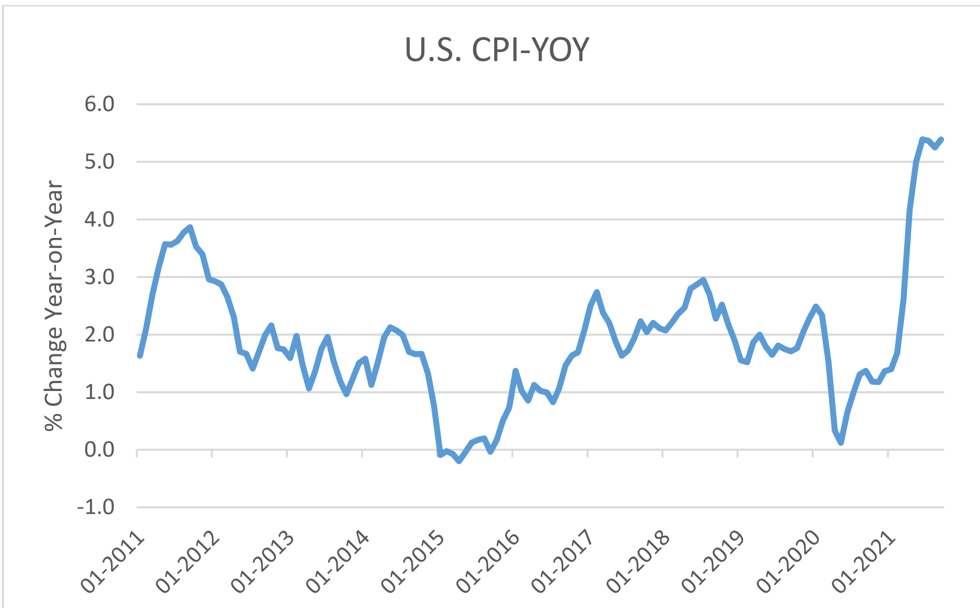
At the beginning of this year, Vigilante Investor warned of looming inflation risk.

> *"The Fed has already supplied the fuel for inflation…via quantitative easing. All inflation needs now is a spark for ignition…If people start to believe that inflation is a threat, they will borrow and spend… to get ahead of rising prices. This process has started to happen in the housing market. If it happens across the entire economy, inflation will soar, and the investment world will turn upside down."*

Already, an inflationary mindset has set in, and inflation is soaring.

Figure 1: Consumer Price Inflation



Source: St. Louis Fed

Multiple forces are working in concert to propel and sustain inflation. But inertia has kept investment markets from reacting, so far. The memory the past 40 years of deflation still colors the expectations of most investors. But investors will soon realize the consequences of high inflation. When the do, they will dump bonds and growth stocks in favor of investments that rise with inflation.

This issue explains the forces driving and sustaining high inflation. It also recommends adding another asset class to the Vigilante Investor Inflation Portfolio.

Supply-Chain Disruptions Trigger an Inflationary Trend

Shortages stemming from supply-chain disruptions are causing price increases across the entire economy. The government-ordered lockdowns of 2020 disrupted global and domestic supply chains. Some businesses emerged from lockdown quickly… others moved more slowly. This left producers without all the supplies needed to efficiently sustain production.

The shortage of a single part can close an entire factory. For example, auto companies have stopped the production of some models due to the shortage of semiconductor parts, leading to a nationwide car shortage. Similar supply disruptions have created chain-reaction shortages of other goods and services. Consumers have learned to pay up, quickly, if they want to buy something.

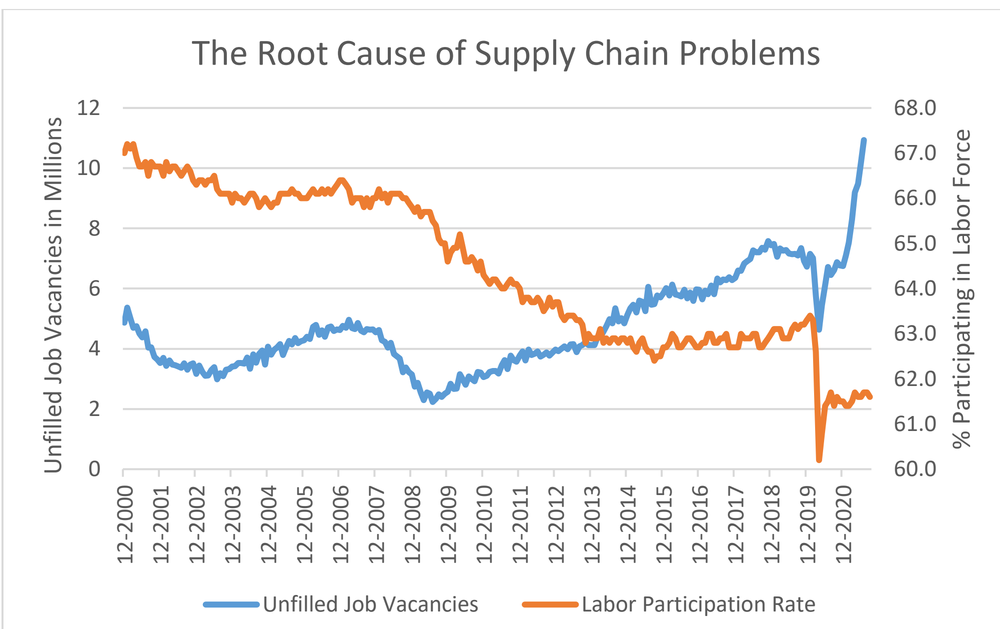
Worker Shortages Intensify Inflation

Businesses are struggling to hire workers. Without adequate staffing, production falls short of demand. This is intensifying and broadening price increases across the economy.

The worker shortage stems from government policy. Generous payments of stimulus subsidies and unemployment benefits incentivized people to leave the labor force. Government payments exceeded the income that recipients could earn from employment. These excessive government payments continued until this past September. Many people continue to resist work. Apparently, they saved enough from generous government benefits to fund consumption going forward… at least for a while.

The statistics support this analysis.

Figure 2: Labor Force Participation vs. Unfilled Job Vacancies



Source: St. Louis Fed

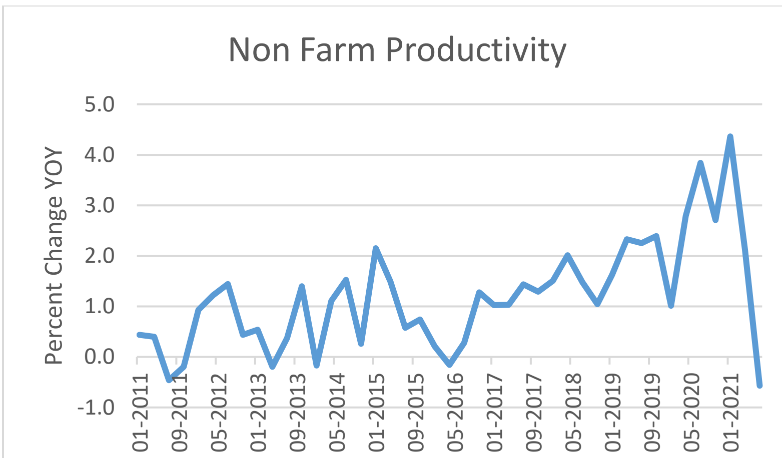
Since the lockdown ended, Unfilled Job Vacancies jumped to eleven million, which is about 3.7 million more than in 2019. Meanwhile, the participation rate remains mired at 61.6%, about 1.5% below the 2019 average, equating to about 3.1 million labor force dropouts.

Secondary Effects Add to Economy-Wide Price Pressures

Labor force dropouts continue to consume, unburdened by their lack of employment, thanks to government subsidies. But they are not contributing production to the economy. So, more money chases fewer goods.

To make matters worse, worker productivity is plummeting. This worrisome development stems from multiple causes, including supply-chain disruptions and the cost of training new workers. Regardless of the cause, declining productivity inevitably leads to higher unit costs, slower growth, and a lower standard of living. In other words, if this doesn't reverse, the economy suffers stagflation.

Figure 3: Labor Force Productivity



Source: St. Louis Fed

Imports Not Filling Supply Gaps

In the global economy, foreign companies should function as a safety valve for production shortages. Imports should fill the supply gap. But thanks to bad management of the ports and shortages of truck drivers, the safety valve is not working. Foreign goods are piling up in American ports. Hundreds or ships are waiting outside of the California ports to unload goods. The California ports cannot find the manpower… or the trucking capacity… to unload the ships and move the goods into America's transportation networks.

A perfect storm? Doubtful. The supply crisis empowers the government to reshape the economy. This is all part of the plan.

Government Vaccine Mandates Will Aggravate Shortages

More workers are leaving the labor force due to the Biden Administration's Vaccine Mandate. The potential dislocations and supply shocks threaten to derail the economy and drive prices even higher. For example, on two separate weekends last month, airline pilots (from Southwest and American Airlines) staged Freedom-Flu protests. The number of pilots on sick leave suddenly surged, leaving the airlines without enough flight crews to staff the scheduled flights. Thousands of flights were cancelled.

The freedom flight protests serve as a warning shot for the economic consequences of the Vaccine Mandate. If airlines fire thousands of pilots, they will drastically reduce flight schedules. Other industries will suffer similar consequences. Some manufacturers will halt production due to supply shortages, worker shortages, or both.

The Vaccine Mandate remains a fluid situation. The 5th Circuit Court of Appeal (in Texas) just issued a temporary stay, ruling that the plaintiffs should litigate the statutory and constitutional authority of the mandate. This stay, however, will probably lapse. The Biden Administration will appeal the stay to the Supreme Court. This Supreme Court typically denies requests for a stay, preferring to let things play out until the underlying case gets a full hearing.

The Biden Administration will probably implement the mandate as planned. Production will fall and prices will rise… more stagflation!

The Fed Is Pouring Gasoline on the Fire

In the Federal Reserve act of 1977, Congress required the Fed to pursue both price stability and full employment. The Fed is complying with full employment part of the mandate. But the Fed fails miserably on the price stability part. Prices are soaring. And contrary to the mandate, the Fed is deliberately fueling more inflation.

If the Fed was serious about the dual mandate, it would have raised interest rates last spring. Rates would now exceed 2%. Instead, the Fed now promises to keep interest rates pinned at zero, indefinitely. And it continues to fuel runaway inflation with an unprecedented money-printing QE program.

This past week, the Fed announced it would scale back the money-printing program and terminate it in 8 months' time. If this doesn't shock and disturb you, then you have grown accustomed an upside-down, inside-out world.

An inflationary wildfire is raging, but the Fed continues to pour gasoline on the fire.

Vigilante Investor Inflation Portfolio

Over the next generation, inflation will wreak havoc on retirement portfolios. Goods prices will rise faster than stock prices. Bond prices will collapse. The typical retirement portfolio, with a balance of stock and bond holdings, will lose purchasing power. Retirees will feel poorer and poorer as they age.

Inflation will also wreak havoc on younger, growth-oriented investors. Soaring interest rates will pummel growth stocks. Because fast-growing companies favor reinvesting earnings instead of paying dividends, investors must wait, indefinitely, for the payoff. As interest rates soar, investors will massively discount growth stock values.

Investors, young and old, need to adjust to inflation. For this reason, I introduced the Vigilante Investor Inflation Portfolio. Issue#2 presented the first leg of the inflation portfolio stool – a basket of Property-Casualty Insurance stocks. So far, these stocks are keeping pace with the overall stock market. When the Fed finally raises interest rates, the overall stock market will decline, but these stocks will march steadily higher.

Issue #3 introduced the second leg of the Vigilante Inflation Portfolio, a basket of natural gas stocks. These holdings are already generating big gains. Due to encroaching environmental regulations, the termination of pipeline infrastructure projects, and the shaming of oil & gas investment, domestic oil and gas supplies will run short of demand for years to come. Windfall profits will accrue to domestic producers. Investors in this sector should prepare for a roller-coaster ride, but they can anticipate exceptional gains for at least the next 5 years.

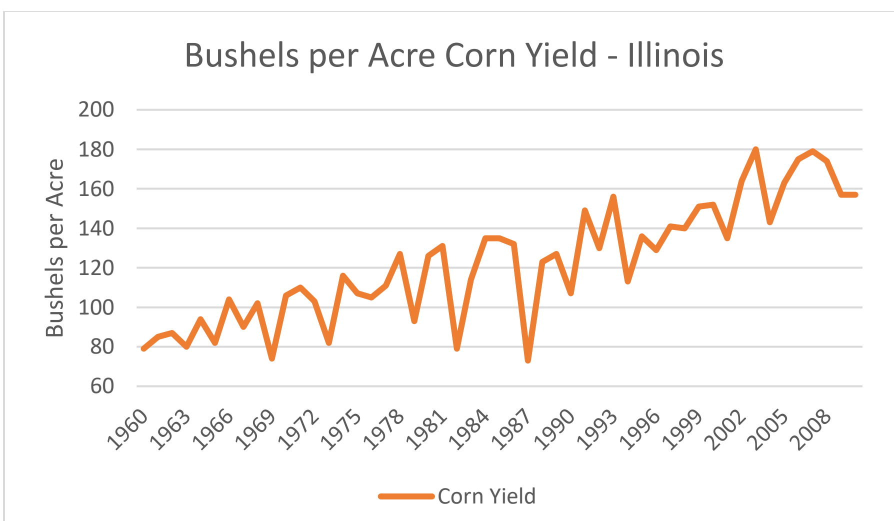
The Third Leg of the Vigilante Inflation Portfolio – Real Estate and Farmland

The value of any asset is a function of the income it generates. For real estate assets, the value depends on the amount of rental income. The amount of rental income depends on of the income generated by the tenant. So, the higher the tenant income, the higher the rent, and the higher the value of the real estate.

All real estate performs well in a high-inflation economy, but farmland performs particularly well. Farmland values track farm income… which tracks the of the most essential consumer good on earth…food. When inflation ticks up… when too much money chases too few goods… food prices are sure to jump.

Farmland investment returns run much higher than food price inflation, by a large margin. Over time, farm productivity rises due to ongoing improvements in farming technology. From 1960 to 2010, corn yields increased by a multiple of 2.5. (See Figure 4.)

Figure 4: Historical Corn Yields, Illinois



Source: USDA

The compounding effect of higher food prices and higher production fuels big gains in farm income and land prices.

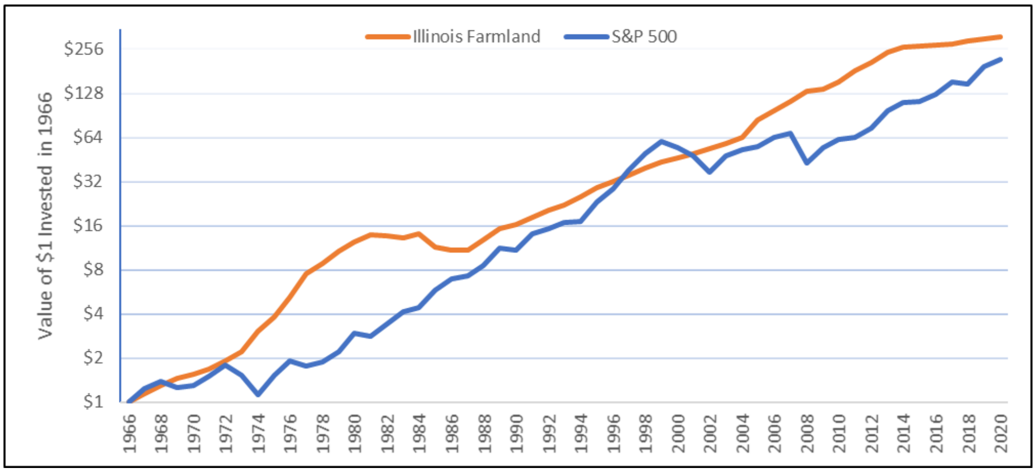
Over the long haul, farmland investment returns compare favorably to stock market returns. The uncorrelated nature of these two asset classes make farmland a particularly effective diversifying asset.

Table 1: Illinois Farmland Returns (Rent plus Capital Appreciation), 1966 -2020

	Illinois Farmland	S&P 500
Average Return Since 1966	11.20%	10.67%
Standard Deviation	10.24%	16.45%
Correlation to S&P 500	-0.206	1
Average Return Since 2015	4.66%	15.93%

Sources: USDA and Standard & Poor's

Figure 5: Illinois Farmland Total Return vs the S&P 500 Total Return



Sources: USDA and Standard & Poor's

Figure 5 shows the inflation-hedging power of farmland investments. Farmland returns soared during the hyper-inflationary 1970s, then crashed during the disinflationary 1980s. More recently, during the low-inflation period from 2015-2020, farmland underperformed stocks by a wide margin. With inflation now soaring, it is farmland's turn to shine.

Buying Real Estate

Real Estate Investment Trusts (REIT) provide the most convenient way for the average individual to invest in real estate. REITS offer economies of scale, diversification, and, if publicly traded, liquidity.

Nevertheless, high management and administrative costs drag down the performance of many REITs. Additionally, REIT managers tend to push borrowings to the maximum allowed. Debt-funded acquisitions increase assets under management, allowing management to charge higher fees and pay higher salaries. Unfortunately, high debt levels raise fixed costs, impairing long-term performance.

Some REITs control costs, restrain borrowing, and generate good long-term performance. Sadly, this is not the case for farmland REITs.

Public Farmland REITs

In 2013 Gladstone Land (LAND) launched the first initial public offering (IPO) of a farmland REIT. Over the next two years, two additional REITs went public, Farmland Partners and American Farmland Company. Then in 2016, the latter two REITs merged under the name of Farmland Partners (FPI).

Since their IPOs, both LAND and FPI have issued additional shares and borrowed extensively to fund the expansion of their farm holdings. As a result, both companies developed scale.

Unfortunately, high fixed costs overwhelm the long-term expected returns. Table 2 quantifies the management and interest expenses of both companies.

Excluding depreciation, operating expenses totaled 3.84% of shareholder equity for LAND and 6.58% for FPI. High interest costs (6.78% and 5.71% respectively) raise the fixed costs even more.

Table 2: High Fixed Costs of Public Farmland REITs

Company	Ticker	Mgt Exp/Equity	Interest Ratio	Mgt + Interest	Debt/Asset
Gladstone Land	LAND	3.84%	6.78%	10.62%	61.15%
Farmland Partners	FPI	6.58%	5.71%	12.29%	46.71%

Sources: Forms 10-K, Gladstone Land and Farmland Partners, 2020

The fixed expense hurdles of 10.62% for LAND and 12.29% for FPI are simply too high. Total returns on farmland have historically averaged about 11%. These REITs have engineered an investment security with more volatility and less (long-term) return than unlevered farmland. They transform an ultra-safe, wealth-building asset into a high-risk security.

Alternative Ways to Invest

Well-endowed investors with at least a million dollars to invest can buy farmland directly… ideally with the assistance of a professional farm property manager. Farm management fees average between 4% and 8% of annual farm income. That fee equates to an annual cost of 0.15% to 0.30% of equity, a fraction of farmland REIT costs. Other (accredited) investors with a smaller budget for farmland purchases might consider investing in unlevered farmland via a limited partnership. In this case, management and administration fees will run between 1% and 2% of equity… still a much better deal than the farmland REITs.

You might still consider buying a farmland REIT. Over the short term, it will generate good returns and can serve as a short-term hedge for inflation. However, you will get better long-term performance from a generic exchange-traded fund (ETF) REIT.

Vanguard Real Estate Index Fund ETF (VNQ)

A generic REIT exchange-traded fund (ETF) can serve as a liquid store of value. It will appreciate as inflation rises. The Vanguard Real Estate Index Fund ETF fulfills this purpose. It provides broad-based exposure to commercial real estate. The fund holdings are more concentrated in cellular communication infrastructure, data centers, logistical facilities, and personal storage. The fund pays about 2.1% annual income.

Strategic Recommendation: If you are an accredited investor, study the possibility of buying farmland through either direct purchase or limited partnership. Meanwhile, you can quickly and easily add real estate exposure with VNQ. It provides low-cost, effective, liquid exposure to real estate.

Figure 6: Vanguard Real Estate Index Fund ETF (VNQ)

The Economy and Markets

The economy has been growing fast, but it is starting to slow. Dangers appear on the horizon, including disruptions from the Vaccine Mandate, as discussed previously.

Last summer, when intense summer heat forced residents of Texas and Florida to retreat to enclosed, air-conditioned spaces, Delta infection rates soared. Similarly, Delta infections will rip through the north this winter as people take shelter in enclosed, heated spaces. It is already starting to happen… and the weather hasn't gotten that cold yet. High infection rates will peak around Christmas, give or take a month... depending (in part) on the timing of the seasonal cold fronts.

Soaring infections in the north at Christmastime will inflict far more harm on the economy than occurred in the south last summer. The southern states did not impose any restrictions during the summertime Delta outbreak. However, officials in the north are far more prone to intervene. And it doesn't matter that vaccine rates are slightly higher in the north. The vaccine doesn't really stop Delta from spreading.

Christmas shoppers may stay home as the media whips up fear of Delta. The timing of the outbreak could devastate the economy

Table 3: Vigilante Investor Scorecard of Economic Conditions –as of 11/05/2021

Economic Condition and Score	Positive	Neutral	Negative
Growth 5 Contraction 1	US Real GDP +4.9% US Non-Manf PMI 61.9 Global Comp PMI 53.0 US 2-10 Spread +1.04% Fed Signal +8.5%		US Productivity -0.6%
Inflation 3 Deflation 0	CPI +5.4% YOY US Wages +4.9% YOY Crude Oil +123.0%YOY	Gold -3.7% YOY Gold / Euro -6.2% YOY US Dollar +2.0% YOY	
Positive $ 2 Negative $ 0	US-Ger2YRSpread +1.14% US-Ger10YRSpread+1.75%		

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

Looking beyond Delta, a new variant of the China Lab Virus has emerged, called "A.30." It evades all antibodies produced by the vaccines. When the vaccine-evading variant spreads, only "natural immunity" and therapeutics can stop the pandemic.

Fortunately, the future for therapeutics looks promising. Until very recently, the pharma-industrial complex rejected therapeutics. But now, Merck is pitching a treatment pill that boasts a 50% reduction in hospitalization and death rates. This is great news. The UK has approved the drug. Let's hope it gets approved and distributed in the U.S. soon.

Even better news comes from Pfizer, who claims a new treatment pill that cuts hospitalization and death rates by 90%. Wow! This pill might be more effective than Ivermectin!

If these drugs gain quick approval from the FDA, doctors and hospitals will prescribe them. Natural immunity will grow with the surge of infections even as death rates plummet. The scourge of the China Lab Virus will then fade away.

But until these drugs are approved, manufactured, and distributed, the threat to society (and the economy) will remain with us.

Regardless of how Delta progresses, the economy will run out of steam in 2022. This expansion, which started in mid-2016, is getting tired. After a brief lockdown interruption, the expansion resumed. Now, the post-lockdown recovery is starting to lose steam. The drag from new regulations and high energy costs are slowing the engine. Higher interest rates next year kill it.

Investment Strategy

Figure 7: S&P 500 as of 11/05/2021 - Log Scale

The stock market has run ahead of the economy. Aided by the Fed's policy of printing money and suppressing interest rates, the broad stock market has pushed up to a historical valuation peak.

The current, high market valuation limits long-term future returns to about 10% per year. Is it worth staying fully invested with such limited long-term upside potential?

In the previous issue, I recommended raising cash to 30%. With this month's addition of the Vanguard Real Estate ETF to the portfolio, I am cutting cash back to 25 %. But cash is essential right now. It stabilizes the portfolio and provides ammo to take advantage of the opportunities that arise when the stock market inevitably crashes.

See Table 4 for the updated model portfolio.

Table 4: The Vigilante Model Portfolio 11/05/2021

Sector	%	Selections	Symbol	Initial Price	Price (Nov 5)
5G	7%				
		Qualcomm Inc.	QCOM	$164.40	$163.12
		Nokia Corp	NOK	$4.85	$5.76
Low-Tech America					
Steel	3%	Cleveland Cliffs Inc.	CLF	$16.58	$22.35
Financials	18%	Citigroup Inc.	C	$60.56	$66.99
		Prudential Financial	PRU	$81.96	$110.95
		Chubb	CB	$165.98	$193.10
		Aflac	AFL	$53.38	$56.75
		AIG	AIG	$47.54	$58.97
		WR Berkley	WRB	$80.37	$80.60
Transportation	3%	Dorian LPG Ltd.	LPG	$11.86	$12.81
Energy	22%	Diamondback Energy	FANG	$61.33	$113.76
		CNX Resources	CNX	$12.21	$14.92
		Pioneer Natural Resources	PXD	$147.07	$185.29
		Coterra (Formerly Cabot)	CTRA	$18.69	$21.58
		Southwestern Energy	SWN	$4.06	$4.96
		Plains All American Pipeln	PAA	$9.02	$10.65
		Cameco Corp	CCJ	$12.73	$26.99
Real Estate	10%				
		Granite Point Mortgage	GPMT	$9.87	$13.79
		Vanguard Real Estate ETF	*VNQ*	*$109.98*	*$109.98*
Agriculture	4%	Mosaic Co	MOS	$28.67	$37.35
Emerging	0%				
Precious Metals	8%	Junior Gold Miners ETF	GDXJ	$46.02	$44.75
		Yamana Gold	AUY	$4.30	$4.16
		Barrick Gold	GOLD	$21.72	$19.59
		Silver Miners ETF	SIL	$42.00	$39.51
Cash	25%	VG ST Corporate Bond ETF	VCSH	$83.12	$82.10

To raise cash to 25%, I am selling Southwest Airlines, Boeing, Ford, and Simon Property Group. I am also selling one third of the positions in Cameco and Cleveland Cliffs.

Considering my appreciation for real estate right now, the sale of Simon Property Group may surprise you. Everything has a price. SPG's price has soared to an extreme valuation, making it less attractive going forward. Additionally, the shopping mall owner is particularly vulnerable to lockdown risk as Delta rips through the north this Christmas.

ETF Model Portfolio

Because some readers prefer investing exclusively in ETFs, I am adding a new feature, the Vigilante Investor ETF Model Portfolio. In doing so, I am adding new ETF selections for the Oil & Gas, Insurance, Real Estate, and Precious Metals sectors.

Table 5: Vigilante Investor ETF Model Portfolio

All ETF Portfolio	%	Selections	Symbol	Initial Price	Price (Nov 5)
Broad Market	5%	VG Mid-Cap Value ETF	VOE	$122.88	$149.31
	5%	VG Large-Cap Value ETF	VTV	$121.81	$144.88
Financials	6%	VG Financials	VFH	$88.21	$99.92
	12%	iShares U.S. Insurance	IAK	$84.25	$84.25
Energy	25%	First Trust Revere Nat Gas	FCG	$19.01	$19.01
Real Estate	12%	*Vanguard Real Estate ETF*	*VNQ*	*$109.88*	*$109.88*
Precious Matals	5%	*VanEck Vectors Gold Miners*	*GDX*	*$32.75*	*$32.75*
	5%	*Global X Silver Miners*	*SIL*	*$39.51*	*$39.51*
Cash	25%	VG ST Corporate Bond ETF	VCSH	$83.12	$82.10

Have a great quarter!

Steve Koomar

November 6, 2021

Disclosures

Publisher Steve Koomar will invest in the securities recommended by this publication.

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