiaries of the flight into perceived mega-cap safety, per the above commentary.)
- Certain international developed markets, especially Japan (Use the recent pull-back for adding to or initiating position in ETFs like EWJ. The Japanese market should be a beneficiary of overseas investors pulling capital out of China.)
- Publicly traded pipeline partnerships, i.e., MLPs and other mid-stream energy securities. (Buy on weakness!)
- Gold-mining stocks (Ditto!)
- Gold (The miners appear far more undervalued at this point.)
- Silver (It has more snap-back potential than gold currently.)

- Select international blue chip oil stocks (Again, it's time to be a buyer for long-term, contrarian investors.)
 - Short-term investment grade corporate bonds (1-4 year maturities; favor shorter maturities due to rising inflation risks because of the likelihood that the Fed and the Treasury are over-stimulating the US economy.)
 - Emerging market (EM) bonds in local currency (focusing on stronger countries, particularly in Asia)
 - Large-cap value (Once more, per the above commentary, use Omicron-driven weakness to accelerate accumulation.)
 - High-dividend equities with *safe* distributions (These, too, have been hit; thus, add selectively though they lack the rebound potential of more aggressive issues, outside of economically-sensitive areas.)
 - Most cyclical resource-based stocks (Buy more aggressively.)
 - BB-rated corporate bonds (Buy more selectively after a spectacular rally and favor shorter maturities.)
 - Canadian REITs (Avoid office issues for now.)
 - South Korean Equities (S. Korea remains one of my favorite markets.)
 - Certain "Virus Victim" equities such as refiners, homebuilders, and select retail stocks (Certain retailers look extremely attractive right now, especially one that is based in Seattle with a famously generous return policy.)
 - Investment-grade floating rate corporate bonds (Despite a vigorous rally this year, there remains decent long-term value in this bond market niche.)
 - The higher quality mortgage REITs (Previously, we had recommended profit-taking; use recent weakness for re-accumulation.)
 - Floating rate bank loans (Although GDP growth this quarter came in much slower than Q2, this should be a pause not a reversal. Thus, the still healthy US economy reduces default risks and the floating-rate structure of bank loans mitigates inflation risks.)
 - Copper producers. (The largest US copper producer has declined about 7.5% recently, creating an attractive entry, or further accumulation, point.)
 - A relatively new sector recommendation is healthcare stocks. Many have corrected and are trading at alluringly attractive valuations, often with lush dividend yields. (Use the recent weakness in some pharma names to accumulate; others, though, have rallied hard and in those cases decrease accumulation.)
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- Uranium and uranium producers (There are better opportunities elsewhere for now.)
 - Renewable Yield Cos (Based on the hefty rally that has occurred with this group in recent months, justifying our buy rating on them earlier this year, we are downgrading them to neutral; some profit-taking is reasonable despite bright long-term prospects.)
 - A wide range of high-income securities, including preferred stocks (Preferred stocks look less attractive with prices up, yields down, and inflation risks on the rise. As with bonds, we prefer the floating-rate variety.)
 - Intermediate-term investment-grade corporate bonds, yielding approximately 2.25% (Now rated neutral due to our increasing inflation concerns and the paucity of attractive yields; they have been under pressure lately due to rising rates overseas and escalating inflation concerns.)
 - Mid-cap value
 - Emerging stock markets; however, a number of Asian developing markets look undervalued (Caveat investor: These are much less bargain-rich than they were a year ago. China is an exception; its market has been crushed creating interesting value plays)

for brave investors. However, it's continuing war on its best companies is a large and legitimate concern. Further, I would note key Chinese equities are breaking multi-year support.)

- US-based Real Estate Investment Trusts (REITs) (It is critical to be highly selective with this sector; however, the reopening of the US economy, despite recent challenges, should relieve pressure on some of the most impaired sub-sectors of the REIT universe—unless they are exposed to cities and/or states that are seeing significant population and business outflows.)
 - Cash
 - Canadian dollar-denominated short-term bonds (The recent yield spike makes these even more interesting—literally.)
 - One- to two-year Treasury notes
 - Traditionally “safe” sectors such as Staples and Utilities (Most utilities have had healthy price bumps lately; consequently, they are less appealing.)
 - Virus Victors (I.E, those companies that have benefitted from global lockdowns and now sport premium valuations. Many have retreated significantly of late; Clorox, for example, remains down materially from its peak.)
 - Small-cap value (This style has corrected 6.5% of late; however, it has held up considerably better than its growth-oriented peer—see below.)
 - European banks (Shifting these back to neutral due to improving vaccination prospects on the Continent. Still-prevailing negative interest rates in Europe are very hard on bank profitability.)
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- Intermediate-term Treasury bonds (They have rallied lately due to pervasive negative sentiment—in other words, they were oversold—and Omicron-driven growth fears; longer-term, all distant maturity treasury bonds look decidedly unattractive.)
 - Small-cap growth (Since late-February, around the time of our negative call on this style, it is now down 11%; in fact, it has swooned by that amount in just the past month (down ~11.5% since 11/8).)
 - As a relatively new tactical recommendation related to the above bullet, investors seeking to reduce equity exposure might want to buy an inverse small-cap ETF. One of these offers twice the upside—and downside—of the small cap index; i.e., should small caps fall 10%. (After the recent correction, this position is slightly positive.)
 - Long-term treasury bonds (These are in the dislike category due to both Evergreen's and Gavekal's rising conviction in a looming burst of inflation; despite a now faltering rally over the last few months, long-treasuries remain down 4.5% on a total return basis this year.)
 - Long-term investment grade corporate bonds (These are viewed negatively because of the narrow yield gap, or spread, between corporate debt and treasuries combined with our escalating inflation fears. However, there are a smattering of long-term issues that still offer attractive yields. Long-term corporate bonds have had a negative total return of -1.3% for the year.)
 - Most municipal bonds (Munis have bounced a bit lately but we remain negatively disposed to longer issues.)
 - US dollar (The dollar has rallied recently, pushing it up roughly 6.8% for the year. This is despite the fact that the US is running a trillion-dollar trade deficit and the Fed continues to fabricate money at a \$1.5 trillion annualized rate. Thus, the dollar's long-term outlook appears very challenging and it remains overvalued versus many currencies, especially those in Asia.)

- Many semiconductor tech stocks (Semis have held up comparatively well during the shakeout; many of these names look extremely pricey and hence vulnerable.)
- Mid-cap growth
- Lower-rated junk bonds (For the first time ever, junk bonds “provide”, on average, a yield below inflation; thus, their other moniker, high yield, no longer applies. In my view, the lowest rated junk bonds offer the worst/risk reward.)
- Green energy stocks (Note, this refers to equities not the Renewable Yield Cos; most of the former had explosive up-moves in 2020 and into this year; lately, though, many green energy plays have been hit hard, especially the dodgiest issues like Lordstown Motors and Nikola. The recent new EV truck maker Rivian looks ludicrously overvalued; justifying that negativity, it has lost about 35% from its recent peak.)
- SPACs (Special Purpose Acquisition Companies, which are structured to greatly favor insiders and disadvantage retail investors. The SPAC ETF has fallen 36% from its February highs, justifying our negative stance on this highly speculative slice of the market.)
- Most new issues (Earlier this year, the IPO market was as frothy as I’ve seen it other than the giddiest days of the dot.com era; there are also signs the new-issue craze is fading, even though some recent IPOs have had explosive moves...*if* you were able to attain shares at the initial offering price, which every few are. Be very careful about chasing these in the secondary market.)
- Despite a disastrous February, most of the popular Reddit/WallStreetBets stocks still have material downside. (As noted above, my repeated bearish views on these lottery tickets has been vindicated, at least for now.)

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