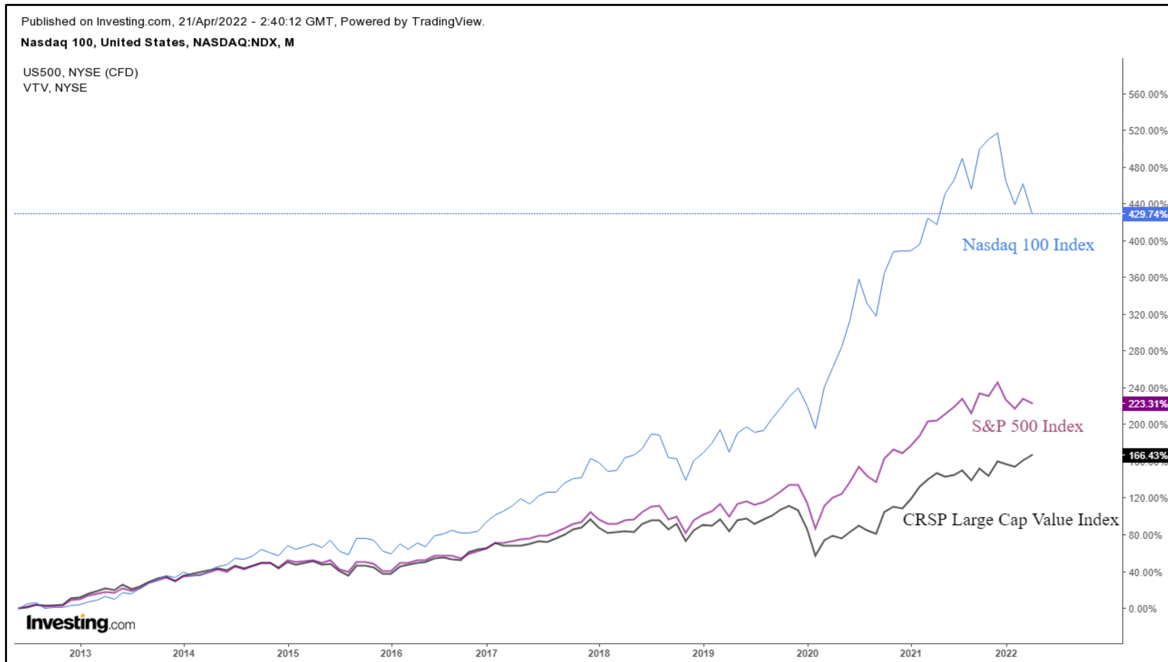
For the past decade, a bi-polar disorder has afflicted the asset markets. Investor demand for growth stocks surged. During the same time, investor interest in "value stocks" (e.g., established, goods-producing companies) languished. As a result, growth stocks soared into the bubble-sphere. Value shares suffered, mired in a decade-long depression.

Distorted central bank policies created the bi-polar asset markets. For the past decade, central bankers desperately tried to create inflation. They lowered interest rates to zero (in the U.S.) and below (in Europe and Japan.) They suppressed bond yields by buying up the supply of government bonds. They also purchased a substantial portion of the mortgage and corporate bond supply. Central bankers crowded private investors out of the bond market.

The suppression of bond yields distorted the stock market. Investment analysts used ultra-low bond yields to discount stock earnings and justify extremely high growth stock valuations. It led to a feeding frenzy for high-tech growth stocks.

Figure 1: Strong Growth Stock Performance of Past Decade-



Over the past ten years, the growth-heavy NASDAQ 100 Index earned 430%. The S&P 500 Index earned 223% return. The CRSP Large Cap Value Index earned 166%.

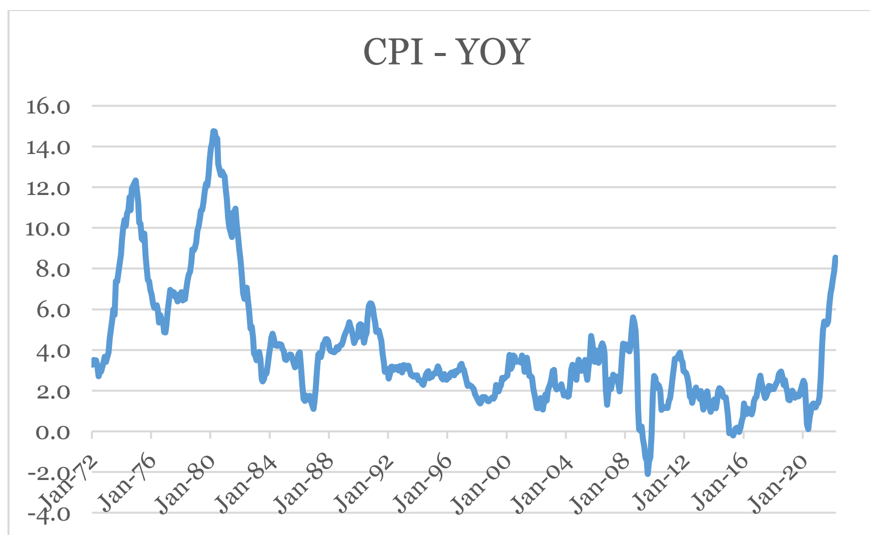
The Fed's money printing activity, which inflated growth stocks, failed to lift the inflation rate for goods and services.

Despite failure, the Fed followed the path of insanity… more of the same policy. In doing so, the Fed fueled a growth stock bubble and built a deep reservoir of inflationary fuel for the economy.

Then lightning struck. The pandemic gave Congress reasons to spend. It filled the wallets of consumers and businesses with stimulus checks, regardless of the need for assistance. As the lockdowns waned, the stimulus checks continued. The reopening of the economy unleashed a torrent of spending. Meanwhile, the pandemic and lockdown had changed consumer preferences. People wanted more spacious homes. They wanted automobiles for reliable, private

transportation. Businesses were not prepared to meet the changing and surging demand. Supply chains broke down, and an inflationary bonfire ensued.

Figure 2: Consumer Price Inflation History as of March 2022



Source: St Louis Fed

Adding fuel to the fire, the Biden Administration put the brakes on oil and gas production. Energy costs soared. Then sanctions related to Russia's recent invasion exacerbated global commodity shortages.

Early this year, the Fed finally pulled its head out of the sand and took notice of the disaster it had created. It stopped buying bonds and started to raise interest rates.

The Fed now claims to be committed to controlling inflation. If true, the course of the next year is set. Until the Fed induces a recession, interest rates and bond yields will soar. At best, growth stocks will languish. Some are plummeting.

The Great Asset Value Reset

As central bankers unwind the QE mistake… by raising interest rates and shrinking their balance sheets… the distorted asset markets will normalize. Stock and Bond investors will re-establish "value" as a critical variable for asset pricing.

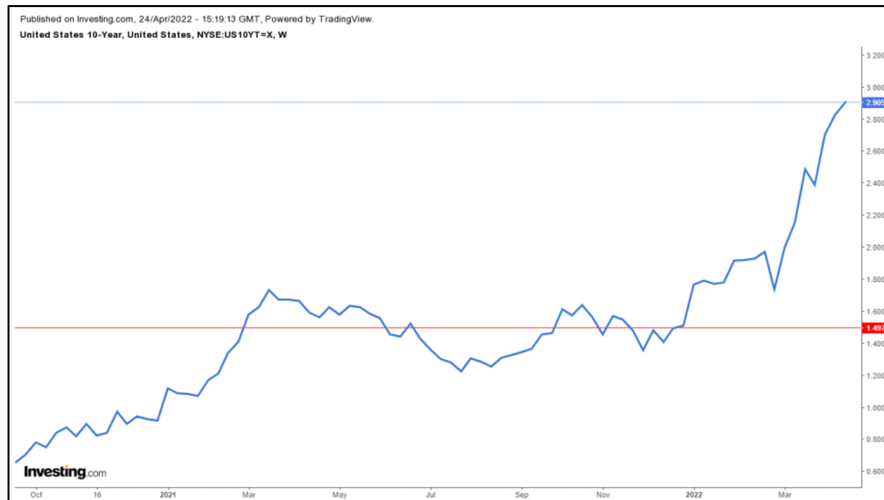
Where Are Bond Yields Going?

For the first time in years, free market forces can determine the level of bond yields. So far this year, the yield on the 10-Year Treasury jumped from 1.5% to 2.9%. Yields will continue to increase, but at a slower pace.

Because the Fed crowded private investors out of the bond market over the past decade, the private sector developed pent-up demand. As yields rise, long-suffering bond investors will

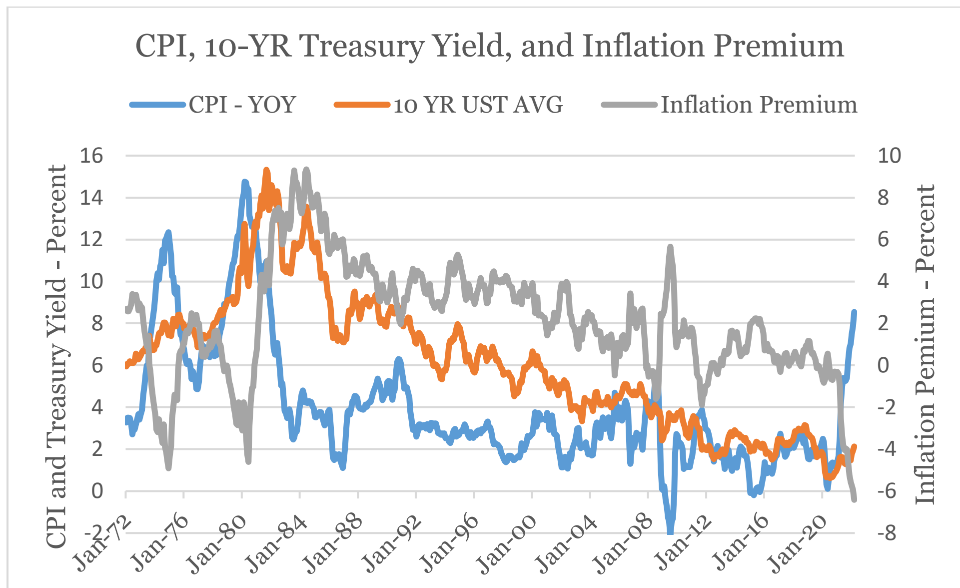
incrementally buy bonds, slowing the upswing in yields. Nevertheless, over the next few years, bond yields will go much, much higher.

Figure 3: 10-Year Treasury Note Yield, Oct 2021 – April 2022



Where will bond yields settle? The bond market will find a fair yield… where bond investors earn a premium over the expected rate of inflation. Figure 3 graphs CPI inflation, the 10-Year Treasury yield, and the difference between the two factors (aka "Inflation Premium").

Figure 3: CPI, Treasury Yield, and Inflation Premium as of March 2022



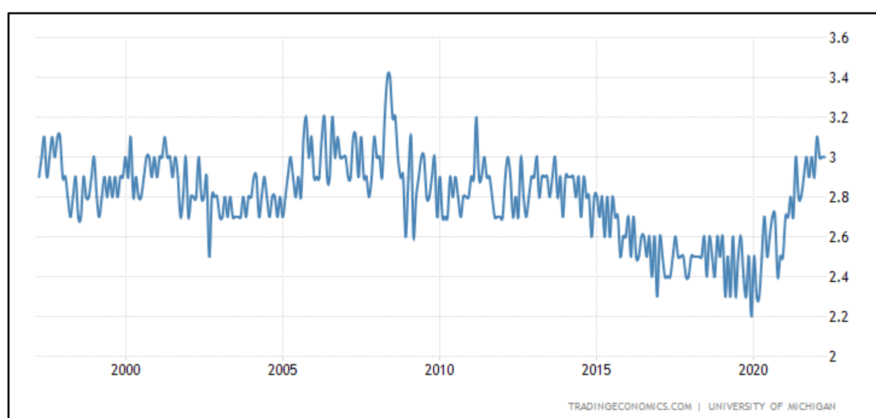
Source: St. Louis Fed

The graph plots Inflation (CPI) in blue and the 10-Year Treasury Note Yield in orange on the left-hand axis. The graph plots difference between these two factors, the Inflation Premium in gray on the right-hand axis.

Over the past 50 years, the Inflation Premium has averaged 2.14%. If history serves as a guide, 10-Year Treasury yields will converge toward about 2% over the expected long-term inflation rate.

So, if we can quantify the expected rate of inflation, we can estimate the future level on bond yields. The University of Michigan 5-Year Inflation Expectations Index represents a good measure of inflation expectations.

Figure 4: Michigan 5-Year Inflation Expectations



Source: TRADINGECONOMICS.COM

In the past year, inflation expectations surged to 3%. Thus, if expectations hold at this level, the 10-Year Treasury yield will eventually push towards 5%.

Of course, inflation expectations could rise or fall from current levels. The bond yield expectation will adjust accordingly.

Stock Market Implications of High Treasury Bond Yields

For the first time in over a decade, bonds will provide a viable investment alternative to equities. In a mirror-image of the past decade, as bond yields rise, investors will sell stocks to buy bonds. The average PE ratio of the S&P 500, currently 22, will revert to the historic average, around 16. In the absence of earnings growth, this implies a 28% market decline, putting the S&P 500 around 3200. Ouch, that would hurt!

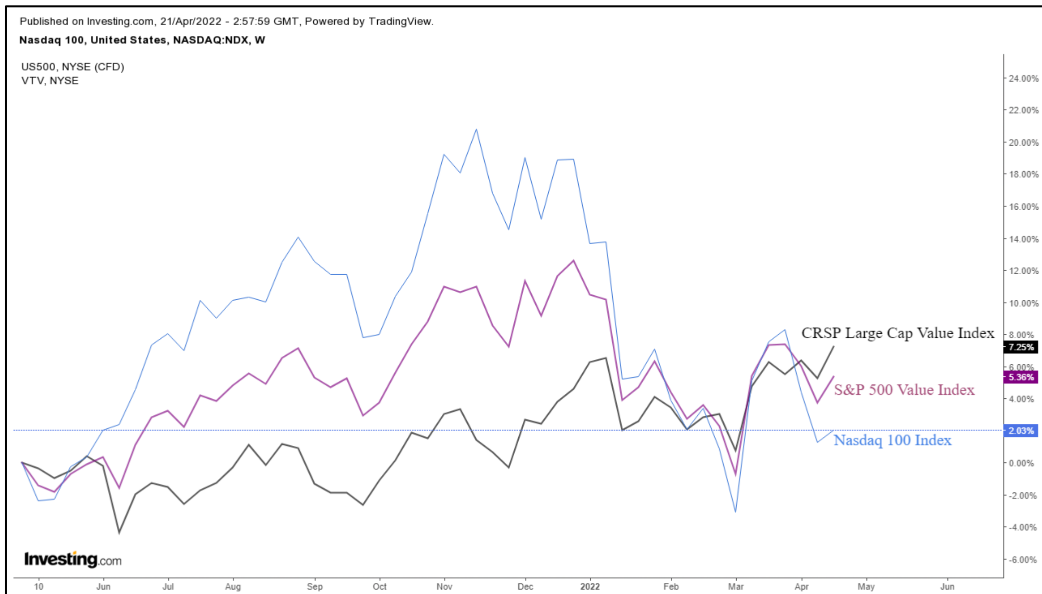
Of course, earnings will continue to rise, and that will mitigate potential losses.

Growth stocks will suffer the most damage. As bond yields rise, so will the discount rate on future cash flows. The more bond yields rise, the more growth stocks underperform value stocks. This phenomenon has already started, and it will accelerate as yields move even higher.

Figure 5 shows relative performance of growth stocks and value stocks over the past year.

Yields started to rise in October. At that time, growth stock performance peaked. Since then, growth stocks declined. Value stocks have continued to generate steady, positive returns.

Figure 5: Negative Growth Stock Returns Amid Rising Rates



The Economy and Markets

The broad market has been trading at overvalued levels for about a year and is now correcting.

Figure 6: S&P 500 Index as on 4/22/2022

The correction should take the S&P 500 Index down to 3850 at a minimum. If an external calamity accompanies the correction, the index could potentially fall to 2700.

On the other hand, the index of value stocks trades around the middle of the historical valuation band. (See Figure 7.) No doubt, value stocks will decline along with the overall market. But value stocks have less downside risk, compared to growth stocks.

Figure 7: Vanguard Value Fund (CRSP Large Cap Value Index) as of 4/22/2022

The *Vigilante Investor* Scorecard of Economic Conditions foretells substantial growth and inflation in the months ahead. The growth score (5 to 1) confirms a red-hot business expansion. Likewise, the inflation score (4 to 1) reinforces expectations for high inflation.

Table 1: Vigilante Investor Scorecard of Economic Conditions –as of 4/22/2022

Score	Positive	Neutral	Negative
Growth 5 Contraction 1	US Real GDP +5.5% US Non-Manf PMI 58.3 Global Comp PMI 52.7 Fed Signal +11.2% US Productivity +2.1%		US 2-10 Spread +0.27%
Inflation 4 Deflation 1	CPI +8.5% YOY US Wages +5.6% YOY Crude Oil +55.7%YOY Gold / Euro +18.8%YOY	Gold +5.2% YOY	US Dollar +12.2% YOY
Positive $ 2 Negative $ 0	US-Ger2YR Spread +2.40% US-Ger10YR Spread+1.94%		

Sources: Tradingeconomics.com, St. Louis Fed, and Investing.com

Despite the current economic momentum, the economy will head into a recession within a year's time. The normalization of interest rates will slow the housing sector. Other interest-rate sensitive sectors, like autos and capital spending, will slow as well. But those sectors alone cannot make the economy contract.

Vigilante Investor expects a large decline in stock values to trigger a recession. As investor portfolios shrink, consumers will spend less, and the economy will contract.

The depth of the recession depends on the Fed. If the Fed responds by reversing recent interest rate hikes, confidence will return quickly. That would limit the pain of the recession, but it would also leave the Fed further behind the curve on the fight to control inflation. If, on the other hand, the Fed continues to raise rates until it tames inflation, the economy will contract more significantly.

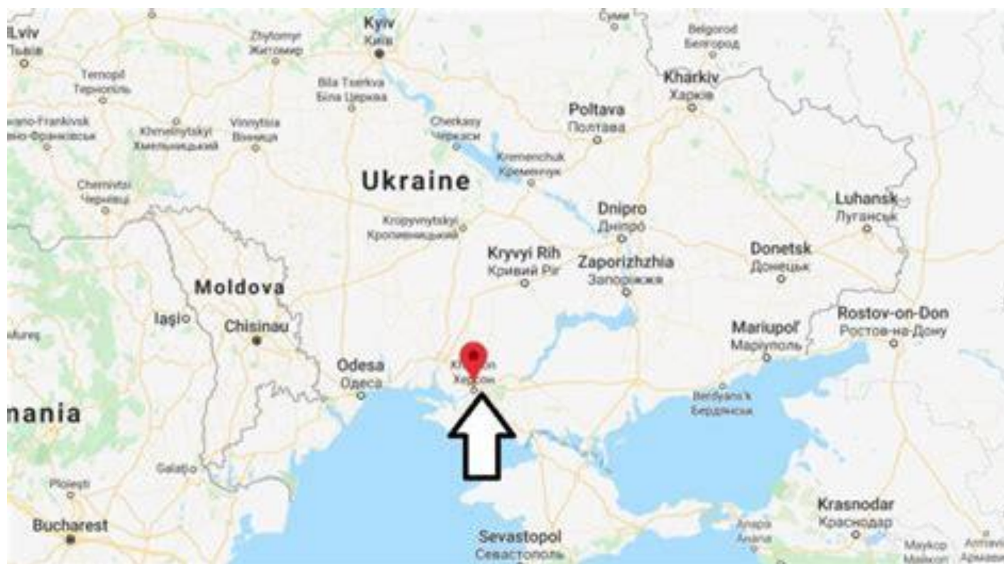
A Few Words on the Invasion of Ukraine

Sadly, the suffering of the Ukrainian people has not motivated world leaders to end this conflict … not Putin… not Zelensky… not Scholz or Macron or Johnson or Biden.

The good news for the West is that Ukraine is destroying Russia's military capability. Russia started the war with an undersized army due to its aging and shrinking population. Thanks to Ukrainian attacks, Russia's army is getting even smaller. So far, Ukraine has killed over 20,000 Russian soldiers. More have been seriously wounded. Russia is losing the capacity to threaten other nations with a conventional strike.

Because of substantial casualties and equipment losses, Russia abandoned its original plan to take Kyiv. Russia reverted to plan 2… to seize southeastern Ukraine. Russia has made little progress on plan 2.

Figure 8: Ukraine – Strategic Importance of Mariupol, Kherson and Dnieper River



Source: wherismap.net

When all else fails, Russia resorts to a scorched earth strategy. As it did to Grozny in 1999 and Aleppo in 2016, Russia leveled Mariupol (in the south) before seizing control. Russia will consolidate its gains around Mariupol. Figure 8 shows the strategic importance of Mariupol for establishing its strategic "land bridge" to the Crimean Peninsula.

Russia's only military success came early in the war, when it seized the strategic port city of Kherson. This city is as critical to Ukraine as Vicksburg was to the U.S. during the Civil War. A permanent loss of control of the Mississippi River would have rendered America's industrial and agricultural heartland worthless.

Similarly, Kherson sits at the mouth of the Dnieper River, where it empties into the Black Sea. Figure 8 shows that the Dnieper River serves as a vital waterway for Ukraine's heartland, connecting the inner cities, rich farmland, and productive mines of Ukraine with the rest of the world. Ukraine's survival depends on regaining Kherson and the entire Dnieper River valley. Absent genocide or nuclear annihilation, Ukraine will never give up the fight for Kherson.

This war will continue, indefinitely. Ukraine's leadership will continue to contest Russia, regardless of the human toll. The West will continue to provide Ukraine lethal weapons, as needed to keep the war going. Russia will continue its offensive until it either obtains its strategic goals or suffers defeat.

Battles throughout Ukraine have turned into a bloody stalemate… reminiscent of Stalingrad in World War II. During Stalingrad, America supplied Russia's war machine. This time America is supplying Russia's opponent. Conversely, logistical incompetence has stymied Russia's war effort. Russia will face ever greater challenges obtaining supplies due to western sanctions. Eventually, Russian troops will run out of supplies. I just hope Russia doesn't hit the nuke button to avoid defeat!

Consequences of the war will weigh on the markets and world order.

- Ukraine has destroyed Russia's future offensive capability. Russia cannot launch another invasion for a long time.
- The world must replace Russian energy. Russia cannot maintain recent production levels of oil and gas without the benefit of western technology. Exxon, Shell, Schlumberger, and Haliburton have all abandoned Russia, and Russia cannot replace that expertise. Russian energy production and exports will not recover for decades, regardless of the war outcome.
- World hunger will rear its ugly head, leading to revolution in some countries. The decline of Ukrainian and Russian grain exports will severely curtail global food supplies over the next year. Current food shortages will worsen in the coming years due to the embargo on Russian fertilizer exports. Shrinking global fertilizer applications mean less global food production, period.

Investment Strategy

Last quarter, *Vigilante Investor* recommended "purchases (of stocks) at around 4200 on the S&P…but don't deploy the entire hoard of cash unless the S&P 500 reaches a downside target of around 3400."

Specifically, *Vigilante Investor* recommended buying **Simon Property Group (SPG)** "starting at a price of $132, filling the entire position at around $120 per share."

The S&P 500 closed slightly below 4200 on March 8 and on March 14, giving us the chance to add to the portfolio. Simon Property Group, (SPG) traded between $123 and $132 per share, allowing acquisition at an average of $127 per share.

Opportunity in Oilfield Services

Nine Energy provides oilfield services in support of land-based well-completion activities in North America. Nine Energy concentrates on hydraulic fracturing services, including cementing of laterals, wireline services that perforate laterals and set plugs, tools and services that isolate each stage of laterals, drilling-out of isolation plugs, and coiled tubing services.

Nine Energy has secured multiple patents for its downhole tools, products, and techniques. Nine pioneered the development of dissolvable frac plugs. These plugs isolate each stage of each lateral during hydraulic fracturing. Compared to traditional frac plugs, dissolvable plugs enable the elimination of the drill-out process, thus reducing well completion time and costs about 20%. Nine has increased market share for patented, dissolvable frac plugs, from around 10-15% in 2018 to 20-25% in 2021. The company projects 35-50% market share by the end of 2023.

Nine Energy has developed an extensive list of blue-chip customers, including Pioneer Natural Resources, Conoco Phillips, Endeavor Energy Resources, EOG Resources, XTO Energy, Southwestern Energy, Diamondback Energy, Devon, and Aethon.

Nine Energy represents a risky bet on the recovery of the energy sector. Oilfield services reside at the bottom of the food chain of the oil & gas industry. In good times, producers desperately need more oilfield services, and service providers command premium prices. But during lean times, oil & gas producers can negotiate extremely low service prices. The lean 2019 to 2021 period severely damaged oilfield service companies. Those with substantial debt, such as Nine Energy, struggled to survive. Three consecutive years of weak sales, poor profit margins, restructurings, and write-offs left the company in a difficult financial position.

The following excerpt explains Moody's low credit rating (of Caa3) on Nine Energy debt.

> "Nine Energy Service, Inc.'s Caa3 Corporate Family Rating (CFR) reflects Moody's view that the company has an untenable capital structure given the still high debt burden despite bond repurchases. The company has high leverage and weak interest coverage. The oilfield services sector is highly competitive amid continued capital discipline by upstream companies which impedes Nine's ability to sufficiently improve its credit metrics. There are rising risks of restructuring as debt maturities approach. The company has small scale and intense competition in a difficult operating environment. Nine is supported by its cash on the balance sheet, modest maintenance capital spending needs and its undrawn ABL revolver."[1]

Table 2 summarizes Nine Energy financials.

[1] https://finance.yahoo.com/news/nine-energy-inc-moodys-announces-185208264.html

Table 2: Nine Energy, Inc. as of 4/22/2022

Ticker	NINE	EPS	$-2.13	Expected 5-YR Growth	NA
Price	$2.77	EPS Forecast	$0.08	Forward P/E	34.6
Book/Share	-$1.29	Market Cap	$101M	Credit Rating	Caa3
Dividend Yield	0%	Enterprise Value	$433M	Debt/Ent Value	77%

Sources: Finviz.com, Seeking Alpha

The dismal financials and credit rating reflect the challenges of the past three years.

However, Nine Energy can look forward to better times ahead. Producers are trying to increase oilfield production. Oilfield service pricing is strengthening. Furthermore, Nine has the best technology, equipment, products, and people in the business. It will earn higher revenues and profit margins as oil & gas production increases.

Figure 9: Nine Energy as of 4/25/2022

Source: Finviz

As Nine Energy's outlook improves, the company may issue additional equity. A prospective equity offering would dilute existing shareholders, but it would also provide a secure financial condition for the company.

Recommended Strategy: Buy ½ of a normal position below $3.20 per share. Use a 50% stop loss to manage your risk.

Gold and Precious Metals

Gold and silver prices rallied this past quarter. The *Vigilante Investor* basket of mining stocks rallied even more than the metals. However, two of the basket holdings, Junior Gold Miners ETF and Silver Miners ETF, remain extremely cheap.

Table 3: *Vigilante Investor* Precious Metal Scorecard[2] as of 04/25/2022

Precious Metal ETF	Price	Ratio	Hist Avg	Rating
GLD	177.05			
SLV	21.83	8.11	6.08	3
Stocks vs GLD	**Price**	**Model**	**vs. Model**	**Value Rating**
Jr. Gold Miners ETF (GDXJ)	$43.89	$50.21	-6.32	2
Barrick Gold (ABX)	$22.73	$24.36	-1.63	4
Gold Miners ETF (GDX)	$35.67	$36.93	-1.26	4
Newcrest Mining (NCM)	$19.42	$20.86	-1.44	4
Sandstorm Gold	$7.82	$7.91	-0.09	5
Wheaton Precious Metals (WPM)	$46.26	$46.05	0.21	5
Yamana Gold (AUY)	$5.58	$5.22	0.36	6
Royal Gold (RGLD)	$134.96	$121.81	13.15	7
Newmont Mining (NEM)	$72.61	$65.18	7.43	8
Stocks vs SLV	**Price**	**Model**	**vs. Model**	**Value Rating**
Silver Miners ETF (SIL)	$34.14	$39.55	-5.41	1
Pan American Silver (PAAS)	$25.50	$27.79	-2.29	4
Hecla Mining (HL)	$5.60	$5.47	0.13	5

Model Portfolio Summary

This quarter, we recommend selling Citigroup shares despite cheap valuation. Citigroup management has been unsuccessful at generating the potential for significant earnings growth, and it will suffer an increase in credit losses in the coming recession.

Table 4: Vigilante Investor ETF Model Portfolio 04/25/2022

All ETF Portfolio	%	Selections	Symbol	Initial Price	Price April 25
Broad Market	8%	VG Mid-Cap Value ETF	VOE	$122.88	$147.04
	8%	VG Large-Cap Value ETF	VTV	$121.81	$145.28
Financials	8%	VG Financials	VFH	$88.21	$88.19
	14%	iShares U.S. Insurance	IAK	$84.25	$88.88
Energy	30%	First Trust Revere Nat Gas	FCG	$19.01	$24.04
Real Estate	12%	Vanguard Real Estate ETF	VNQ	$109.88	$109.47
Precious Matals	5%	VanEck Vectors Gold Miners	GDX	$32.75	$35.67
	5%	Global X Silver Miners	SIL	$39.51	$34.14
Cash	10%	VG ST Corporate Bond ETF	VCSH	$83.12	$77.12

[2] The Vigilante *Investor* Scorecard rates large and mid-sized miners, streaming companies, and ETFs. The cheapest securities have the lowest Value Ratings, color coded in green. Fair Value is yellow, and expensive stocks are red. The scorecard also rates SLV, the iShares Silver Trust, relative to gold bullion.

Table 5: The Vigilante Model Portfolio 4/25/2022

Sector	%	Selections	Symbol	Initial Price	Price April 25
5G	8%				
		Qualcomm Inc.	QCOM	$164.40	$136.56
		Nokia Corp	NOK	$4.85	$5.21
Low-Tech America					
Steel	4%	Cleveland Cliffs Inc.	CLF	$16.58	$27.75
Financials	21%	Citigroup Inc.	C	$60.56	Sell $51.14
		Prudential Financial	PRU	$81.96	$113.95
		Chubb	CB	$165.98	$207.32
		Aflac	AFL	$53.38	$62.41
		AIG	AIG	$47.54	$59.73
		WR Berkley	WRB	$53.58	$67.94
Transportation	4%	Dorian LPG Ltd.	LPG	$11.86	$14.19
Energy	25%	Diamondback Energy	FANG	$61.33	$125.82
		CNX Resources	CNX	$12.21	$21.05
		Pioneer Natural Resources	PXD	$147.07	$231.17
		Coterra (Formerly Cabot)	CTRA	$18.69	$28.65
		Southwestern Energy	SWN	$4.06	$7.43
		Nine Energy	*NINE*	*<$3.20*	*$2.77*
		Plains All American Pipeln	PAA	$9.02	$10.53
		Cameco Corp	CCJ	$12.73	$27.00
Real Estate	15%				
		Granite Point Mortgage	GPMT	$9.87	$10.08
		Vanguard Real Estate ETF	VNQ	$109.98	$109.47
		Simon Property Group	SPG	$127.00	$126.32
Agriculture	5%	Mosaic Co	MOS	$28.67	$63.61
Emerging	0%				
Precious Metals	8%	Junior Gold Miners ETF	GDXJ	$46.02	$43.89
		Gold Miners Index	GDX	$29.30	$35.67
		Pan American Silver	PAAS	$21.13	$25.50
		Silver Miners ETF	SIL	$42.00	$34.14
Cash	10%	VG ST Corporate Bond ETF	VCSH	$83.12	$77.12

Have a great quarter!

Steve Koomar

April 26, 2022

Disclosures

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