At the end of January, amid widespread bullish sentiment, this publication suggested that investors prepare for a bear market:

> *"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."*

We got it half right - correctly called a bear market. We bought stocks on the dip below 4200, but the market kept going south, leaving our new purchase underwater. Stocks eventually found a (temporary) bottom around 3636 on the S&P index.

Figure 1: S&P 500 Daily Chart

Why did the market bounce there? Looking into the rear-view mirror, the answer seems obvious.

Using historical measures of stock valuation, the market offers modest value around the recent lows. The market PE multiple has averaged 16 over the past century. The current market *earnings* estimate for the S&P Index is $240. Thus, the historic average valuation would be *16 times $240 = 3840*. When the S&P Index traded 3636, it represented a 5% discount to the historic average valuation.

Dowside Risk Remains

Within the next year, the stock market will plunge even lower. Bear markets rarely end at fair value.

Keep in mind the laws of nature... specifically Newton's Third Law of Motion. *Every action has an equal and opposite reaction*. Excessive optimism and irrational buying pushed stocks to

extreme overvaluation in 2021. The unwinding will foster excessive caution, irrational selling, a crash, and extreme undervaluation.

The economic cycle will eventually flip from expansion to contraction, compounding the downside stock market risk. Higher interest rates and the unwinding of Covid related spending are cooling demand and leaving businesses with bloated inventories. Target (TGT) second quarter results offer an example of the economic risk. Target's earnings shortfall crashed the stock 40%.

Eventually, earnings expectations will decline across the market, causing stock prices to sink even more. If, for example, S&P 500 *earnings* drop to $220, a modest drop for a recession, the historic fair value estimate would drop to around 3520.

And remember, bear markets don't stop at fair value. With the usual irrational selling, stock prices will undershoot fair value by 10% to 20%. That would sink the S&P 500 Index to the 2800 - 3200 range.

Implications for Investment Strategy

At current stock prices, upside and downside risks are reasonably balanced. For the near term, until the economy stabilizes, substantial downside risk remains. However, in the long term, stock investors can look forward to significant gains.

Figure 2 : Weekly S&P 500, Log Scale as of 7/11/2022

Figure 2 shows that, in the long term, the stock market is an easy bet. On average, the S&P 500 has earned a total return of about 10% per year.

The current bear market provides a safe entry point for investors. The slide brought stock values into the middle of the "value range", depicted in the shaded channel. From these levels, long-term investors can expect historically average returns of around 10% per year.

Yet, for the near term, the economic and market momentum still favors a return of bear-market conditions. Investors should take advantage of any substantial rallies to incrementally raise cash.

Revised Portfolio Strategy: In addition to buying dips, Vigilante Investor recommends incremental selling of stocks on big rallies.

Specifically, we suggest selling stocks on rallies into the 4080-4250 range for the S&P 500. At the top of that range, target a 15% cash position.

At the same time, look for opportunities to buy dips below 3600. If the index reaches 3100 or lower, target a portfolio composed of 0% cash and 100% stocks.

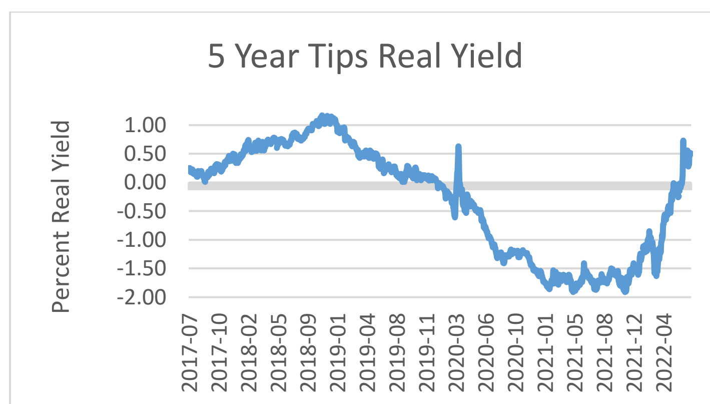
What to Do With Cash?

In bear markets, large cash balances help investors stabilize portfolio performance. It preserves resources until stock bargains emerge.

However, inflation can make it costly to hold a big hoard of cash. The combination of high inflation and low interest rates assures a loss of purchasing power over time. The longer investors hold cash while waiting for stocks to get cheap, the more purchasing power they lose.

Fortunately, a lifeboat has emerged. The recent cheapening of inflation-protected bonds allows investors to earn (around) the rate of inflation on Treasury Inflation Protected Securities (TIPS).

Figure 3: Real Yield History- Treasury Inflation Protected Securities (TIPS)



Source: St Louis Fed

Until very recently, Real Yields on TIPS have traded negative... as low as -2% in 2021. At that time, TIPS investors had to pay a 2% per year premium to get inflation protection.

But the TIPS market normalized after the Fed ended QE (in March). TIPS prices declined, and Real Yields jumped. Currently, the Real Yield trades at around 0.5% on 5-year TIPS and 0.7% on 10-year TIPS.

Investor Lifeboat - Treasury Inflation Protectected Securities (TIPS)

The defintion of TIPS, from the Treasury Direct website.

> *"The U.S. Treasury has been issuing Treasury Inflation-Protected Securities (TIPS) since 1997. TIPS provide investors with protection against inflation. The principal of a TIPS increases with inflation and decreases with deflation, as measured by the Consumer Price Index for All Urban Consumers (CPI-U)"*

> *"TIPS pay interest semiannually at a fixed rate. The rate is applied to the adjusted principal; so, like the principal, interest payments rise with inflation and fall with deflation."* [1]

Investors earn the fixed rate *times* the principal amount. The principal increases by the annual rate of CPI inflation. Therefore, if CPI runs at 8%, the principal of the bond increases in value by 8%.

Remember, TIPS are fixed income securities, not money-market funds. The price fluctuates inversely to changes in the fixed rate. The longer the maturity, the bigger the price fluctuation. Therefore, when investing liquid cash balances in TIPS, investors should only buy TIPS with short maturities.

How to Buy Tips

Series I Savings Bonds

Investors can pruchase Series I Saving Bonds (I Bonds) through Treasury Direct (https://www.treasurydirect.gov .) The next 6-month coupon period pays an annual rate of 9.62%.

The Treasury limits investors to $10,000 of I Bonds per year. The Treasury also penalizes early redemption. I Bonds redeemed within 5 years of purchase lose 3 months interest. These limitations render the I Bond unuseable for the Vigilante Portfolio.

Keep in mind that the I Bond makes a great gift for children and grandchildren, especially for college savings.

Buy TIPS at Auction from Treasury Direct

Using Treasury Direct, investors can buy TIPS at the the high yield awarded in the auction, via "noncompetitive bid." The noncompetitive bid offers the most efficient way for individual investors to accumulate a portfolio of Treasury securities. However, to sell before maturity, the holder must move securities to a brokerage account and sell through a broker.

Buy TIPS through your Brokerage Account

Investors can gain efficiency and liquidity if they buy and sell TIPS through a brokerage account. However, investors who lack experience with trading fixed income securities would be well advised to consider the next option.

Buy a TIPS Mutual Fund or ETF

Mutual funds and ETFs offer easy, liquid access to a professionally managed TIPS portfolio.

Because of its short average maturity, low volatility, low transaction cost (4 basis points per year), and immediate liquidity, the Vanguard Short-Term Inflation-Protected Securities ETF (VTIP) offers a high-yielding substitute for cash.

Investor Recommendation: Move portfolio-related cash holdings into the Vanguard Short-Term Inflation Protected Securities Fund (VTIP)..

Optimizing the Energy Portfolio

It sounds counter-intuitive. Due to insufficient investment, the oil and gas industry will achieve and sustain record profits that will keep growing for years to come. A sustained shortage of oil and gas supply assures rising prices and profits.

It will take years to reverse the supply problem that afflicts the industry. "Green Think" discourages regulators from enabling more production. It discourages bankers and investors from providing capital for oil & gas production. It encourages oil & gas producers to return profits to shareholders instead of reinvesting in the business.

But the march of human progress demands ever more oil and gas production. Without rising oil and gas production, the human condition will regress. Agricultural production will plummet. Human and goods transport will collapse. The buring of wood (for heat) will decimate the forests and thicken the air with unbearable pollution.

If you doubt this assessment, consider the dreadful conditions in Sri Lanka. The country recently earned a near-perfect ESG score of 98. In the process, food production plummeted. The fuel needed to cook food has vanished.. The economy has collapsed, and so has the government. It could not withstand the massive citizen uprising, caused by the suffering inflicted by green policies.

Dutch farmers have also initiated massive protests in response to proposed green-policy restrictions on farming practices.

As you can see, green policy restrictions must be eased or reversed. Otherwise, people all over the world will revolt. The masses will not accept inevitable depression, starvation, isolation, sickness, and premature death.

For this reason, oil and gas production will remain the core of the global economy… somehow.

Because of lack of competition for investment in the sector, investors now have an opportunity to earn terrific returns.

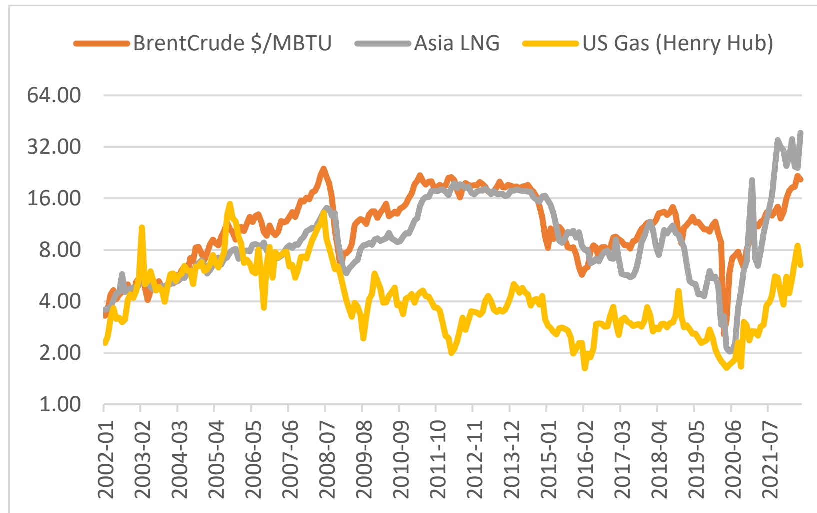
Favor U.S. Gas Production vs. Crude Production

Thesis: The global energy markets are adjusting to shrinking Russian supplies. European gas shortages are accelerating the development of the America's Liquified Natural Gas (LNG) export machine. As exports expand and domestic supplies shrink, U.S. gas prices will converge toward international prices, leading to a doubling or tripling of domestic gas prices. As a result, producers' profits will soar, and so will stock prices.

Prior to the proliferation of shale production, crude oil and natural gas traded in tandem, at the same price per unit of energy (per BTU)… all across the world.

Starting around 2005, shale production proliferated in North America. Excess gas supplies began to build. Because of a lack of export infrastructure, American gas began trading at a discount to crude oil and foreign gas. By 2007, a full-fledged glut developed. American gas has since traded at massive discounts to oil and global gas.

Figure 4: Price per BTU for Crude Oil, Asia Liquified Natural Gas, U.S. Natural Gas



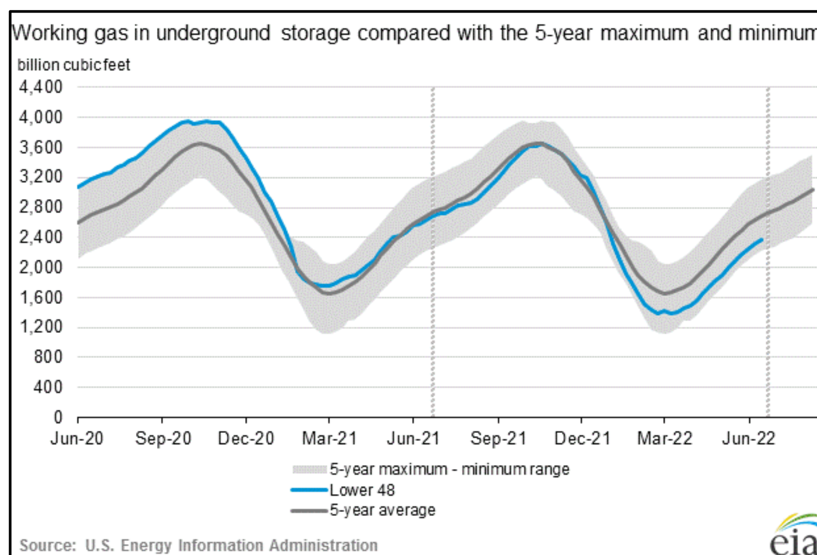
Sources: St Louis Fed, Investing.com

American industry developed many new uses for its bounty of cheap gas. Electric utilities converted from coal to gas-powered generation. In the process, utilities cut costs *and* pollution. Energy-intensive industries built plants in America. Domestic production of fertilizer, paints, metals, chemicals, and plastics all expanded.

Exporters also began to build gas export infrastructures… pipelines into Mexico and Canada… and Liquified Natural Gas (LNG) export terminals. Now, exports consume almost 20% of domestic gas production. About half of the export flow has developed since 2018.

Meanwhile, domestic gas production still runs at 2019 levels. Exports are steadily consuming gas inventories. Figure 5 shows that inventories have slid to record lows for this time of year.

Figure 5: U.S Natural Gas Storage History



The laws of supply and demand never change. Low supplies lead to higher prices. Natural gas prices have tripled over the past 2 years.

Without an immediate and massive increase in production, gas prices will double or triple again… possibly soon.

Several large export facilities under construction will begin operations in the next 2 years. This will further strain supplies. Even more facilities have been approved by regulators. They need sufficient export orders to get the funding necessary for construction.

Russia's invasion of Ukraine has ignited massive European demand for American LNG. This assures that American exporters will secure funding for construction of more LNG facilities. In the next 5 years, exports could double.

The tsunami of LNG exports helps gas producers. But it harms American consumers. Gas producers do not plan to materially lift production for the forseeable future. Therefore, domestic gas prices must soar high enough to ration scarce supplies. In other words, gas prices must get high enough to get electric utilities to switch back to coal.

In the near future, gas prices will move towards the BTU-equivelent price of crude oil. If you divide the per-barrel price of crude by 5.8, you arrive at the BTU-equivelent price.

- If Crude = $80, Gas = $13.79
- If Crude = $100, Gas = $17.24
- If Crude = $120, Gas = $20.69

So even if crude prices decline 20%, gas will double. If crude prices rise 20%, gas will triple.

Do you think those prices will incentivize more production? Yes, if regulators don't prohibit the pipeline infrastructure needed to move more gas to market.

Antero Resources Corporation (AR)

Antero is well positioned to take advantage of soaring gas prices, and the stock is now trading as cheap as any stock I have ever seen.

Antero produces natural gas and gas liquids, exclusively in the Southwestern corner of the Marcellus and Utica shale basins, the most productive gas basin in North America.

Because production is located on the southwestern edge of Appalachia, Antero has access to 3 pipelines that feed LNG export terminals… in Louisiana and Maryland. In fact, 75% of Antero production gets exported.

Antero's bottom line will gain the full benefit of gas price increases. Antero paid down a sizable portion of its debt in recent years. Because of its financial security, Antero has stopped hedging its production. Only 33% of 2022 production and 1% of 2023 production is hedged. Thus, Antero will fully benefit from soaring prices and export demand.

An extremely cheap stock valuation makes Antero irresistible. Companies with a forward PE of 3.85 typically have a highly levered balance sheet and slow growth. Antero has the opposite.

Table 1: Antero Resources Corporation as of 7/15/22

Ticker	AR	EPS	$-1.08	Expected 5-YR Growth	NA
Price	$32.67	EPS Forecast	$8.27	Forward P/E	3.85
Book/Share	$17.43	Market Cap	$10.2B	Credit Rating	BB
Dividend Yield	0%	Enterprise Value	$15.4B	Debt/Ent Value	34%

Sources: Finviz.com, Seeking Alpha

At current production and prices, earnings will climb. Soaring gas prices will compound earnings gains. Eventually, as pipeline capacity increases, Antero can raise production. This will exponentially compound earnings growth.

Figure 6: Antero Resources Corporation as of 7/15/22

Investment Strategy: Buy a full position of Antero below $38. To fund this purchase, sell oil producer Pioneer Natural Resources (PXD). Use a 50% stop loss on Antero to manage risk.

The Economy and Markets

Some investment strategists are proclaiming that the U.S. economy has entered recession. If true, this is the most unusual recession ever recorded.

How often has the economy contracted amid rising employment and wages? Never

How often does the economy contract while the Service PMI registers significantly above 50? Never.

Table 2: Vigilante Investor Scorecard of Economic Conditions –as of 7/15/22

Score	Positive	Neutral	Negative
Growth 4 Contraction 1	US Real GDP +3.5% US Non-Manf PMI 55.3 Global Comp PMI 51.5 Fed Signal +8.1%	US Productivity +0.5%	US 2-10 Spread -0.20%
Inflation 4 Deflation 1	CPI +9.1 YOY US Wages +5.1% YOY Crude Oil +32.0%YOY Gold / Euro +10.3%YOY	Gold +-6.4% YOY	US Dollar +17.1% YOY
Positive $ 2 Negative $ 0	US-Ger2YR Spread +2.70% US-Ger10YR Spread+1.80%		

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

Still, multiple warning signs point to a recession in the foreseeable future. The inversion of the Treasury yield curve (10-Year minus 2-Year = -0.20%) provides the most ominous indication of a contraction. This indicator typically leads the onset of a recession by 6 months to 2 years. Other signals show a slowing economic expansion. Odds favor a shallow recession within the next year… without any severe financial dislocations the likes of 2008.

The downturn will probably feel more like stagnation than recession. Persistent inflation will prevent the Fed from making big rate cuts to stoke the economy.

The next recovery won't feel as good as a typical recovery. It will feel more like a hangover from an amazing party.

But what a party! Starting in July 2020, the government ended lockdowns but continued to line the pockets of businesses and consumers with subsidy payments. Meanwhile, the Fed used zero interest rates and Quantitative Easing to fire up the housing and stock markets. We just witnessed the biggest boom of a lifetime… an amazing sugar high… the likes of which we will never experience again.

Now we are left to deal with the hangover… a lethargic economy…with inflation persistently robbing workers of purchasing power. The hangover could last for a long time.

Model Portfolio Summary

The Vigilante Portfolio got shellacked in Q2.

The bear market took down the best-performing sector of the economy…. oil & gas, crushing the core of the Vigilante Portfolio. No doubt, recession worries intensified energy sector selling.

Table 3: The Vigilante Model Portfolio 7/15/22

Sector	%	Selections	Symbol	Initial Price	Price April 25
5G	4%				
		Qualcomm Inc.	QCOM	$164.40	$144.37
		Nokia Corp	NOK	$4.85	$4.61
Low-Tech America					
Steel	4%	Cleveland Cliffs Inc.	CLF	$16.58	$14.99
Financials	21%				
		Prudential Financial	PRU	$81.96	$92.33
		Chubb	CB	$165.98	$184.19
		Aflac	AFL	$53.38	$54.31
		AIG	AIG	$47.54	$50.08
		WR Berkley	WRB	$53.58	$63.03
Transportation	4%	Dorian LPG Ltd.	LPG	$11.86	$15.27
Energy	29%	Diamondback Energy	FANG	$61.33	$109.14
		CNX Resources	CNX	$12.21	$17.58
		Pioneer Natural Resources	PXD	$147.07	$208.45
		Coterra (Formerly Cabot)	CTRA	$18.69	$26.92
		Southwestern Energy	SWN	$4.06	$5.76
		Antero Resources Corporation	*AR*	*32.67*	*32.67*
		Nine Energy	NINE	$2.72	$2.25
		Plains All American Pipeln	PAA	$9.02	$10.12
		Cameco Corp	CCJ	$12.73	$22.39
Real Estate	15%				
		Granite Point Mortgage	GPMT	$9.87	$9.53
		Vanguard Real Estate ETF	VNQ	$109.98	$91.79
		Simon Property Group	SPG	$127.00	$96.36
Agriculture	5%	Mosaic Co	MOS	$28.67	$45.02
Emerging	0%				
Precious Metals	8%	Junior Gold Miners ETF	GDXJ	$46.02	$30.04
		Gold Miners Index	GDX	$29.30	$25.59
		Pan American Silver	PAAS	$21.13	$18.27
		Silver Miners ETF	SIL	$42.00	$23.96
Cash	*0%*	*VG ST Corporate Bond ETF*	*VCSH*	*$83.12*	*$76.30*
	10%	*VG ST Infl Protected Sec ETF*	*VIPSX*	*$12.90*	*$12.90*

Table 4: Vigilante Investor ETF Model Portfolio 07/15/22

All ETF Portfolio	%	Selections	Symbol	Initial Price	Price April 25
Broad Market	8%	VG Mid-Cap Value ETF	VOE	$122.88	$130.64
	8%	VG Large-Cap Value ETF	VTV	$121.81	$132.26
Financials	8%	VG Financials	VFH	$88.21	$77.87
	14%	iShares U.S. Insurance	IAK	$84.25	$80.14
Energy	30%	First Trust Revere Nat Gas	FCG	$19.01	$21.20
Real Estate	12%	Vanguard Real Estate ETF	VNQ	$109.88	$91.79
Precious Matals	5%	VanEck Vectors Gold Miners	GDX	$32.75	$25.59
	5%	Global X Silver Miners	SIL	$39.51	$23.96
	0%	*VG ST Corporate Bond ETF*	*VCSH*	*$83.12*	*$76.30*
Cash	*10%*	*VG ST Infl Protected Sec ETF*	*VIPSX*	*$12.90*	*$12.90*

Assets with big gains, like energy stocks, always suffer intense selling pressure in a bear market. Many investors take gains on their biggest winners to cover the losses on other stocks.

Undervalued energy stocks still enjoy the business momentum to rebound sharply. Current prices present a terrific opportunity for new investors to enter the market.

Currently, we are adding Antero and selling Pioneer, keeping our allocation to the energy sector maxed out at around 30%. We are selling Nokia due to the winding down of the 5G network buildout.

Speaking of 5G, we continue to hold Qualcomm. Its 5G chips (for multiple non-phone uses such as automation) will benefit from the expansion of 5G network usage.

Gold and Precious Metals

The bear market drove selling in the precious metals and related stocks. Precious metal stocks fell to extremely cheap levels. The stocks in the Vigilante Basket remain the cheapest in the sector.

Table 3: *Vigilante Investor* Precious Metal Scorecard[1] as of 7/15/2022

Precious Metal ETF	Price	Ratio	Hist Avg	Rating
GLD	159.01			
SLV	17.19	9.25	6.08	1
Stocks vs GLD	**Price**	**Model**	**vs. Model**	**Value Rating**
Jr. Gold Miners ETF (GDXJ)	$30.04	$43.15	-13.11	0
Gold Miners ETF (GDX)	$25.59	$31.63	-6.04	0
Newcrest Mining (NCM)	$12.69	$19.51	-6.82	1
Barrick Gold (GOLD)	$15.66	$20.48	-4.82	1
Sandstorm Gold (SAND)	$5.48	$6.85	-1.37	2
Wheaton Precious Metals (WPM)	$33.80	$37.44	-3.64	3
Royal Gold (RGLD)	$103.40	$111.44	-8.04	4
Newmont Mining (NEM)	$54.73	$55.06	-0.33	5
Yamana Gold (AUY)	$4.57	$4.36	0.21	6
Stocks vs SLV	**Price**	**Model**	**vs. Model**	**Value Rating**
Silver Miners ETF (SIL)	$23.96	$31.16	-7.20	1
Pan American Silver (PAAS)	$18.27	$20.36	-2.09	4
Hecla Mining (HL)	$3.77	$3.47	0.30	6

[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.

Have a great quarter!

Steve Koomar

July 17,2022

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