Fed Chairman Jerome Powell believes the current inflation spike is transitory. He expects commodity prices to level off or reverse, eventually.

For the most part, Chairman Powell makes good sense.

However, Powell's forecast does not apply to all commodities. For one vital, out-of-favor commodity, inflation will persist… creating a compelling investment opportunity.

To understand the case for investing in this commodity, it helps to understand why Chairman Powell expects the current inflationary surge to dissipate.

The Big Picture on Inflation

The current inflation stems from pandemic-related dislocations that led to commodity shortages. The pandemic shuttered most businesses, causing entire industries to hunker down in a fight to survive. The economy reopened with fits and starts. Some supply chains struggled. Restarting entire industries, such as semiconductors, isn't easy. Shortages developed.

The lumber market offers an interesting case study on the unforeseeable impacts of the pandemic. Many mills shut down. But the lockdowns led to unexpected demand for lumber. Homeowners used their extra time to work on home-improvement projects, and lumber supplies started to dwindle, As the economy reopened, a homebuilding boom started, and severe lumber shortages quickly developed. In response to high prices, lumber mills expanded output. More abundant supplies led to price competition. Ultimately, lumber prices collapsed, giving up most of the pandemic-era gains.

Figure 1: Lumber Futures as of July 23, 2011

The pandemic changed consumer behavior across much of the economy. It is taking some time for manufacturers and supply chains to adjust to the changing demand, intensifying some shortages.

For example, many consumers began to value personal transportation, and car demand soared. Consumers also began to appreciate the benefits of a larger home. Low interest rates made homeownership more affordable, intensifying demand.

When the economy reopened, consumers scooped up the supply of homes and autos. Supply shortages developed across the economy. Some prices soared.

Unprecedented Home Price Inflation

The lumber shortage quickly resolved itself. The market rationed the limited supply of lumber to those who could afford to pay high prices. Lumber prices quadrupled, and then lumber mills rehired enough workers to expand production.

It will take longer to resolve housing inflation. Fundamental demand for homes appears to have changed. Young families are no longer waiting to buy a bigger home… they want it now. As a result, home prices have spiked 16% in the past year. Prices will probably continue to run higher for a few years… perhaps until the Fed raises interest rates substantially. But one way or another, housing demand will get satisfied, home prices will level off, and home price inflation will fall back to normal levels.

As Chairman Powell says, this home inflation is probably transitory… albeit over the course of a few years.

Auto Prices Take Off

The pandemic initially shuttered auto assembly lines while also stoking car-ownership demand. At first, it appeared a supply shortage might be averted. Car buyers could buy cars from dealer inventories and from car rental companies… who needed to sell their fleets to stay alive. When the lockdown eased, manufacturers restarted production. But they quickly ran into a production bottleneck. They could not acquire the semiconductors needed to build the advanced cars of our day.

Somehow, Chinese companies saw the semiconductor shortage coming. They bought up supplies and placed large orders for future production, leaving many industries in the U.S. without adequate supplies. The parts shortage forced carmakers to limit production.

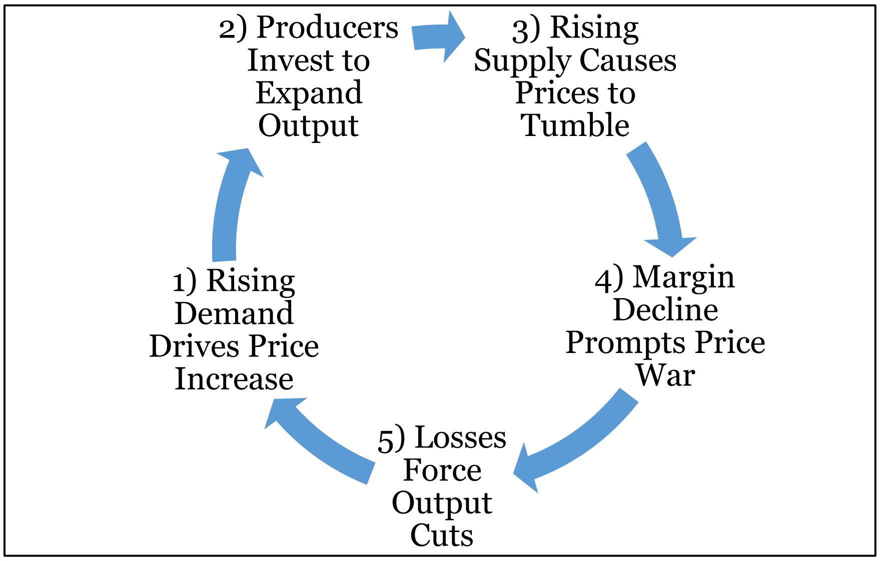
The intense competition of the auto industry normally keeps a lid on prices. But now, with car supplies limited, consumers must pay higher and higher prices to get what they need. Both new and used car prices have soared.

This too shall pass. Within the next six months, automakers will probably secure an adequate supply of semiconductors. They will expand production. Eventually, they will produce too many cars, requiring price cuts to move excess inventories.

Typical Inflation Cycles

Indeed, Chairman Powell is correct. This bout of inflation stems mostly from supply shortages and thus is *mostly* transitory. Commodity goods tend to follow a common price pattern.

Figure 1: Typical Commodity Price Cycle



When a shortage develops, prices jump. Then greed takes over. Producers make more of the commodity to capture an unusually large profit. Eventually, supply and demand find a balance, and prices stop rising. Typically, greed gets the best of producers. They make too many goods, a glut develops, and producers are forced to cut prices.

But, in one critical commodity market, the supply-response (to rising prices) has stopped functioning. Despite a doubling of prices, producers are not increasing supplies. To make matters worse, foreign demand is growing, which puts more stress on domestic supplies, and makes it impossible to use imports to meet rising demand.

This is a perfect recipe for sustainable, enduring price increases, and it is happening in the world's most important commodity market… natural gas.

Investors Boycott Oil & Gas

Over the past 2 decades energy companies, private equity investors and bankers have poured capital investment into America's oil and gas industry. Most investments focused on extracting oil and gas by the hydraulic fracturing of shale. U.S. oil and gas production soared. The massive supply influx caused oil and gas prices to swing wildly. Every price spike inspired massive new investments. Eventually, a glut would develop and prices would collapse, leaving investors with losses.

For the most part, shale producers can no longer access outside capital investment. Private equity investors and bankers have tired of losing money on shale. To make matters worse the ESG movement has villainized oil and gas investments, making it all but impossible to find new sources of capital.

Despite soaring prices and profit potential right now, shale producers cannot raise the capital needed to expand production. The steep initial decline in shale-well production (after the first year) requires shale producers to continuously drill and complete new wells. Constant drilling is required to keep overall production from falling.

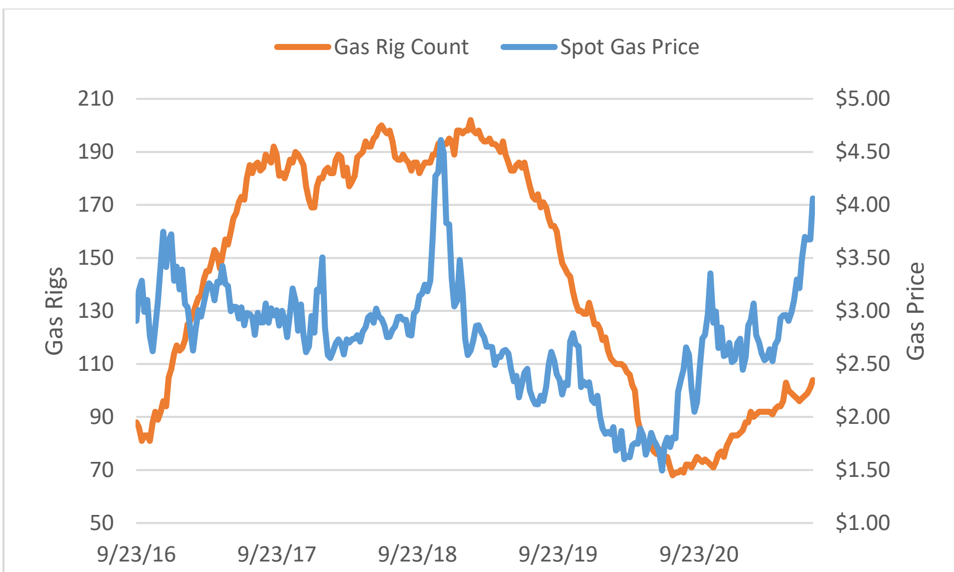
The bottom line- gas producers aren't drilling enough wells to maintain peak production.... And they can't get close to meeting growing demand.

Shale producers can only use "Cash Flow from Operations" to fund new drilling and completions. Unfortunately, cash flow has been strained by the forward sales executed during the pandemic (at much lower prices.) Many gas producers were worried about surviving at that time. They were spooked by the brief experience with negative oil prices in April 2020. Subsequently, they sold future production at suboptimal prices. These low-priced forward sales are limiting cash flow, the only funding source for drilling new wells.

As stated earlier, lenders, investment bankers, and private equity investors are not interested in funding new drilling activity. So, even though high gas prices assure soaring profits for gas producers, drilling activity is not keeping up with demand.

Figure 2 illustrates the result. Drilling rigs in use are at half of the 2018 level.

Figure 2: Natural Gas Spot Price and Rig Count

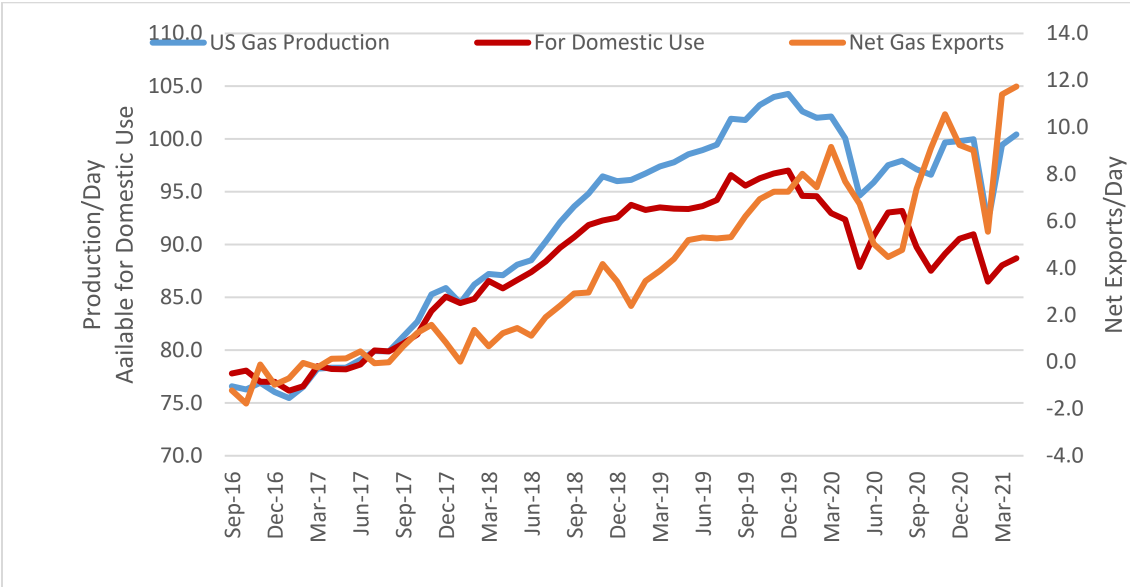


Sources: Oilprice.com and Investing.com

And gas production remains below the pre-pandemic peak, as shown in Figure 3.

In a nutshell, typical commodity-supply response to rising prices has broken down. Despite a doubling of prices, production remains depressed due to the unavailability of capital.

Figure 3: U.S. Gas Production, Exports, and Amount Available for Domestic Use



Source: U.S. Energy Information Administration

Figure 3 above shows that production remains about 5 Mcf/day below the pre-pandemic peak. With gas exports to Mexico and Asia soaring, the gas available for domestic has declined… by almost 10 Mcf/day. Where can the U.S. consumer buy gas when supplies run out?

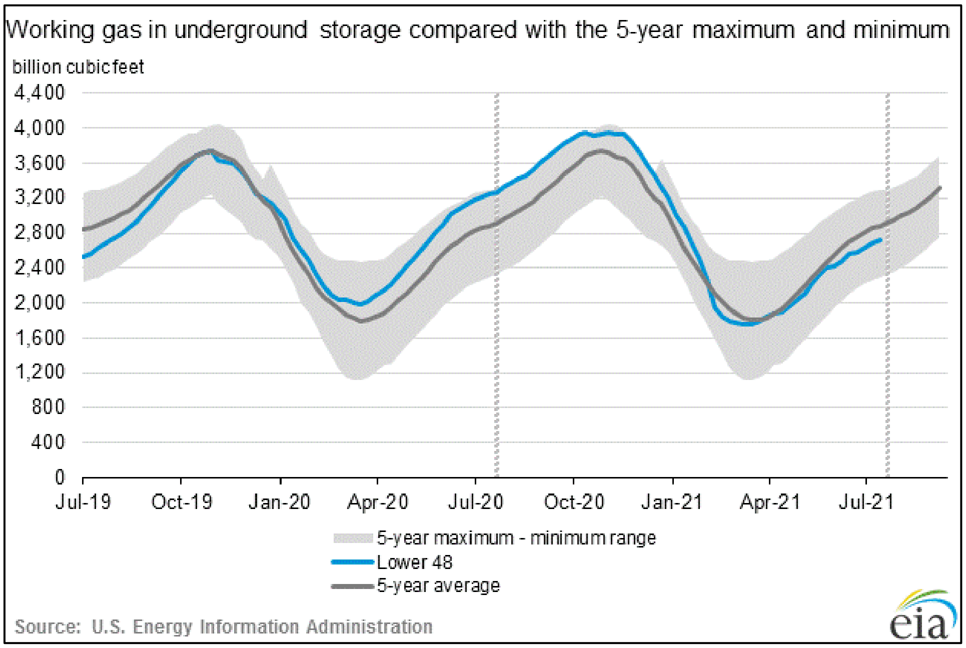
Not from imports! Gas prices in Asia trade at 4x U.S. gas. There will be no hope of imports filling demand.

Figure 4: Japan-Korea Gas Price

To make matters worse for consumers, U.S. gas exports are growing as quickly as the gas-export infrastructure can be built. Companies are completing more pipelines into Mexico and more Liquified Natural Gas Export (LNG) terminals along the coasts.

Figure 5 shows a gas shortage is starting to develop.

Figure 5: U.S. Natural Gas Storage Report, July 23, 2021



Despite a relatively cool summer (so far) and lower-than-normal electricity demand for cooling demand, summertime gas inventories are building more slowly than usual.

Shortages of this commodity are catastrophic for people and the economy, especially during the winter. People rely on gas to heat their homes in winter. Utilities rely on gas to produce electricity. The industrial economy relies on gas for fuel and feedstock. For most consumers, there is no substitute for gas. When prices soar, almost everyone pays whatever price is required by the market.

With a warm winter this year, the gas market might avoid a catastrophic shortage in 2022. But an unusually warm winter would just delay the day of reckoning.

One way or another, gas prices will run higher… high enough to bring private investment back to shale… high enough to reduce export demand… or both.

In the meantime, domestic gas producers are sitting in a great position. With no competition from outside capital, gas companies can reinvest ongoing cash flow in new production with the promise outstanding returns.

The Second Leg of the Vigilante Inflation Portfolio

Last quarter, we recommended a strategy to build wealth during inflationary times by investing in Property-Casualty insurance companies.

This quarter, we recommend a second strategy… one that will profit, from the persistent natural gas inflation over the next year or two.

The Vigilante Portfolio already holds some investments in the oil and gas producing sector. With our outlook of gas prices and profits, we are allocating more to the sector.

In Table 1 below, we display our current holdings in black ink…and our new recommendations in blue ink.

Table 1: Vigilante Investor Oil & Gas Company Basket

Company	Industry	Ticker	Price	Div Yield	Debt/ Ent Value	Fwd EPS Expected	Fwd P/E Ratio	5-Year Exp Growth	PEG Ratio
CNX Resources	*Gas*	*CNX*	*$12.21*	*0.00%*	*0.45*	*$1.14*	*10.76*	*35.70%*	*0.30*
Pioneer Natural Resources	*Oil & Gas*	*PXD*	*$147.07*	*1.52%*	*0.17*	*$17.70*	*8.31*	*48.20%*	*0.17*
Diamondback Energy	Oil & Gas	FANG	$79.54	1.60%	0.37	$12.86	6.18	46.44%	0.13
Cabot Oil & Gas	Gas	COG	$15.90	2.77%	0.14	$1.88	8.46	40.83%	0.21
Southwestern Energy	Gas	SWN	4.9	0.00%	0.42	$1.16	4.23	NA	NA

Sources: Finviz.com and Seekingalpha.com as of July 30, 2021

CNX Resources (CNX)

This company produces natural gas exclusively in the Marcellus and Utica shale basins, with operations in Pennsylvania, Ohio, and West Virginia. The company enjoys very low costs of $1.05 per Mcf… perhaps the lowest in the Appalachian region. With such low costs, the company functions as a cash flow machine. In 2021, the company projects $475M of Free Cash Flow, about 17% of stock market value. You won't find many companies with such a high cash flow rate. The cash flow should get even better as the underwater hedges run off and company captures higher prices for future gas sales.

Pioneer Natural Resources (PXD)

Pioneer produces oil and natural gas in the Permian Basin. With extremely low debt and arguably the lowest production costs in America, Pioneer seems to enjoy a bear market. In the past, Pioneer used market downturns to strategically buy its competitors. In the most recent pandemic-related oil collapse, Pioneer acquired Parsley Energy and privately held DoublePoint Energy.

Pioneer's production is composed of approximately 63% crude oil and 37% natural gas and gas liquids. For years, gas production has served as a biproduct of Pioneer's crude oil production. But now, with gas prices soaring, gas production will provide a meaningful boost to Pioneer's bottom line.

Recommended Strategy: Buy full positions of CNX Resources and Pioneer Natural Resources at current prices.

The Economy and Markets

The economy is running very hot. The Vigilante scorecard has never shown such a one-sided balance of risks. All six growth indicators are flashing green. For the first time in years, none of the indicators favor deflation. At this point, it doesn't seem like the economy can get any hotter.

Table 2: Vigilante Investor Scorecard of Economic Conditions –as of 7/15/2021

Economic Condition and Score	Positive	Neutral	Negative
Growth 6 Contraction 0	US Real GDP +12.2% US Non-Manf PMI 60.1 Global Comp PMI 56.6 US Productivity +4.4% US 2-10 Spread +1.14% Fed Signal +16.5%		
Inflation 3 Deflation 0	CPI +5.4% YOY US Wages +3.7% YOY Crude Oil +83.0% YOY	Gold -9.6% YOY Gold / Euro -9.1% YOY US Dollar -1.0% YOY	
Positive $ 2 Negative $ 0	US-Ger2YRSpread +0.81% US-Ger10YRSpread+1.67%		

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

Investment Strategy

The S&P 500 continues to show upside momentum, but it is nearing a high valuation barrier.

Figure 6: S&P 500 as of 7/29/2021- Log Scale

With the high valuation barrier so close, investors should start working to protect their gains. That includes liquidating some stocks to raise cash and reallocating some of the portfolio to "value stocks", which show more upside potential than the typical growth stock in the S&P 500.

Figure 7: Vanguard Value ETF as of 7/29/2021

The old-economy, value-oriented sectors have substantially more upside potential than the S&P average. For this reason, it makes sense to continue holding many of these stocks. But keep in mind, if the broad market takes a big dive, the value stocks will get hit just as hard as the growth stocks. And the day of reckoning is getting nearer. No one knows the day… so start getting ready now. Take profits incrementally (and raise cash) as your stock holdings appreciate.

Investors should re-evaluate all stock holdings. Sell stocks where conviction is lacking.

The Vigilante Portfolio is selling Ciena, Nucor, Exxon Mobil, iShares Mexico, and iShares India. Considering our perspective view on gas inflation, the Exxon sale may surprise you. But the board takeover by environmental interests changes everything. Exxon may cease to operate in the best interest of shareholders. I see no reason to continue holding this stock.

For ETF investors, we recommend selling the Vanguard Small-Cap Value Fund.

If the market continues higher in the next month, we recommend taking profits, incrementally, on the rest of the portfolio. The Vigilante Portfolio recommends the following scaled selling:

- QCOM $160 to $200
- NOK $7.50-$11.00
- CLF $35-$50
- C $80-$96
- PRU $120-180
- LPG $22 to $30
- BA $275 to $325
- LUV $63 to $76
- F $16-$19
- FANG $120 to $140

- SPG $140 to $160
- GPMT $16.70 to $17.50
- MOS $46 to $62

Some of these price targets are close to current levels; some are far away. Whether or not the stocks hit the targets, we will try to raise cash to 30% of the portfolio by Labor Day.

Table 2: The Vigilante Model Portfolio 07/29/2021

Sector	%	Selections	Symbol	Initial Price	Price (July 29)
5G	8%				
		Qualcomm Inc.	QCOM	$164.40	$150.99
		Nokia Corp	NOK	$4.85	$6.05
Low-Tech America	54%				
ETFs		VG Mid-Cap Value ETF	VOE	$122.88	$141.86
		VG Large-Cap Value ETF	VTV	$121.81	$139.49
		VG Financials	VFH	$88.21	$90.76
Steel		Cleveland Cliffs Inc.	CLF	$16.58	$24.86
Financials		Citigroup Inc.	C	$60.56	$68.81
		Prudential Financial	PRU	$81.96	$101.43
		Chubb	CB	$165.98	$167.43
		Aflac	AFL	$53.38	$55.61
		AIG	AIG	$47.54	$47.87
		WR Berkley	WRB	$80.37	$73.56
Transportation		Dorian LPG Ltd.	LPG	$11.86	$12.23
		Boeing Co	BA	$203.86	$231.63
		Southwest Airlines	LUV	$45.62	$51.55
		Ford Motor Company	F	$11.29	$14.39
Energy		Diamondback Energy	FANG	$61.33	$79.54
		CNX Resources	*CNX*	*$12.21*	*$12.21*
		Pioneer Natural Resources	*PXD*	*$147.07*	*$147.07*
		Cabot Oil & Gas	COG	$18.69	$15.90
		Southwestern Energy	SWN	$4.06	$4.90
		Plains All American Pipeln	PAA	$9.02	$10.02
		Cameco Corp	CCJ	$12.73	$18.05
Real Estate		Simon Property Group	SPG	$97.48	$125.92
		Granite Point Mortgage	GPMT	$9.87	$14.23
Agriculture		Mosaic Co	MOS	$28.67	$31.13
Emerging	0%				
Precious Metals	8%	*Junior Gold Miners ETF*	*GDXJ*	*$46.02*	*$46.02*
		Yamana Gold	*AUY*	*$4.30*	*$4.30*
		Barrick Gold	*GOLD*	*$21.72*	*$21.72*
		Silver Miners ETF	SIL	$42.00	$42.58
Cash	30%	VG ST Corporate Bond ETF	VCSH	$83.12	$82.84

Precious Metal Review

Precious metal mining shares, on average, remain cheap. However, 3 of the holdings in the Vigilante Investor Precious Metals basket are trading more expensive. We recommend taking profit on Sandstorm Gold (SAND), Royal Gold (RGLD), and Wheaton Precious Metals (WPM). We recommend replacing those positions with cheaper stocks… the Junior Gold Miners ETF (GDXJ), Yamana Gold (AUY), and Barrick Gold (GOLD)

Table 3: *Vigilante Investor* Precious Metal Scorecard[1] as of 07/29/2021

Precious Metal ETF	Price	Ratio	Hist Avg	Rating
GLD	171.17			
SLV	23.72	7.22	6.08	3
Stocks vs GLD	**Price**	**Model**	**vs. Model**	**Value Rating**
Jr. Gold Miners ETF (GDXJ)	$44.31	$50.63	-6.32	1
Yamana Gold (AUY)	$4.31	$5.13	-0.82	1
Barrick Gold (ABX)	$21.81	$24.38	-2.57	3
Newcrest Mining (NCM)	$19.77	$21.61	-1.84	4
Gold Miners ETF (GDX)	$35.07	$36.25	-1.18	4
Sandstorm Gold	$7.82	$7.99	-0.17	5
Royal Gold (RGLD)	$121.49	$121.10	0.39	5
Newmont Mining (NEM)	$62.72	$61.18	1.54	6
Wheaton Precious Metals (WPM)	$46.11	$43.39	2.72	7
Stocks vs SLV	**Price**	**Model**	**vs. Model**	**Value Rating**
Pan American Silver (PAAS)	$28.28	$32.04	-3.76	3
Silver Miners ETF (SIL)	$42.58	$44.30	-1.72	4
Hecla Mining (HL)	$6.85	$6.18	0.67	6

Have a great quarter!

Steve Koomar

August 5, 2021

Disclosures

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

Disclaimer: Investors should not rely only on the research in this or any other publication. It is the Investors' responsibility to perform their own research and due diligence before investing. Investors should always determine that the risks are appropriate before investing, and they should avoid making any investment if the risks associated with the investment are not well understood.

[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.