Positioning Recommendations – January 7th, 2022

Nearly all *EVA* readers should be aware that one of this newsletter's most repeated anti-recommendations over the last fifteen months or so pertains to what I've often called the COPS, my corny acronym for Crazy Over-Priced Stocks. After a spectacular first few months of 2021, it's been rough sledding for the COPS, in many cases going all the way back to last summer.

Two of the most publicized of those have been the poster-boy meme stocks, Gamestop and AMC Entertainment. Both are off to a much tougher start to the year than the stock market. The former is down 10% despite a 4% bounce today (on dubiously positive news) while the latter is off 14%. Over the past six months, they have tumbled by 28% and 50%, respectively. From their 2021 peaks, the red ink totals a very scarlet 70% and 65%, again respectively.

Of course, the list of stocks that could be characterized as outrageously overvalued remains a very long one, even if many of these have dramatically returned to Earth in recent months. A number have fallen even more precipitously than Gamestop and AMC. Consequently, I think it's fair to say that sometime in the first half of last year we passed the "Peak Insanity" stage.

As I've written before, this period seems to me to be remarkably similar to 2000 when the tech bubble met its maker. Back then, the overall market barely missed a beat but most of the stocks that had been the superstars during the Nasdaq's spectacular rise in the late 1990s began to vaporize.

Frankly, I think it's nearly inarguable that there were far more equities and other asset classes (using that term very loosely, per the next sentence) which had been caught up in the vortex of mass speculation during this bubble than there were 22 years ago. The case for this belief becomes even more conclusive when you consider the 6000 or so crypto currencies and countless NFTs (Non-Fungible Tokens, such as Gamestop announced yesterday) that sprang to life--however fleeting that may turn out to be--during what I have long called Bubble 3.0.*

Another echo of early 2000 is now rising interest rates. While the Fed has not yet started tightening, this week has seen another pummeling of longer-term bonds. The 10-year T-Note is hitting nearly 1.8% this morning, up from just above 1.5% last week. This rate rise is beginning to hit even the previously bullet-proof mega-cap tech names such as Microsoft and Apple, though, thus far, their pullbacks have been mild.

A further similarity with 22 years ago is that the previously neglected "old economy" stocks, such as energy, are rising even as supposedly hyper-growth—and, for sure, hyper-valued—sectors get slammed. The main energy ETF has risen 7% this year while the mid-stream energy infrastructure (MLPs) ETF has nudged up by 3 ½%.

Our Positioning Recommendation section has also repeatedly endorsed financial stocks and they have been acting well lately, too. On the disappointing side, are the precious metals miners. There's little doubt that is a function of the pop by treasury yields. Higher interest rates are perceived to be negative for gold and silver. Generally, that's true; however, given how far behind the inflation curve the Fed is presently, it's almost inconceivable it will be able to raise rates high enough to create a positive yield, net of inflation, at least anytime soon. In other words, even if the Fed were to hike eight times up to a bit over 2%, its key overnight rate would still be deeply negative in real terms. Once the market recognizes this reality, the precious

metals miners should produce a spectacular rally. Until then, stay patient!

*In an upcoming EVA, we will be announcing the re-publication of my book "Bubble 3.0". For those that read it in its original version, via this newsletter, there is a significant amount of fresh content, thanks to what has been—or, at least, had been--the ever-expanding nature of Bubble 3.0!

Positioning Recommendations

As indicated previously, we are beginning to reformat this section. Our goal is to make it less cluttered and, therefore, easier to read and assimilate. We also want to provide a sharper focus on our most (or least) favored ideas. Don't be shy about letting us know what you think of our changes.

Consistent with this format shift, this week I'd like to highlight our long-standing buy rating on the South Korean stock market. This is similar to Louis Gave's positive view of Japanese equities per today's main EVA. Both countries are export juggernauts and are extremely reasonably priced. They've also had important technical breakouts over the last year. In the case of the Korean market, it has corrected hard, down 20% from its early 2021 all-time high. It now trades at just 11 ½ times trailing (past 12 months) earnings and only 1.4 times sales. The comparative numbers in the US are 25 times earnings and 3.5 times sales (the highest ever for the latter).

LIKE

- Large-cap growth.
- Certain international developed markets, especially Japan
- Publicly traded pipeline partnerships, i.e., MLPs and other mid-stream energy securities.
- Gold-mining stocks
- Gold
- Silver
- Select international blue chip oil stocks
- Short-term investment grade corporate bonds
- Emerging market (EM) bonds in local currency (focusing on stronger countries, particularly in Asia)
- Large-cap value
- High-dividend equities with *safe* distributions
- Most cyclical resource-based stocks
- BB-rated corporate bonds
- Canadian REITs
- **South Korean Equities**
- Certain "Virus Victim" equities such as refiners, homebuilders, and select retail stocks
- Investment-grade floating rate corporate bonds
- The higher quality mortgage REITs
- Floating rate bank loans
- Copper producers
- Healthcare stocks

Based on rising interest rates, be careful with some of the more rate-sensitive sectors listed below, like REITs and preferred stocks, at least for now. As with gold and silver miners, I believe that, before long, the market will wake up to the reality of how little the Fed can tighten

without creating havoc in financial markets. The same is true with how far bond rates can go up without triggering serious weakness in US equities per my comments below.

- Uranium and uranium producers
- Renewable Yield Cos
- **A wide range of high-income securities, including preferred stocks**
- Intermediate-term investment-grade corporate bonds, yielding approximately 2.25%
- Mid-cap value
- Emerging stock markets; however, a number of Asian developing markets look undervalued
- **US-based Real Estate Investment Trusts (REITs)**
- Cash
- Canadian dollar-denominated short-term bonds
- One- to two-year Treasury notes
- Traditionally "safe" sectors such as Staples and Utilities
- Virus Victors
- Small-cap value
- European banks

As noted above, the bond market is on its heels this week. After such a sharp move up in yields, a mild retracement is possible, even probable. However, I do expect the 10-year T-note to hit very close to the 2% yield level and possibly even exceed it. How much it will be able to rise above that without causing equity market dislocations is highly uncertain but I suspect not a lot; anything approaching 2 ½% is likely to be problematic, especially if it gets there quickly. It is fair to note that the 10-year jumped as high as 3.24% in 2018, during the Fed's prior tightening cycle. Moreover, inflation is much higher today. However, unless it is a gradual and orderly rise, I doubt we're headed there again, at least not any time soon. The stock market is almost certain to cry uncle well before yields get that high.

Regardless, the weakness seen in bonds over the last year does validate my repeated negative views of them expressed in numerous EVAs last year (actually going back as far as the late summer of 2020 when the yield on the 10-year treasury was around 0.5%). After this week's swoon, the 10-year has a had a negative return of 5 ½%, since 12/31/20, while the 30-year has lost 8.6%. And, of course, this is before taking inflation into account.

Another area where I want to highlight increasing concerns is the previously very robust semiconductor sector. Our excellent semi analyst has mounting fears about excess supply in certain segments of this industry as 2022 progresses. Many of the names in this group continue to be extremely pricey (though, there are some pockets of value within it).

- **The Indian stock market**
- **Intermediate-term Treasury bonds**
- Small-cap growth
- **Long-term treasury bonds**
- **Long-term investment grade corporate bonds**
- Most municipal bonds
- US dollar
- **Many semiconductor tech stocks**

- Mid-cap growth
- Lower-rated junk bonds
- Green energy stocks
- SPACs
- Most new issues
- Despite a disastrous February, most of the popular Reddit/WallStreetBets stocks still have material downside.

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