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INVESTMENT COMMENTARY & OUTLOOK

July 2021

So far this year, dividend growth stocks have been the stars and are anticipated to continue to perform well due to collapsing bond yields. These same collapsing yields also helped our growth stocks in June after China did a commodity "dump" to squelch soaring material prices.

We are clearly in an inflationary environment that is expected to persist due to accommodative central banks. The latest catalyst for bond yields collapsing was the European Central Bank's (ECB) recent announcement that it would tolerate up to 2% annual inflation over the "medium term" and essentially ignored the current annual inflation target of just below 2%. So just like the Fed, the ECB is going to allow inflation to temporarily "overshoot" its inflation targets. The ECB essentially signaled that easy money will now be available, which could anger Germany.

Germany still remembers the hyperinflation of the early 1920s, when a wheelbarrow full of money was required to buy normal food items. The hyperinflation in Germany began after World War I and continued through the end of 1923. This caused subsequent German central bankers to be ultra conservative. In that light, we are eagerly awaiting a response from the Bundesbank regarding the ECB's policy change, but so far, Germany is withholding criticism.

If and when the Fed decides to raise key short-term interest rates, they will not be able to raise rates much, since with about $30 trillion in accrued federal debt, the interest on the federal debt now exceeds the Defense Department's annual budget. The rest of the world is watching America and they increasingly expect the U.S. to embrace MMT and eventually reach negative Treasury yields. We already have negative TIPS yields which are a function of negative real interest rates after inflation. There was a time in the U.S. during WWII and afterwards where real interest rates were negative after inflation for 10 years in the 1940s using a predecessor version of MMT.

Another example of the conundrum that America faces is the fact that junk bond yields have now fallen below the Consumer Price Index (CPI) for the first time in history, according to Bespoke Investment Group research. What a strange new world we are living in when both junk bonds and Treasury bonds have negative yields relative to inflation. The Fed does not want nominal rates to be negative, as they are in Europe, as it backfires in the banking system; but it sure does not mind seeing positive nominal rates and negative real rates.

The last time inflation exploded higher was back in the late 1990s, when Navellier & Associates, Inc. had its most successful period investing in growth stocks, especially small- to-mid-capitalization stocks. So please excuse our excitement about the money supply surging from the practitioners of MMT, and specifically our belief that the Federal Reserve and Treasury Secretary Janet Yellen will not try to constrain the money supply with significantly higher interest rates that might impede economic growth.

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In the past three months, our average growth stock has had its consensus earnings estimate revised over 20% higher. Typically, positive analyst earnings revisions precede future earnings surprises. Although the second-quarter announcement season is supposed to represent "peak sales and earnings momentum," many of our growth stocks will sustain strong sales and earnings momentum and continue to break out as market leaders.

All bull markets become increasingly narrow as the stock market climbs higher, but many of our fundamentally superior growth stocks are so strong that we do not envision them being derailed anytime soon.

As you may know, we do not like August, since it is a seasonally weak month. For one thing, most of Europe and many on Wall Street go on extended vacations, so the market often experiences "air pockets" of limited buying pressure. Any pullbacks in the upcoming months will likely be great buying opportunities. Due to the current "Goldilocks" environment from low Treasury bond yields and strong earnings, the remainder of the year looks great as I said on **Fox Business with Maria Bartiromo.**

The $64,000 question out there remains: Why are Treasury bond yields continuing to decline as inflation heats up? Basically, there is strong demand for corporate bonds, which is now pushing Treasury bond yields lower, while the negative interest rate environment in Europe is also boosting demand for U.S. debt, which pushes rates lower. One of the tenets of MMT is that there is no danger in massive money creation if interest rates stay low and inflation stays low, so MMT believes money creation is a "free lunch."

No matter what the cause, the stock market remains a bargain compared to falling bond yields. Considering that our average growth stock should continue to post an average earnings surprise of 30% or more. That means the stock market is not overvalued and has a tremendous amount of appreciation potential ahead in the upcoming months.

We never expect that our growth stocks will appreciate as fast as their underlying earnings growth – due to price-to-earnings (PE) ratio compression – so when you have 200% average annual forecasted earnings growth, as some of our growth stocks do, does that mean that our growth stocks have 200% appreciation potential? The answer is "no" due to anticipated PE ratio compression. However, the prospect is excellent for many of our of growth stocks after they announce better-than-expected sales and earnings and then provide positive future guidance.

Money supply has risen approximately 40% since the pandemic began and all this new money is "sloshing around" in several markets. This liquidity is chasing stocks, residential real estate, and some collectibles. However, we expect that stocks and residential real estate will be the biggest winners in the long run since they are the least volatile and have higher investor confidence.

Our current Treasury Secretary, Janet Yellen, is a very smart person who our favorite economist Ed Yardeni likes to call "The Fairy Godmother" of the stock market, since when she was Fed Chairman, she used to sprinkle "fairy dust" on the stock market via her positive comments. However, we also believe that Janet Yellen and other progressive leaning people in the Biden Administration must be aghast at how their easy money policies keep making rich people richer and that wealth is not trickling down to others as fast as they want. This causes a big conundrum regarding what policies the Biden Administration should emphasize going into the mid-term election year in 2022.

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Clearly, rising homelessness; higher crime in many major cities; higher food, energy, and housing prices, plus a growing sense of being left behind – as 6.8 million workers have not been replaced since the pandemic started – have created a large base of unsatisfied voters. This is not what the Biden Administration has set out to accomplish, so rifts are growing within Biden's party, which is why tax reform and other proposals have stalled.

We expect that the 2022 mid-term elections will result in more divided government – which is what the stock market typically wants and bodes well for the future.

This year is shaping up to be a big year for economic growth, due to the fact that the money supply has been increased dramatically, which has also triggered inflation that in turn creates even more economic growth. Managing the velocity of money, which is how fast money changes hands, is an art; but due to inflation, supply chain bottlenecks, and pent-up global demand, the second half of this year should be characterized by 6% GDP.

Amazingly, as inflation has heated up, Treasury bond yields have fallen as strong corporate bond demand, plus falling yields has apparently pushed Treasury bond yields lower. In fact, for the first time ever recorded, junk bonds now yield less than inflation based on the CPI. So now both junk bonds and Treasury bonds have negative yields relative to inflation. (What a strange new world we are living in!) As a result, we are increasingly convinced that Treasury bond yields will be following their European peers and eventually have absolute negative yields in our lifetime!

Much of the rest of the industrialized world, like Japan and Europe, have much lower interest rates than the U.S., so it just makes sense that Treasury yields will also fall into equilibrium, especially as Secretary Yellen, the Fed, and the Biden Administration embrace MMT. The last time inflation exploded was back in the late 1990s, when we had our most successful period investing in growth stocks, especially small- to mid-capitalization stocks. So please excuse our excitement about the money supply surging 40% and our belief that Treasury Secretary Yellen will not try to constrain the money supply with significantly higher interest rates that might impede economic growth.

The truth of the matter is that we are in a "Goldilocks" environment with an accommodative Fed and Treasury Secretary. The ultra-low interest rate environment is great news for both residential real estate and growth stocks, which are naturally great inflation hedges. The U.S. is now leading worldwide economic growth and since more supply chains have to become more local, we expect economic growth to remain strong.

The Biden Administration's policies are making the rich richer but they are having a hard time explaining why 6.8 million jobs have disappeared since the pandemic began, despite record economic growth. The truth of the matter is that the pandemic accelerated U.S. productivity and profitability, which is great news for the stock market. Since economic prosperity has not trickled down to folks that do not own a home or have money in the stock market, there is a lot of finger-pointing about being "left behind," as well as who is responsible for rising homelessness; rising crime in major cities; and higher food, energy, and housing prices. Furthermore, inflation is hurting poor people while inflating asset prices for wealthy people. This means a big change is brewing for the mid-term elections, so that a divided government, which Wall Street prefers, is becoming increasingly likely.

In the end, as investors, our best defense remains a strong offense of fundamentally superior stocks. Our fundamentally superior growth stocks are "locked and loaded" for the upcoming quarterly announcement

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season with strong forecasted annual sales growth and annual earnings growth. Despite "peak sales and earnings momentum" for the overall stock market, we expect many of our growth stocks will continue to sustain strong sales and earnings momentum and retain their status as market leaders.

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