Theoretically, the Fed should serve as a moderating force, patiently adjusting interest rates to smooth the cyclical swings in the economy. Not Jerome Powell's Fed.

Powell's Fed delivered the most expansive monetary policy in American history. Despite soaring growth and inflation in 2021, Powell kept the Fed Funds Rate pinned at zero while pumping up the money supply with Quantitative Easing. At the time, Powell flippantly rationalized the Fed's extreme dovishness, stating that inflation was "transitory".

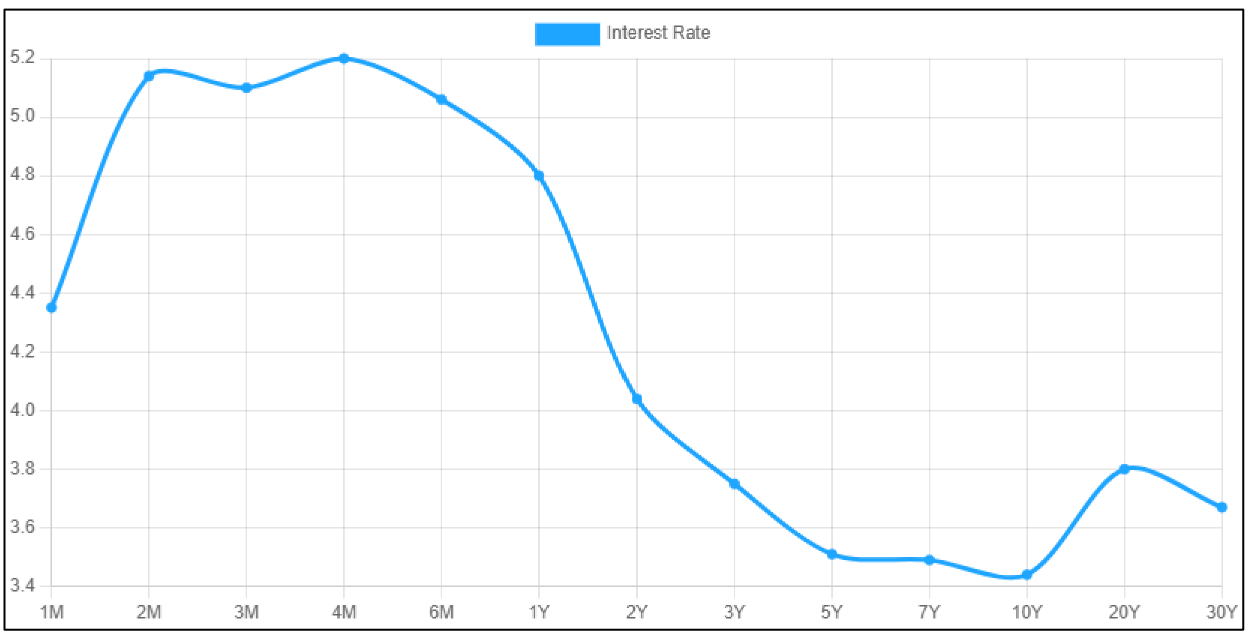
For the next year, the Fed fueled a raging fire of inflation.

In March 2022, the Fed finally started to put out the fire. Within a year, the Fed raised its interest rate by a record 4.75%, cutting inflation in half. But the Fed remains wary of the persistent strength of consumption. Thus, the Fed continues to drown the economy with interest rate increases.

So now, just one year after the most dovish Fed ever, we may have the most hawkish Fed ever.

Bond investors agree that the Fed is now unnecessarily hawkish. They believe the Fed will soon see the error of its ways and cut rates. Bond investors have put their money where their proverbial mouths are. They are paying higher prices for bonds, driving down long-term yields. The current Treasury Yield Curve reflects expectations of large interest rate cuts in the next year.

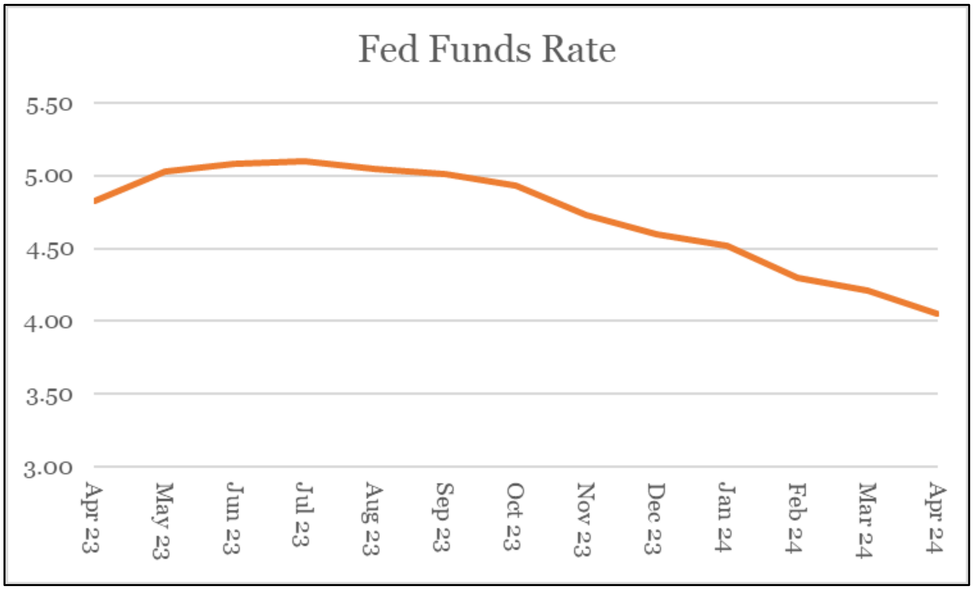
Figure 1: Yield Curve of Treasury Interest Rates- 4/28/2023



Source: USTreasuryYieldCurve.com

When and how much will the Fed cut interest rates? The CBOT Fed Funds Futures contracts show the market expectation for Fed Funds interest rates.

Figure 2: Fed Funds Rate Futures as of 4/28/2023



Source: Investing.com

Investors expect the Fed to start cutting rates by October and to slash the interest rate by 100 bps by next April.

What is the Fed Missing?

Many analysts have failed to grasp the importance of a one-time factor. Since the start of the pandemic lockdowns, it has boosted consumption by about 1% of GDP. It will reverse by September of this year, dragging GDP down by about 1%.

In 2020, to help young workers cope with lockdown layoffs, the Trump administration placed a moratorium on Student Loan debt repayments. The moratorium provided a windfall for Millennial and Gen Z households which is fueling consumption and inflation.

Keep in mind, the "young adult" demographic group always serves as the engine for consumption. Adults aged 22 to 45 naturally have enormous needs. They must spend heavily (and borrow) to establish households. The initial purchase of autos, housing, and related big-ticket items requires extensive borrowing. Childbirth puts spending on an even higher trajectory. When young adults get a windfall, they tend to spend it.

This is exactly what happened with the windfall from the Student Loan moratorium. Young adults spent it. Consider the impact of every Student Loan borrower spending a windfall at the same time? Of course, prices must rise. No supply chain in the world could have prepared for the sudden surge in demand.

The moratorium should have ended with the 2021 recovery, but the Biden Administration kept it in place. The windfall of consumption continues to this day.

Before announcing an end to the moratorium, President Biden signed an executive order to forgive up to $20,000 of debt per Student Loan Borrower. If forgiveness is allowed, about a quarter of borrowers will have no future debt payments. Thus, questions about the constitutionality of Biden's forgiveness plan have delayed the end of the moratorium.

Before the end of its current term (June 30), the Supreme Court will rule on the constitutionality of Biden's forgiveness plan. The Biden Administration will end the moratorium and resume debt collections 60 days after the Supreme Court decision.

Thus, by September 1, borrowers will resume Student Loan payments. The windfall will end. Loan payments will displace consumption, depressing economic growth. Table 1 analyzes the likely volume repayments. It will likely cut GDP by -0.73% if the Court allows Biden's forgiveness plan... or by -0.96% if the Court disallows it.

Table 1: Impact of Ending Student Loan Moratorium

	$Billions Without Forgiveness	$Billions With Forgiveness
Total Student Loan Debt	$1,757.224	$1,327.224
Assumed Interest Rate	6%	6%
Annual Interest Due	$105.433	$79.63
Annual Principal (12 Year)	$146.435	110.602
Annual Student Loan Obligation	$251.869	$190.24
% of GDP	0.96%	0.73%

Data Sources: St Louis Fed, Ned Wallet, Lending Tree

Considering that the economy is growing at a 1% annual rate, the immediate 1% drop in consumption will tip the economy into recession.

By then, the economy will feel the full impact of 500 bps rate hikes, adding momentum to a vicious, deflationary contraction.

Unemployment will rise, inflation will plunge. Due to divided government, the Congress cannot rescue the economy with fiscal stimulus. In a Presidential election year, policymakers will totally depend on the Fed to rescue the economy with rate cuts. In the typical extremist fashion of Jerome Powell, he will cut rates aggressively. Don't be surprised if rates fall below 3% before the next election.

Fed Policy and the Regional Bank Crisis

The recent failures at Silicon Valley Bank and Signature Bank stem from poor asset-liability management. These banks grew accustomed to paying 0% for deposits. As deposits soared in recent years, they mindlessly invested excess funds in the bond market, paying no attention to interest rate risk.

Rising interest rates caused bond yields to rise... and bond prices to plunge. Banks suffered losses on their bond portfolios. Some banks avoided recognizing a loss by categorizing bonds as "Hold-to-Maturity" securities. This strategy worked initially. Since banks were paying zero interest on deposits, they could still earn a small margin on underwater bond holdings while avoiding the recognition of losses.

Eventually, the music stopped. Deposits started to flow out of certain banks. Initially, the comparatively high rates on money market funds enticed deposit withdrawals. The withdrawals cascaded as solvency worries emerged for certain regional banks… leading to an avalanche when Silicon Valley and Signature Banks collapsed. Another bank will drop this weekend, First Republic Bank.

Absent First Republic, most regional banks have stabilized their deposits. Many banks had to pay competitive market rates on CDs to attract depositors. Thus, most regional banks will report somewhat lower interest margins and lower earnings.

Understandably, stock prices for regional banks have taken a big hit. However, some regional banks do not deserve to be painted with the same broad brush. Indeed, most regional banks rely on lending. Most avoided big bond investments and thus avoided big bond losses.

For the well-managed regional banks, the recent bear market created bargain stock prices for investors.

Until the Fed starts lowering rates, regional bank stocks will probably remain mired in a bear market. This provides an opportunity for investors to patiently accumulate shares of well-managed, well capitalized bank stocks. Whenever the cycle turns higher, these stocks will enjoy significant upside. Many will double over the next two to three years.

America's Best-Managed Bank – Bank OZK

Established 1903 in Jasper, Arkansas, Bank of Ozark changed its name to Bank of the Ozarks in 1994 and then to Bank OZK in 2018. For the most part, Bank OZK operates in Arkansas, Texas, Georgia, Florida, and North Carolina

Bank OZK has thrived under the steady leadership of George Gleason, Chairman and CEO since 1979. The bank maintains a diversified, conservative asset portfolio which is principally sourced from its own loan origination platform.

Bank OZK leans heavily on real estate lending, which comprises 62% of the loan portfolio. The real estate portfolio is highly diversified, with 29% multi-family, 17% Mixed-Use, 16% Office, 10%Medical and Condo, and 8% Industrial.

Bank OZK's next largest lending category, behind real estate, is Community Banking, with 22% of the loan portfolio.

Bank OZK loan quality and performance ranks among the best in the country. Since going public in 1997, annual net charge-offs outperformed the industry in EVERY year. Bank OZK charge-offs have averaged 35% of the industry during these past 25 years. More recently, over the last ten years, annual net charge-offs averaged 14 bps, which is 31% of the industry's ratio. For 2022, Bank OZK's net charge- off ratio was 0.04%, compared to the industry average of 0.24%.

Bank OZK operates a very efficient lending machine. The bank has developed a great loan origination team. It maintains a conservative loan-to value ratio ("LTV'), currently 43%. Very few Bank OZK loans go into default. Of the loans that do default, Bank OZK typically recovers most… if not all the principle.

Interest Rate Risk and Deposit Stability

Let us not forget the worries-of-the-day.

Bank OZK holds a small bond portfolio equal to 12% of its assets. The bank uses bond holdings for liquidity management. The bonds are held as "Available-For-Sale", which means that the assets are marked-to-market. Any losses related to rising bond yields have been recognized. The bank holds shorter-maturity bonds (Duration = 3.6 years), so the losses were modest.

What about the stability of deposits? Bank OZK is bucking the reginal bank outflow trend. In the first quarter of 2023, deposits increased by 3.6%. About 40% of deposits are uninsured.

Why now?

Bank OZK holds high-margin assets in the form of variable-rate loans. The Bank's funding rate is increasing less than the interest rate on its loans. Thus, the bank's Net Interest Margin (NIM) is increasing. In the latest quarter, Bank OZK's NIM reached 5.5%.

Due to its highly efficient operations, Bank OZK shareholders retain most of the benefit of the high NIM. Bank OZK enjoys the industry-leading efficiency ratio of 33.6%. The Efficiency Ratio is defined as *Non-Interest Expense/Revenue*. According to Investopedia, a 50% Efficiency Ratio is considered optimal. Most banks maintain a ratio between 50% and 66%. Bank OZK's ratio is off-the-chart. With extremely high productivity and efficiency, Bank OZK delivers more profitability to shareholders than just about any other bank in the country.

Table 2: Bank OZK as of 4/28/2023

Ticker	OZK	**EPS**	$4.93	**Forward P/E**	6.67
Price	$35.72	**EPS Forecast**	$5.35	**Expected 5-Yr Growth**	12.0%
Book/Share	$36.95	**Tangible Book/Share**	$32.68	**Credit Rating LT Deposit**	A3
Dividend Yield	4.12%	**Market Cap**	$4.58B	**Tier 1 Capital Ratio**	12.6%

Sources: Finviz.com, Yahoo Finance, Shareholder Report

Bank OZK is trading with a forward P/E ratio of 6.67, which is about half of the expected 5-year growth rate. This shows the exceptional value of the current stock price.

The downside risk is limited, as the liquidation value (Tangible Book) is just 8.5% below the current price.

Recommended Strategy: Buy ½ position of OZK at current prices and add another ½ position below $34 per share.

Figure 3: Bank OZK as of 4/28/2023

Source: Finviz

The Economy and Markets

Several economic indicators switched from contraction to growth in the past quarter. The indicators now favor growth by a score of 4-to-2.

However, the most important long-term prosperity indicator, productivity, has turned decidedly negative. This is a very bad omen for the U.S. economy. Without rising productivity, growth cannot be sustained.

Table 3: Vigilante Investor Scorecard of Economic Conditions April 28, 2023

Score	Positive	Neutral	Negative
Growth 4 Contraction 2	US Real GDP +1.6% YOY Fed Signal +2.1% US Non-Manf PMI 51.2 Global Comp PMI 53.4		US Productivity -2.1% US 2-10 Spread -0.79%
Inflation 3 Deflation 1	CPI +5.0% YOY US Wages +4.2% YOY Gold +10.4% YOY	US Dollar -2.8% YOY Gold / Euro +4.5%YOY	Crude Oil -30.5% YOY
Positive $ 2 Negative $ 0	US-Ger2YR Spread +1.30% US-Ger10YR Spread+1.11%		

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

Indicators still favor inflation by a score of 3-to-1. Except for Gold, all the price-level indicators are beginning to trend toward deflation.

The Stock Market

The stock market indices have shown resilience, rallying around 20% from the 2022 bear-market lows despite ongoing rate hikes and the imminent threat of recession.

Figure 4: S&P 500 Long-Term Log Chart

However, market gains are narrowly focussed in mega-cap tech stocks. Alphabet rallied 25%, Amazon 32%, Apple 36%, Microsoft 40%, Tesla 64%, Nvidia 99%, and Meta 170%. The rest of the market is trending lower.

Two factors contribute to the relative strength of mega-cap tech, the decline in bond yields and the Artificial Intelligence (AI) craze. The lowering of bond yields has added substantial value to long-duration tech stocks. Also, Chat GPT and related AI developments has inspired significant buying of Microsoft and Nvidia shares.

The divergence between tech stocks and the rest of the market will not continue forever. Either the broad market will join the rally or tech stocks will get pulled down by the coming recession. I favor the latter scenario.

Portfolio Changes

Over the course of the past quarter, we added the other half of the ProPetro position at $7.00, bringing the average cost for the full position to $8.25.

We are selling our position in Qualcomm. The 5G chip leader has harvested much of the gains from the 5G conversion. Additionally, Qualcomm doesn't make its own chips, making it very vulnerable to shutdown if there is a war over Taiwan. Finally, chipmakers tend to struggle during recession. Three strikes… and Qualcomm is out!

Otherwise, we remain defensive, with large positions in cash and inflation-linked bonds. Investors should prepare for recession, a broadening of the war in Europe, and the increasing likelihood of war over Taiwan.

Table 4: The Vigilante Model Portfolio as of 4/28/2023

Sector	%	Selections	Symbol	Initial Price	Price Apr 28
5G	0%	Qualcomm Inc.	QCOM	$164.40	$116.80
Low-Tech America					
Financials	20%	Chubb	CB	$165.98	$201.56
		Aflac	AFL	$53.38	$69.85
		AIG	AIG	$47.54	$53.04
		WR Berkley	WRB	$53.58	$58.92
		Bank OZK	OZK	$35.72	$35.72
Energy	28%	ProPetro	PUMP	$8.25	$6.94
		Diamondback Energy	FANG	$61.33	$142.20
		Black Stone Minerals	BSM	$17.36	$16.54
		Coterra (Formerly Cabot)	CTRA	$18.69	$25.60
		Southwestern Energy	SWN	$4.06	$5.19
		Antero Resources Corporation	AR	32.67	22.99
		Plains All American Pipeln	PAA	$9.02	$12.90
		Cameco Corp	CCJ	$12.73	$27.49
Agriculture	4%	Mosaic Co	MOS	$28.67	$42.85
Precious Metals	10%	Junior Gold Miners ETF	GDXJ	$46.02	$39.75
		Gold Miners Index	GDX	$29.30	$33.58
		Pan American Silver	PAAS	$21.13	$17.81
		Silver Miners ETF	SIL	$42.00	$29.88
		Newmont Mining	NEM	$53.32	$47.40
TIPS	18%	VG ST Infl Protected Sec ETF	VIPSX	$12.90	$12.18
Cash	20%	Broker Money Fund			

Table 5: Vigilante Investor ETF Model Portfolio 4/28/2023

All ETF Portfolio	%	Selections	Symbol	Initial Price	Price Apr 28
Broad Market	4%	VG Mid-Cap Value ETF	VOE	$122.88	$134.99
	4%	VG Large-Cap Value ETF	VTV	$121.81	$140.56
Financials	4%	VG Financials	VFH	$88.21	$79.58
	14%	iShares U.S. Insurance	IAK	$84.25	$88.90
Energy	24%	First Trust Revere Nat Gas	FCG	$19.01	$23.11
Real Estate	0%				
Precious Matals	5%	VanEck Vectors Gold Miners	GDX	$32.75	$33.58
	5%	Global X Silver Miners	SIL	$39.51	$29.88
	20%	VG ST Infl Protected Sec ETF	VIPSX	$12.90	$12.18
Cash	20%	Broker MoneyFund			

Have a great quarter!

Steve Koomar

April 29, 2023

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