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INVESTMENT COMMENTARY & OUTLOOK

October 2022

The third quarter was supposed to end on a positive note since the Fed's September 21st key interest rate hike was supposed to be the last big 75 basis point increase. Unfortunately, the Fed is also shrinking its balance sheet by $95 billion per month and driving Treasury yields higher, so the Fed has to continue to raise key interest rates to "catch up" with market rates. In fact, all the gains from the rally in Treasury bonds since mid-June have been wiped out, as the 10-year Treasury bond yield has soared close to the 4% level.

The other factor that caused this surge in Treasury yields was that the core rate of inflation resumed rising in August, even when energy prices were falling. However, energy prices are no long falling, since the Biden Administration's artificial manipulation of the crude oil market is anticipated to end soon. The release of 1 million barrels per day from the Strategic Petroleum Reserve (SPR) is expected to end sometime after the midterm elections. We expect that after the midterm elections, the Biden Administration will have to start refilling the SPR as it is now at its lowest level in approximately four decades!

The other reason that crude oil prices are rising again, despite weak seasonal demand, is that OPEC+ recently announced up to a 2 million barrel per day production cut. However, the real production cut may be more like 900,000 barrels per day after factoring in Russia's production declines and some quota cheating from smaller OPEC members. The bottom line is OPEC+ wanted to "shock" energy markets to get crude oil prices per day up to $100 per barrel. As always, Saudi Arabia can implement the biggest production cuts and its output will likely determine the ultimate crude oil production cut.

Worldwide demand for crude oil naturally rises in the spring when demand picks up, so $120 per barrel crude oil is now very possible in 2023, especially if China's economic engine fires up again. China's "Zero Covid" lockdown policy in key provinces is now being cited as a possible way that President Xi Jinping can squelch opposition after dispatching tanks for people who were upset that they could not withdraw their savings from the People's Bank of China. The Communist Party is meeting in mid-October when over 2,000 members will take part in selecting the new leadership for the party's Central Committee, the 25-person Politburo, as well as the 7-person Politburo Standing Committee. President Xi Jinping is vying for an unprecedented third term after his two previous predecessors stepped down after two consecutive 5-year terms.

The bottom line is the leadership in China and Russia is extremely authoritarian. It will be very interesting to see if both Xi and Putin show up at the G20 meeting that is scheduled for mid-November in Bali, Indonesia. Interestingly, both Xi and Putin have been reluctant to travel due to their respective domestic problems.

Right now, Vladimir Putin, is under tremendous domestic pressure as reservists flee the country since they do not want to join the fight in Ukraine. The surrender and retreat of Russian soldiers in Ukraine is expected to possibly overthrow Putin's leadership. In the meantime, the blast on the Crimea bridge is further isolating Russian troops, since a key supply line has been cut off. Putin's retaliation for the bridge blast was a series of long-range cruise missile attacks on Kiev and other major Ukrainian cities, which is very disturbing.

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In the current environment, the only thing that is certain is that fossil fuels will remain in high demand in 2023, as Europe strives to diversify away from Russia. An economic recovery in China, as well as Europe, would also put more upward pressure on crude oil prices.

Our favorite economist, Ed Yardeni, recently said that he believes the Fed should finish hiking key interest rates at its November Federal Open Market Committee (FOMC) meeting, which is running counter to the Fed's guidance. Yardeni also cited a strong U.S. dollar as another reason the Fed should stop raising key interest rates after its November FOMC meeting. There were widespread rumors that the Fed might only hike key interest rates 0.5% at its November FOMC meeting when the stock market got off to a strong start in October.

Unfortunately, we respectively disagree with this optimistic Fed speculation, since hoping the Fed will diverge from its previous guidance is dangerous. Ed Yardeni is qualified to be Fed Chairman and his advice is important, but we are not sure that Fed Chairman Jerome Powell respects Yardeni as much as we do. The Fed is notorious for overshooting, so it will be interesting to see if the Fed tightens too much or listens to wise advice from Yardeni and other respected economists.

Interestingly, *The Wall Street Journal* recently reported that the Biden Administration is preparing to scale down sanctions on Venezuela, which would allow Chevron to reopen crude oil exports to Europe and the U.S. In exchange for significant sanctions relief, the government of Venezuelan President Nicolas Maduro would have to resume long-suspended talks with the country's opposition to discuss conditions needed to hold free and fair presidential elections in 2024.

Furthermore, the U.S., the Venezuelan government, as well as some Venezuelan opposition figures have also worked out a deal that would free up hundreds of millions of dollars in Venezuelan state funds frozen in American banks to pay for imports of food, medicine and equipment for the country's battered electricity grid and water systems. *The WSJ* added that details are still under discussion and cautioned that any deal could fall through.

To deal with energy issues and climate change, tThe Inflation Reduction Act that provided generous electric vehicle (EV) incentives for vehicles with U.S.-sourced lithium batteries, has irritated the European Union (EU), Japan and South Korea, who now acknowledge that the EV incentives violate World Trade Organization (WTO) rules.

Since the Inflation Reduction Act has rattled U.S. allies, it may actually interfere with the international cooperation needed to onshore U.S. battery production.

In the end, fossil fuels accounted for 80% of global energy production in 2020 according to the Energy Information Administration. However, because Europe, India, Indonesia and China are now burning more coal, it is estimated that fossil fuels in 2022 are likely accounting for up to 84% of global energy production in 2022. The green revolution has been stalled by the soaring prices of lithium, nickel and cobalt, which is why Ford, Lucid, Rivian, Tesla and other electric vehicle (EV) companies keep raising the prices of their EVs.

ESG polices drove most energy stocks out of the Dow Industrials (with the exception of Chevron) and energy stocks fell to barely 2% of the S&P 500 at the end of 2021. Today, energy stocks have risen to almost 6% of the S&P 500 and are expected to rise to as high as 30% if coal, crude oil and natural gas prices remain high for the foreseeable future. As you know, our dividend and growth portfolios remain grossly overweighted in energy stocks, which we anticipate will post strong sales and earnings for the next couple of quarters. As a result, we are optimistic about the upcoming third-quarter announcement season.

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SUMMARY

The energy stocks are in the midst of a massive mean reversion rally after being shunned and neglected by ESG investment policies. The world cannot easily break away from fossil fuels, as Europe has clearly demonstrated this year. Furthermore, a strong U.S. dollar is driving the cost of energy and other commodities higher outside of the U.S., since commodities are priced in U.S. dollars.

Our dividend and growth portfolios are poised to profit from the high prices of coal, crude oil and natural gas. We also recommend companies which are profiting from solar energy, powerwalls and EVs, but the transition to a green economy has stalled due to the rising cost of lithium, nickel, cobalt and other battery components.

The Inflation Reduction Act has angered our allies, since its lucrative tax credits, if lithium batteries can be 80% U.S.-sourced by 2026, caused Tesla to cancel its Berlin, Germany battery manufacturing plans and divert that battery manufacturing back to the U.S.. The truth of the matter is, the price of EVs continues to soar as battery costs soar, so the green revolution may be postponed until battery costs stop soaring.

A strong U.S. dollar impedes multinational companies' earnings, because approximately 50% of the S&P 500's sales are from outside of the U.S., so the third and fourth quarter earnings announcements for the S&P 500 are expected to be lackluster. However, energy and many other commodity stocks are expected to continue to post record sales and earnings for the third and fourth quarters. As a result, we expect that our dividend and growth stocks will emerge as leaders and oasis stocks amidst a rapidly changing investment environment.

Price-to-earnings (PE) ratios have been compressed to ultralow levels due to the fact that the Fed has not raised key interest rates this rapidly before, since the Volcker era in 1981,when key interest rates hit 20%. *We are not back in 1981*. The Fed mistakenly allowed the money supply to swell over 30% in recent years, when the underlying economic growth did not justify the recent money supply explosion. Essentially, the Fed is now hitting the brakes by raising key interest rates and shrinking its balance sheet.

The U.S. has emerged as an oasis around the world, since we do not have (1) tanks in the streets, like China (to discourage bank withdrawals), (2) 0% interest rates, like Japan, and (3) soaring utility bills, like much of Europe. A strong U.S. dollar should encourage more foreign capital flight and help to stabilize Treasury bond yields. Unfortunately, despite record tax revenue, the federal government also has record budget deficits. The Biden Administration has been trying to manipulate crude oil prices with a 1 million barrel per day release from the SPR, which has also shrunk the trade deficit. However, due to the recent OPEC+ production cut, crude oil prices have resumed rising and could hit $120 per barrel in the spring when seasonal demand soars.

In summary, our dividend and growth portfolios are poised to profit from the current environment due to the many energy stocks in our portfolios, so we expect these stocks to continue to be a silver lining, critical path which all investors can follow. Although most of our energy-related stocks do not pass ESG standards, fossil fuel usage is soaring worldwide, due to Europe divesting from Russian energy, as well as soaring prices for battery components. The fourth quarter is seasonally strong, so we are expecting a strong finish to the year, fueled by our fundamentally superior dividend and growth stocks!

Navellier & Associates owns Ford Motor Co. (F), and Chevron Corp (CHV), a few accounts own Tesla (TSLA), per client request, in managed accounts. We do not own Rivian Automotive (RIVN) or Lucid Group

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(LCID). Louis Navellier and his family own Ford Motor Co. (F), via a Navellier managed account. He does not own Tesla (TSLA), Lucid Group (LCID), Chevron Corp (CHV) or Rivian Automotive (RIVN) personally.

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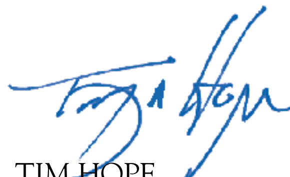

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