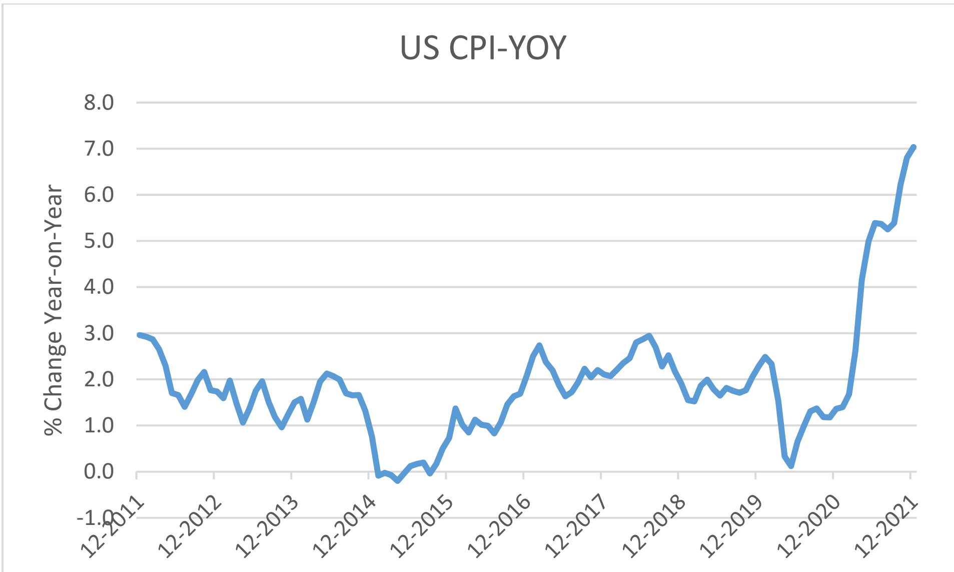
For much of the past year, the Fed ignored inflationary signals. When the annual inflation rate jumped above 3%, the Fed labelled inflation a "transitory" problem, implying it would soon vanish. When the inflation rate soared above 5%, the Fed retired the word "transitory" and talked of "tapering" asset purchases. In doing so, the Fed recognized that inflation wouldn't magically disappear.

Figure 1: Consumer Price Inflation



Source: St. Louis Fed

Finally, with the inflation rate now at 7%, the Fed is preparing to raise interest rates.

Investors are preparing for higher interest rates by selling stocks, especially tech stocks. The stock market looks bearish.

To make matters worse, the potential for war in Europe looms over the markets. *Vigilante Investor* predicted this threat in 2017, in the old monthly, Issue #15, The New World Disorder. If you are interested, follow the link. The 2017 analysis is still relevant today.

World Disorder

Russia has been waging a war of expansion since 2008. In that year, Russia expanded southward. Allied separatists invaded two regions in Georgia, South Ossetia and Abkhazia. Russia still controls these regions.

In 2014, Russia expanded to the east. It seized the Crimean Peninsula from Ukraine. In doing so, Russia secured its strategic Sevastopol Naval Base, the home of Russia's Black Sea Fleet.

It now appears that Russia is preparing to seize more of Ukraine. At the very least, Russia wants to secure land access to its Crimean ports. It is possible that Russia also wants to seize Kiev, Ukraine's capital city, and install a puppet government.

We will get an answer soon. A Russian invasion of some sort is almost certain.

To understand Russia's motivations, switch perspectives. Consider what America would do if it faced a similar threat.

Imagine if America's biggest rival, China, had established a military alliance with most of Central America. Imagine also that Mexico had asked to join the Chinese alliance. Such a move would put thousands of Chinese troops and weapons on America's southern border. Furthermore, China could build naval bases in Mexico and sever America's access strategic military bases in Hawaii.

Fortunately, this will never happen. But if it did happen, I would expect the American President to do whatever is required to keep China out of Mexico, including a pre-emptive invasion.

As it relates to Russia and Ukraine, Putin is simply doing his job. Ukraine has asked to join NATO, which would put hostile troops with sophisticated weapons on his eastern border.

I do not mean to justify Russia's provocative actions. Russia would be better served to avoid confrontation.

Instead of invading Ukraine, Russia should build business relationships with Ukraine and other countries to the west, the way it has with Germany, who depends on Russia to provide vital natural gas supplies. Germany is now so dependent on Russia that it cannot afford to participate in NATO military actions against Russia.

If Russia would strengthen commercial ties with more western neighbors, as it has with Germany, its security concerns would recede. Sadly, that is not happening.

As a result, Russia is preparing to use its military forces to improve its security situation. The timing couldn't be better. Germany and the rest of Europe are going through a cold winter, lacking adequate gas supplies. Germany gets all its heating fuel from Russia. So, Germany cannot afford to join the fight for Ukraine, or its people will freeze, literally.

Most likely, Putin is also encouraged by America's disastrous withdrawal from Afghanistan. That withdrawal raises questions the competence of America's military leadership. In the unlikely event that America responds to Russia with a military campaign, could those same officers (who mismanaged the Afghanistan withdrawal) launch an effective strike against a well-organized opponent? Probably not.

In preparation of Russia's Ukraine invasion, America's foreign policy community is making a lot of noise. But for the most part, it is all bark and no bite. America will send troops to Poland and Lithuania… to make certain Russian troops do not invade a NATO ally. Following the invasion, the CIA will use covert actions to disrupt Russian control of Ukrainian territory.

But America will probably not take bold action to stop Putin.

What does it mean for the markets? If the U.S. does not escalate, the market impact will be limited. The stock market will drop for a few days. Treasury bonds will rally, temporarily. Then the markets will go back to business as usual.

However, the risk of a wider conflict still looms. What happens if the U.S. engages Russia militarily? The situation quickly gets very dangerous. No one wants to see nuclear powers firing weapons at each other. Even worse, a war with Russia would stretch America's military to the point where it could not respond to attacks elsewhere. For example, China might be tempted to move on Taiwan. Iran might invade a neighbor on the Persian Gulf. Can you imagine the supply chain disruptions for semiconductors, crude oil, and natural gas? The stock markets would get crushed, totally!

Let's hope that cooler heads prevail! I believe they will.

Preparing the Portfolio for Inflation

A year ago, in Issue #1, this publication warned that serious inflation would soon emerge. Subsequent issues presented strategies to help investors prepare for persistent inflation. Over the course of a year, we developed the Vigilante Investor Inflation Portfolio, a four-sector portfolio that seeks to harness inflationary energy to maintain purchasing power and drive strong returns.

Sector #1: Rising inflation creates the ideal conditions for building wealth via equity investments in Property Casualty (P&C) insurance companies. See Issue #2 for details.

Sector #2: A host of factors are constraining capital investment into the oil & gas industry. The lack of investment assures supply shortages and rising energy prices for years to come. High energy prices will lead to soaring profits and stock prices for energy producers. See Issue #3 for details.

Sector #3: Real Estate performs well in inflationary conditions. See Issue #4 for information and analysis on Real Estate Investment Trusts.

Sector #4: Every portfolio should include a modest allocation to the timeless defense against inflation… gold and precious metals. In this issue, Vigilante Investor outlines a value-driven strategy to invest in the mining sector.

What - No Bitcoin!?

Indeed, the Vigilante Inflation Portfolio excludes Bitcoin and all other cryptocurrencies.

Vigilante Investor published an analysis of Bitcoin in monthly Issue #24, January of 2018. Bitcoin offers one unique benefit. It allows people to secretly make payments or move assets across borders. Otherwise, it has no intrinsic value.

Indeed, this Bitcoin benefit could be worth something. If masses of people and intuitions embrace Bitcoin, develop payment mechanisms, and commonly make transactions in Bitcoin, it will grow enormously in value.

Since 2018, some of these things have started to happen. Widespread interest has prompted a few large financial companies to develop a Bitcoin ecosystem for payment processing. It hasn't hurt that the Fed kept interest rates at zero, making Bitcoin a costless speculation. Bitcoin soared more than 1,500% and made many speculators very rich.

In the meantime, the world has grown more aware of an enormous Bitcoin liability: the huge daily energy cost of maintaining the enormous blockchain ledger.

This past month, as the Fed prepared to raise interest rates, the value of Bitcoin dropped by half. What happens if the Fed raises rates more than expected? Will Bitcoin fall below $10,000? Considering the high electricity cost of maintaining the blockchain ledger, could Bitcoin fall far enough to cause its network of miners to stop maintaining the ledger? Would that trigger a total collapse of the Bitcoin market? In that scenario, where is Bitcoin's floor? $1,000?... $100?... $10?...

I do not mean to discourage Crypto speculation. I understand there are valid reasons for it. Speculation involves very high risk and very high reward.

However, don't confuse speculation and investment. And don't fall for the ruse that Crypto speculation offers inflation protection. Crypto speculation involves risking a tiny part of your nest egg to participate in the (unlikely) creation of an entirely new global system for payments. Inflation protection involves investing your nest egg in a way that preserves its purchasing power.

Gold is a time-tested inflation asset. It will not make you rich, and it won't make you poor. It just preserves purchasing power.

The Fourth Leg of the Vigilante Inflation Portfolio – Precious Metals

Investors can buy precious metals and take physical possession, as people have done for millennia.

Modern stock exchanges provide other ways to invest in precious metals. Thanks to the innovation of Exchange Traded Funds (ETFs) investors can buy a share of large portfolios of gold and silver without ever taking physical delivery. These giant ETFs, SPDR Gold shares (GLD) and iShares Silver (SLV), are very liquid. Any investor with a brokerage account can buy them.

Investors can also gain exposure to precious metals by buying shares of mining companies. Shareholders implicitly own a share of the gold and silver in the ground… as well as the operation that mines and refines the metal.

Mining shares implicitly lever a precious metals investment. Consider a gold miner with $1,000 per ounce of production cost. When gold trades at 1,500 per ounce, the company earns a gross profit of $500 per ounce. If the gold price rallies 33% to $2,000 per ounce, the gross profit increases to $1,000 per ounce, or 100%. If that profit margin is sustained, the stock price could increase 100%. In this example, the return potential of mining shares could be 3x that of the gold bullion investor.

Keep in mind, leverage cuts both ways. When bullion prices decline, mining shares typically suffer bigger losses than physical bullion.

Enhancing Returns with a Basket of Mining Stocks

Share prices don't typically move in lockstep with bullion prices. Sometimes, mining stock prices move much more… sometimes much less.

Furthermore, at any given time, each mining stock responds to technical factors, such as concentrated buying and selling activity of shareholders. Trading activity can temporarily distort the relationship between the stock price and bullion prices. These "technical factors" cause a great deal of dispersion in short-term price movements of mining companies.

Figure 2: Past Year Share Performance Compared to the GLD ETF 1/27/2022

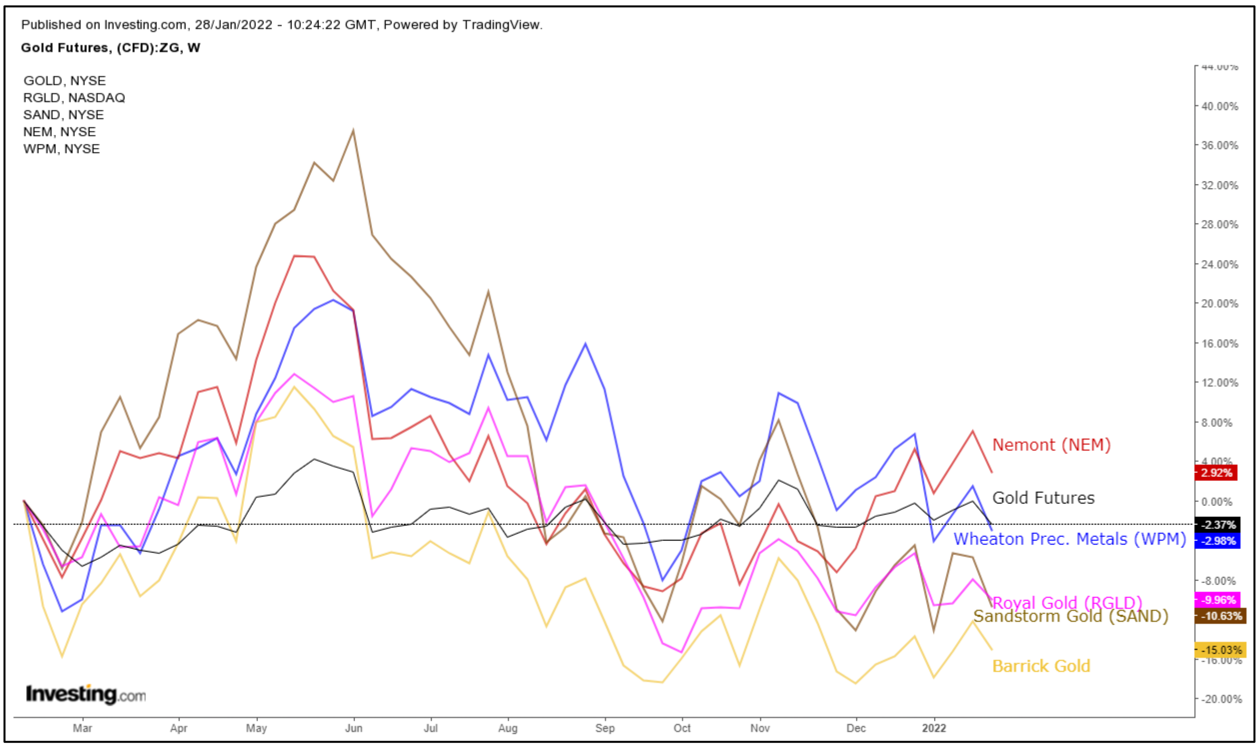


Figure 2 demonstrates the variation in performance of mining shares. At one time in the past year, Sandstorm Gold outperformed GLD by about 40%. But as of January 28, it had underperformed by 5% on the year, a 45% collapse in relative value. Barrick Gold performed the worst over the past year. This giant, low-cost producer of Gold probably represents a good value currently.

Keep in mind that, over the long term, mining shares trend toward the true economic value, as dictated by the bullion price.

This pattern of variable short-term price movement with long-term mean reversion allows investors to enhance returns. The Vigilante strategy involves buying a basket of the cheapest precious metals stocks and then rotating into other stocks as the initial holdings reprice at higher levels. If all mining stocks become expensive, the investor should temporarily sell all mining shares and invest the proceeds in the ETF (GLD or SLV).

Vigilante Investor developed a statistical model to measure the relative value of various gold and silver mining stocks. The output is displayed in the Scorecard below.

Table 1: *Vigilante Investor* Precious Metal Scorecard[1] as of 01/26/2022

Precious Metal ETF	Price	Ratio	Hist Avg	Rating
GLD	169.79			
SLV	21.72	7.82	6.08	3
Stocks vs GLD	**Price**	**Model**	**vs. Model**	**Value Rating**
Jr. Gold Miners ETF (GDXJ)	$38.87	$48.46	-9.59	1
Gold Miners ETF (GDX)	$30.63	$35.07	-4.44	1
Barrick Gold (ABX)	$19.03	$23.08	-4.05	2
Sandstorm Gold	$6.01	$7.56	-1.55	2
Yamana Gold (AUY)	$4.17	$4.88	-0.71	2
Newcrest Mining (NCM)	$17.10	$20.68	-3.58	3
Royal Gold (RGLD)	$101.62	$116.77	-15.15	3
Wheaton Precious Metals (WPM)	$39.70	$42.76	-3.06	3
Newmont Mining (NEM)	$61.69	$60.08	1.61	6
Stocks vs SLV	**Price**	**Model**	**vs. Model**	**Value Rating**
Silver Miners ETF (SIL)	$33.70	$39.98	-6.28	0
Pan American Silver (PAAS)	$22.54	$27.91	-5.37	2
Hecla Mining (HL)	$4.94	$5.40	-0.46	4

Assumptions and Use of the Precious Metals Scorecard

Statistical modeling of historical data can yield useful *estimates* of relative value for large mining companies. By evaluating the relationship of stock prices to gold or silver prices, we establish an estimate of value. The model relies on several assumptions including:

1. Large mining companies do not experience sudden, significant shifts in reserves.
2. Large miners cannot easily change their cost structures.
3. Over the short term, there is an inverse relationship between the mining cost and reserves. More thorough, expensive mining operations tend to yield greater quantities of metal and more reserves. When a company switches to lower-cost mining techniques, the expected yield (and reserves) declines, and visa-versa. Thus, short-term operational changes typically produce offsetting effects on stock value.
4. Investors who allocate capital to mining stocks should spread the risk across multiple companies. Each miner has its own unique costs and risks. If an investor concentrates risk in a single mining company, the investor becomes vulnerable the idiosyncratic risk of one company.

[1] 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.

The Scorecard in Table 1 shows the value rankings of the mining stocks tracked by *Vigilante Investor*. The ranking of "0" represents the cheapest level. The ranking of "10" represents the most expensive.

Almost the entire universe of mining stocks is trading cheap to bullion currently. This rare phenomenon can probably be attributed to Crypto speculation, which is sucking capital away from the precious metals sector. This sets up a good buying opportunity.

The analysis shows that silver bullion is trading at an historically cheap level compared to gold bullion. Consequently, if all else is equal, we favor silver miners over gold miners. Currently, we suggest a 2% allocation to each of the following stocks: Silver Miners ETF (SIL), Pan American Silver (PAAS), Junior Gold Miners ETF (GDXJ), and Gold Miners ETF (GDX).

To execute the allocation change from the existing portfolio, we are selling Yamana (AUY) and Barrick (GOLD) to fund the purchase of Gold Miners ETF and Pan American Silver.

The Economy and Markets

The U.S. economy continues a very strong post-lockdown recovery, accompanied by severe inflationary pressures. However, the Vigilante Economic Scorecard is showing early signs that these trends are decelerating.

Table 2: Vigilante Investor Scorecard of Economic Conditions –as of 1/28/2022

Economic Condition and Score	Positive	Neutral	Negative
Growth 4 Contraction 1	US Real GDP +5.5% US Non-Manf PMI 62.0 Global Comp PMI 54.3 Fed Signal +11.7%	US 2-10 Spread +0.60%	US Productivity -0.6%
Inflation 3 Deflation 1	CPI +7.0% YOY US Wages +4.7% YOY Crude Oil +46.8%YOY	Gold -2.3% YOY Gold / Euro +5.9% YOY	US Dollar +7.5% YOY
Positive $ 2 Negative $ 0	US-Ger2YRSpread +1.78% US-Ger10YRSpread+1.82%		

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

The Growth Score declined to 4-to-1. The change is attributed to the 2-to-10-Year Treasury curve, which collapsed from 104 bps to 60 bps. This development demonstrates that bond market participants expect the Fed tightening to slow economic growth. However, this indicator is not yet forecasting a recession.

The inflation scored also declined, to 3-1. The dollar index moved into deflationary territory. Dollar strength represents a sign of improving confidence in the dollar. A stronger dollar will reduce U.S. inflationary pressure.

Short-Term Strength Likely

Near-term factors favor a strong economy for the next two quarters. The pandemic is ending. The Omicron variant is so contagious that practically everyone will contract the virus. Because Omicron lacks the lethality of prior variants, the societal and economic costs of the current contagion will be limited. In the end, Omicron will generate a benefit to public health in the form of natural antibody protection. Practically all of society will gain stronger and more durable protection than previously provided by so-called vaccines. Future variants will likely be even less lethal than Omicron.

Boom…

As the public realizes that the pandemic has ended, the economy will accelerate. More people will return to work. More workers will work in the office. More workers will take business trips. More people will spend money on entertainment and travel. Across the board, the economy will enjoy a short-lived burst of energy.

…and Bust

Sadly, the energy will burn out quickly. Further acceleration of growth will stoke the fires of inflation. The Fed will try to put the fire out by raising interest rates faster and higher than currently expected. Rising interest rates will eventually bust the tech-stock bubble, leading to a correlated rout of all asset markets. Value stocks will collapse. Crypto will plummet. Even the housing market will suffer a short-term correction.

The" wealth effect" of asset losses will destroy consumer and business confidence. Consumer spending and investment will shrink. The economy will contract.

It will probably take a year or longer for the bust to develop. But rest assured, it will occur.

Investment Strategy

In the previous two issues, *Vigilante Investor* has recommended a very defensive portfolio, including a 25% cash position. The primary reason for such a defensive allocation was high valuation. Figure 3 shows that the S&P 500 Index has run far ahead of the long-term trend.

Figure 3: S&P 500 as of 01/28/2022 - Log Scale

High Valuation, alone, does not cause a bear market. A bear market also requires a trigger.

The typical trigger, a high interest rate, is getting closer to reality. Thus, investors are beginning to liquidate stocks, especially technology stocks.

The stock market probably needs to fall even further before it resumes the relentless long-term trend higher. No one knows where and when the inflection point will occur. Thus, investors should gradually deploy cash to add stockholdings.

Even though *Vigilante Investor* expects a serious bear-market bust to develop next year, we do not want to miss out on the boom that we expect over the next six-to-nine months.

Therefore, we will cautiously buy the dip. *Vigilante Investor* suggests initiating new purchases at around 4200 on the S&P. Slowly buy more stocks, but don't deploy the entire hoard of cash unless the S&P 500 reaches a downside target of around 3400.

What stocks should investor buy? For now, Vigilante Investor recommends adding to existing positions, with one exception.

Table 3: The Vigilante Model Portfolio 1/28/2022

Sector	%	Selections	Symbol	Initial Price	Price Jan 28
5G	8%				
		Qualcomm Inc.	QCOM	$164.40	$166.81
		Nokia Corp	NOK	$4.85	$5.72
Low-Tech America					
Steel	4%	Cleveland Cliffs Inc.	CLF	$16.58	$16.67
Financials	24%	Citigroup Inc.	C	$60.56	$66.49
		Prudential Financial	PRU	$81.96	$110.19
		Chubb	CB	$165.98	$196.89
		Aflac	AFL	$53.38	$62.35
		AIG	AIG	$47.54	$56.96
		WR Berkley	WRB	$80.37	$84.66
Transportation	4%	Dorian LPG Ltd.	LPG	$11.86	$12.04
Energy	22%	Diamondback Energy	FANG	$61.33	$128.72
		CNX Resources	CNX	$12.21	$15.00
		Pioneer Natural Resources	PXD	$147.07	$215.37
		Coterra (Formerly Cabot)	CTRA	$18.69	$21.63
		Southwestern Energy	SWN	$4.06	$4.31
		Plains All American Pipeln	PAA	$9.02	$10.68
		Cameco Corp	CCJ	$12.73	$19.04
Real Estate	15%				
		Granite Point Mortgage	GPMT	$9.87	$11.94
		Vanguard Real Estate ETF	VNQ	$109.98	$104.95
		Simon Property Group	*SPG*	*Scale $120-132*	*$146.40*
Agriculture	5%	Mosaic Co	MOS	$28.67	$39.77
Emerging	0%				
Precious Metals	8%	Junior Gold Miners ETF	GDXJ	$46.02	$37.13
		Gold Miners Index	*GDX*	*$29.30*	*$29.30*
		Pan American Silver	*PAAS*	*$21.13*	*$21.13*
		Silver Miners ETF	SIL	$42.00	$32.04
Cash	10%	VG ST Corporate Bond ETF	VCSH	$83.12	$80.26

Table 4: Vigilante Investor ETF Model Portfolio 01/28/2022

All ETF Portfolio	%	Selections	Symbol	Initial Price	Price (Jan 28)
Broad Market	8%	VG Mid-Cap Value ETF	VOE	$122.88	$144.43
	8%	VG Large-Cap Value ETF	VTV	$121.81	$144.29
Financials	8%	VG Financials	VFH	$88.21	$94.87
	14%	iShares U.S. Insurance	IAK	$84.25	$84.31
Energy	30%	First Trust Revere Nat Gas	FCG	$19.01	$19.41
Real Estate	12%	Vanguard Real Estate ETF	VNQ	$109.88	$104.95
Precious Matals	5%	VanEck Vectors Gold Miners	GDX	$32.75	$29.30
	5%	Global X Silver Miners	SIL	$39.51	$32.04
Cash	10%	VG ST Corporate Bond ETF	VCSH	$83.12	$80.26

If given the opportunity, *Vigilante Investor* would repurchase shares of **Simon Property Group (SPG)** starting at a price of $132, filling the entire position at around $120 per share. You may recall we sold this stock last November at a little more than $160 per share. We plan to repurchase this stock at a 20% to 25% discount from where we sold it. The stock dividend would yield more than 5% at our target levels.

Figure 4: Simon Property Group (SPG), 1/28/2022

Source: Finviz.com

Strap on your seat belts and prepare for a wild ride over the next quarter. At times, the volatility could make you sick. But hang in there. Set up a plan to profit from the big market swings. Be patient. And remember… you make money by buying low… not selling low.

Have a great quarter!

Steve Koomar

January 30, 2022

Disclosures

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

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