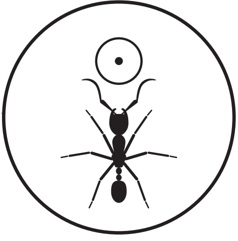

Myrmikan Research

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Daniel Oliver
Myrmikan Capital, LLC
doliver@myrmikan.com
(646) 797-3134

The Powell Pivot

The S&P 500 is down 22% from its all-time in December. It is going lower. That's not just Myrmikan's opinion: that mandate comes straight from Bill Dudley, former chief economist for Goldman Sachs, former manager of the System Open Market Account for the FOMC, former president of the New York Fed.

Dudley began his recent Bloomberg column: "It's hard to know how much the U.S. Federal Reserve will need to do to get inflation under control. But one thing is certain: To be effective, it'll have to inflict more losses on stock and bond investors than it has so far." The reason "the stock market is important [is] because a lot of people have exposure to the stock market and the level of the stock market effects their wealth…." In other words, the more the stock market goes up, the richer people feel, and the more they spend. With inflation roaring at 8.5%, it is obvious that there is too much money chasing too few goods (try getting a hotel reservation in any resort town…).

This is not the first time the Fed has blamed inflation on the stock market. When inflation began to creep higher in 1999, Greenspan told the FOMC: "The only way to eliminate the wealth effect, which has to be eliminated, is for the discount rate—the market interest rate used by investors to calculate the present value of expected earnings—to rise.… [T]he question is how we can facilitate that rise.… I think the crucial point here is that we express and continue to express a general view that our goal is basically to move the funds rate up consistently."

By March 2000, the fed funds rate stood at 6 percent, up 1.25% in less than a year, a shock to the banking system. The technology-laden NASDAQ Composite Index peaked on March 10, having risen twelvefold over the previous nine years. It fell by a third within two months. Greenspan increased rates again that May: "I believe the risks in moving 50 basis points today are not very large because I think the underlying momentum in the economy remains very strong." By the end of the year, the NASDAQ was an additional 26 percent lower, having fallen by half in nine months. The official recession would start five months later.

Greenspan celebrated his victory over the stock market and ignored the real economy: he told the FOMC: "I have gotten calls from a number of senior hightech executives who are telling me that the market is dissolving rapidly before their eyes. But I suspect that a not inconceivable possibility is that what is dissolving in front of their eyes is their own personal net worth! [Laughter]." Many small investors similarly saw their personal net worths destroyed.

The economic contraction was deeper than Greenspan had anticipated, and within a year he had dropped the fed funds rate to 1.75% in an effort to increase the wealth effect: "Low rates have also encouraged households to take on larger mortgages when refinancing their homes. Drawing on home equity in this manner is a significant source of funding for consumption and home modernization."

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Three years later, inflation was running hot again. Bernanke told the FOMC in 2004: "we should pause to take some satisfaction in the Federal Reserve's contribution to the turnaround" from the internet bubble collapse. But then he admitted: "I certainly did not anticipate the pickup in inflation we have seen in the past few months." The Fed hiked rates again to 5.25%.

The increase in rates did not have immediate effect. The Fed does not create or destroy loans with which to stimulate or suppress demand—private banks fulfill that function—the Fed merely influences the conditions under which those loans are made. Pre-2008, the Fed's open market purchases would determine the size of banking reserves required by banks to create loans. However, even when the Fed limited the growth of banking reserves, credit growth could continue as long as banks were willing to increase their own leverage that they applied to those reserves—and they were. By 2007, Citigroup was operating with a debt-to-equity ratio of 48:1. The leverage ratio at Morgan Stanley and Lehman Brothers stood at 40:1, and Goldman Sachs was at 32:1. Fannie Mae and Freddie Mac combined stood at a 75:1 leverage ratio.

Operating with such absurd amounts of leverage meant that even very small losses would tip the financial system into insolvency. What ended the housing bubble of the 2000s was not so much the increase in rates (though that certainly contributed by causing bids on assets to dry up), it was that the low rates had encouraged massive overbuilding. Overcapacity then lowered prices, leading to collapse and the QE response.

Recent episodes of Fed mismanagement have addressed the wealth effect of the stock market, but the errors were no more benign in previous decades. In the 1960s, for example, after the Fed had kept rates too low and let inflation run hot, Fed chairman William Martin told Congress:

> After several years of rapidly rising prices, it is only natural that many spending decisions are motivated now by the fear that prices will be even higher next year, or by the conviction that inflation will bail out even the most marginal speculation.… Consumers continued to increase their outlays at a rapid rate, drawing on their savings and borrowing heavily to finance both higher taxes and higher spending. The ebullient behavior of consumers infected the business community. With retail sales booming, business plans for adding to inventories and plant capacity were revised upwards sharply, and in this heady atmosphere, cost increases were rapidly passed on in the form of higher prices.[1]

It would be hard to pen more accurate words to describe the economy of the past two years. The Fed jacked up rates from 4% in 1967 to 9% in 1969. Martin told a group of bankers: "There is no gadgetry in monetary mechanisms and no device that will save us from our sins. We're going to have a good deal of pain and suffering before we can solve these things." A recession hit shortly thereafter. The stock market would fall by more than a third over the ensuing eighteen months, and unemployment jumped. Annual inflation did moderate from 6.4% in 1970 to 2.9% during the slowdown. But then railroads and brokerage firms and other highly levered sectors began to wobble. Arthur Burns, who became chairman of the Fed in 1970, cut rates to 2.25%, and inflation surged to 12% by 1974.

This history, as similar as it sounds to our own time, also reads no differently than Bresciani-Turroni's 1931 treatment of the German hyperinflation:

1 U.S. Congress, 1969. *The 1969 Economic Report of the President*, Hearings, Joint Economic Committee. 91st Cong., 1st sess.: 648-51.

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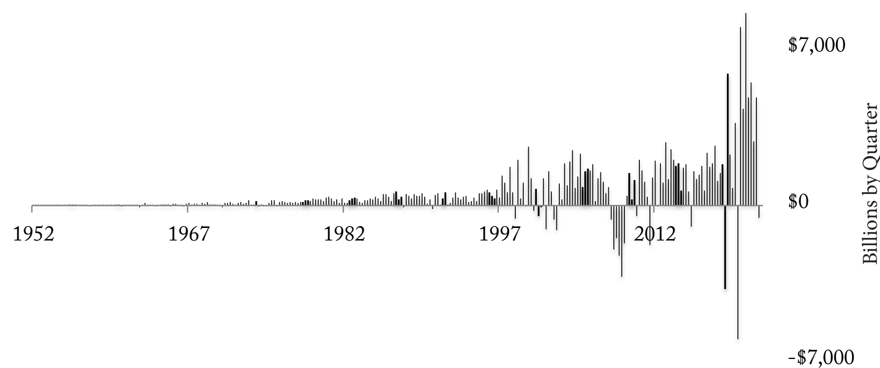
> The depreciation of the mark provoked a considerable increase of orders. The metallurgical industries were working at full pressure so that they had to introduce overtime, and they refused to accept new orders. Even the automobile industry had a peak of prosperity then. The textile trade was assured work for several months; the cotton firms were for some time unable to undertake new engagements; … in the silk industry delivery dates were six months after orders; the linen industry had sold its output until the spring of 1922 and would not accept new orders.
>
> From November 26th to December 1st, 1921, the price of the dollar rate fell sharply from 293 to 190 paper marks [i.e., the mark jumped 54%]. There was a moment of suspense in the business world. The Press declared that the improvement of the mark had been a catastrophe for German industry. Trade orders rapidly diminished.[1]

Returning to our own time, Dudley emphasized in an interview about his column: "If financial conditions don't cooperate with the Fed, the Fed is going to have to do more until financial markets do cooperate."[2] So much for the myth that America stands for free markets.

The Fed is targeting stocks for the same reason that robbers rob banks: that's where the money is. Back in 2007, at the peak of the last bubble, American households and nonprofits held $23 trillion in real estate financed with $11 trillion in home mortgages. Households also held $16 trillion in stocks (two-thirds directly, the remainder indirectly) plus $5.6 trillion in bonds (directly and indirectly).[3]

According to the latest Fed figures, as of the end Q1 2022, households and nonprofits hold $40 trillion in real estate funded in part by $12 trillion in home mortgages. Households also hold $46 trillion in stocks and $8.6 trillion in bonds. In other words, since the last crisis, bond exposure is up by half, housing equity has more than doubled, stock market exposure has nearly tripled, and much of that change occurred in the past two years.

CHANGES IN NET WORTH: HOUSEHOLDS AND NONPROFIT ORGANIZATIONS



Of course the Fed must make stocks and bonds and real estate go down to contain inflation. It is, in fact, worse than just asset prices. Household liquidity (comprising of currency, deposits, and money market funds) has jumped 50% from pre-COVID levels.

1 https://mises.org/library/economics-inflation-study-currency-depreciation-post-war-germany
2 https://www.youtube.com/watch?v=Fiiib9oqTB0 at 1:40
3 https://www.federalreserve.gov/releases/z1/dataviz/z1/balance_sheet/table/

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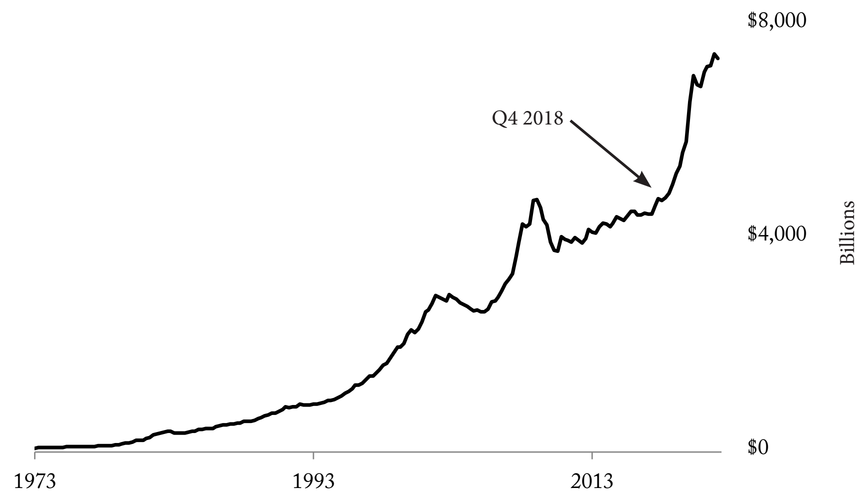
MONEY MARKET BALANCES, BANK DEPOSITS, AND CURRENCY IN CIRCULATION



Source: FRED, Federal Reserve Bank of St. Louis: https://fred.stlouisfed.org/graph/?g=OBrX

Unlike assets, the value of which the Fed can try to deflate, the chart above represents "cash." The line above may have jumped 50% since Q4 2018, but the price level has increased only 15%. If inflation were to run at a steady 8% per year, it would take the price level another five years to catch up to the increase in money supply, assuming the money supply were to stay the same.

The Fed will try to drain some money in order to limit inflation, but that is not easy. In our monetary system, money is created through the issuance of debt, both private and public; so to decrease cash requires retiring debt. To illustrate: Imagine a hypothetical economy with no debt. A buyer gets a mortgage to buy a house and pays the purchase price over to the seller, who deposits it in the bank. The buyer is now effectively short *future* dollars over the next thirty years which has created a corresponding increase in the supply of *present* dollars, ready to be spent, which is held by the bank for the seller in his deposit account.

In theory, as an aggregate, rising interest rates on debt encourages those holding cash to pay down their debts and thus extinguish money, another reason why the Fed wants to raise rates. In practice, however, those with the cash do not overlap well with those saddled with debt, creating defaults instead of repayment (compare, for example, the dreadful earnings of Target and Walmart to the robust earnings of high-end Nordstrom).

Rising interest rates that catalyze defaults may, in fact, make inflation worse. Imagine in the example above that the buyer defaults. In a free market, the bank fails, the depositor loses his deposit, and monetary conditions return to the *ex ante* position. In our system, however, depositors are not permitted to lose money: FDIC bailouts, Fed QE, and stimulus create outcomes whereby the impaired short position is transferred to the government's balance sheet for cash that is funded by sales of Treasury bonds.

Which leads us to public debt, the other way to create or destroy dollars. The mechanism is the same as with mortgage debt: the Treasury issues a multi-year bond, spends the money raised immediately, and promises to repay the borrowed money in the future—meanwhile, the Treasury bond itself goes on functioning as quasi-money because any bank will accept it as collateral.

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In theory, higher rates suppress government creation of money in the same way as through the private channel: it is much easier to deficit spend with low rates than high, and the higher rates go, the more incentive to pay down debt and reduce the money supply.

This theoretical reasoning has no practical application. The federal debt stands at $30 trillion, and the deficit was $667 billion just in the first half of the 2022 fiscal year. There is no political will to create a budget in surplus, which would be the opposite of stimulus, creating an economic crash and major societal strife. Nor is there any political need—the function of the Fed is to fund the government, as elucidated so clearly by Roosevelt's Fed chairman, Marriner Eccles:

> Congress appropriates the money; they levy the taxes; they determine whether or not there should be deficit financing. The Treasury then is charged with the responsibility of raising whatever funds the Government needs to meet its requirements.… I do not believe it is consistent to have an agent so independent that it can undertake, if it chooses, to defeat the financing of a large deficit [by raising interest rates], which is a policy of the Congress.

In other words, no matter how much the Fed may be able to reduce the money supply in private hands, rates cannot go so high as to impinge government money supply growth.

The Fed has thus far raised the fed funds rate to 0.83%. Yet policy makers seem to forget that "the market" is really a collection of individuals all of whom want to make, not lose, money: given the Fed's posture, "the market" is not waiting for a higher fed funds rate: bond prices have cratered such that the 2-year rate has surged from 0.39% in November to 3.38% currently. The 10-year Treasury yield, which serves as a benchmark for many structure financial products has jumped from 1.38% to 3.35%. It is worth noting that the U.S as a whole has added $35 trillion in debt since 2011, the previous time the 10-year Treasury yield was above 3.3%

Beyond losses suffered by the institutions that hold bonds, these rate movements are already having profound effects on the economy. Mortgage rates, for example, have surged such that the payment on a standard 30-year mortgage has jumped 38% in only six months. This means that the same mortgage payment funds a mortgage 28% smaller than six months ago. It is hard to envisage housing prices rising further with such a large, sudden increase in financing cost.

Unlike in 2008, there may not be a sudden banking crisis, first, because nearly all existing mortgages are fixed rate, and, second, because banks have insulated themselves from losses. As explained in detail in Myrmikan's May 2018 letter, many banks, instead of issuing mortgages, lend to non-bank mortgage originators, which lend to home buyers and flip the mortgages to Fannie Mae and the other GSEs. The money-center banks then buy the quasi-federally guaranteed mortgage-backed-securities (MBSs) issued by Fannie (Fannie retains the credit risk of the MBSs through guarantees: if a mortgage borrower defaults, Fannie must make whole the purchaser of the MBS).[1] Even though Fannie bonds explicitly state that they are not federally guaranteed, it is a good bet that Congress will never allow the GSEs to collapse. Congress is insolvent, which means that mortgage losses will eventually end up on the Fed's balance sheet.

The corporate sector is another area that will have a slow bleed. The BBB corporate bond yield has moved from 2.2% in September to 5.2% currently; the CCC corporate yield has moved from 7.2% to 14.0%. As with mortgages, this increase in rates is not likely to cause a sudden crash. Bank lending to corporations became so competitive that debt

1 https://crsreports.congress.gov/product/pdf/R/R46746: page 3.

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covenants were virtually abolished, meaning lenders cannot shut down failing companies until a missed payment and (presumably) after most of the assets have been liquidated in the desperate gambit to survive. For their part, corporate bonds have fixed interest rates, so companies do not feel the pain of rising rates until the bonds mature and they have to refinance. But when they come back to market, their financing costs will increase substantially. How many will survive with their equity value intact? How many will survive at all?

Blackstone, a major private-equity sponsor, has seen its stock fall 34% from December's high. The Blackstone Secured Lending Fund, which invests in first lien, senior secured debt of Blackstone's portfolio companies is down 35%. The defaults have not even hit yet, but the market knows what's coming.

The real carnage, of course, has been in the "innovative" sector. For example, investors in LUNA, which backed the "stable" crypto-coin Terra, were up 20 times since mid-2021, 400 times since Mid-2020. They lost it all, $60 billion of value, in five days (despite the fact that Harvard professor Marco Di Maggio, economics PhD from MIT, authored a paper claiming Terra was "highly robust" based on "1 million years' worth of simulation data.")[1] More conventionally, Cathy Woods' "innovation ETF" jumped nearly ten times from 2016 to 2021 and is now down 76% from its highs. Blackrock's Innovation and Growth Trust is down 64%.

The gamblers that invested in LUNA and ARKK early probably have a much higher propensity to lever and spend than the slow-pokes in the S&P500 ETF, which means that these enormous losses (though still concentrated) will have an out-sized effect on the economy. Moreover, as projected by Bank of America, federal stimulus payments—which were also sent to those with the highest propensity to consume—are on track to fall from $2.8 trillion in 2021 to $0.6 trillion in 2022.

Not surprisingly, consumer sentiment is collapsing, with the University of Michigan survey plunging to the lowest reading since the index began in 1960.[2] Retail sales in March and April adjusted for inflation were negative, year-over-year.[3] This is because real wage growth has been negative for over a year.[4] This decline in real sales met companies still scrambling to build inventory to guard against supply disruptions: retail inventories (excluding auto) are up 8.6% year-over-year even when adjusted for inflation, the sharpest increase since this data series began in 1994.[5] Target announced recently that Q1 inventories grew 43% compared to a nominal sales increase of 3.3%. The inventory at Kohl's grew 40%, and at Walmart the growth was 33%. These stores and others like them are scrambling to sell down their inventory as they cut new orders: According to FreightWaves, "Truckload spot rates for dry van freight (NTI) have plummeted 18% since the start of the year, but if you remove fuel (NTIL), it nearly doubles to 32%. From an annualized perspective, those numbers moderate to -7% and -22%, respectively, but are still impressive nonetheless."[6]

The broader markets are confirming the weakness: The DOW Jones Transportation Average is down 22% just in the past three months; the S&P Homebuilders index is down 22%; the Semiconductor Index is down 34%; the Household Durables Industry Index is down 34%.

1 https://agora.terra.money/t/stability-stress-test/55
2 http://www.sca.isr.umich.edu/
3 https://fred.stlouisfed.org/graph/?g=OhJ5
4 https://fred.stlouisfed.org/graph/?g=OhKl
5 https://fred.stlouisfed.org/graph/?g=OhJy
6 https://www.freightwaves.com/news/truckload-spot-rates-tank-fast-thanks-to-fuel-costs

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Normally such an economic slowdown that is evidently occurring would be confirmed by falling commodity prices (though commodities are priced globally, U.S. rate conditions are transmitted to the rest of the world through the Eurodollar system, as explained in Myrmikan's January 2022 letter). The conflict in Ukraine, however, has kept many commodities high and still rising. There is a word for rising prices during a recession: stagflation.

The word *stagflation* brings the 1970s to mind, as it should. But conditions are very different this time. The 1970s saw Federal debt increase from $370 billion to $850 billion. But inflation during that time reduced federal debt as a percentage of GDP from 35% to 31%.[1] Total debt for all sectors ended the decade at 160% of GDP.[2]

The federal debt to GDP ratio now stands at 125% and total debt at 370%. A one-time dollar devaluation of 75% would return debt to 1980s levels *ceteris paribus*—but, of course, all things are never equal. The devaluation will be expressed in terms of the general price level as influenced by commodity prices. And the quadrupling of prices that a devaluation of that magnitude implies would shock GDP lower, which would then boost the debt ratios again and require even more dollar weakness to bring debt levels back to sustainable levels.

Remember as well that GDP is an absurd statistic: GDP measures economic activity, not wealth. When the Chinese build a high-speed rail to nowhere or a ghost city, the expenditure adds to GDP but consumes wealth. How much of U.S. GDP is wealth-enhancing versus wealth-destroying? The markets will tell us in due time. But a clue may be gleaned from the chart above on page 3. The spike in household liquidity did not begin with the COVID lockdown, but rather in Q4 2018.

Back in 2018, Myrmikan had been expecting the next financial crisis to arrive in the form of corporate debt defaults as opposed to retail mortgages. Events were confirming that thesis. But then in March the lockdowns gave the Fed and the Treasury an excuse to bailout corporate borrowers, delaying the corporate debt bubble reckoning. As Dudley wrote in 2020:

> The Fed's actions have a cost because they tend to encourage risky behavior that we want to avoid—a problem known as moral hazard.… Consider, for example, the Fed's enormous purchases of Treasuries as trading began to seize up. It was, in fact, a backdoor bailout of highly leveraged hedge funds that were caught in an untenable trade of being long cash Treasuries and short Treasury futures.…
>
> Heavily indebted corporations also got a helping hand. This is significant because many corporations took on lots of debt by choice. The Fed's response was to set up corporate bond facilities, limiting the fall in lower-rated corporate debt prices and keeping these markets accessible for companies that needed to raise funds.… Both the asset managers and the retail investors who bought shares in these junk-bond funds escaped bearing the cost of their actions.[3]

With rates rising, stimulus ending, and QT threatened, the corporate sector may soon have to mark its malinvestments to market. Will the Fed sit back and allow a debt-unwind, as it is accused of doing in the early 1930s, ushering in a depression and plunging

1 https://fred.stlouisfed.org/series/GFDEGDQ188S
2 https://fred.stlouisfed.org/graph/?g=QvBL
3 https://www.bloomberg.com/opinion/articles/2020-06-05/federal-reserve-s-coronavirus-rescues-invite-bigger-bailouts?sref=lsNUbNMA

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tax revenue (while the U.S. is all but at war)? Or will it be forced again to print to bailout financial and corporate speculators?

Fed chairman Powell has channeled his inner Volcker: "[Volcker] was prepared to be unpopular for that, because he was looking at the medium and longer term, well, for the country.... We know that what Paul Volcker did was right in his situation, and it's something like that might turn out to be right here." He also repeated William Martin's line: "I will also say that the process of getting inflation down to 2% will also include some pain."[1]

And, indeed, Powell has some standing to say this: in 2012 as a new Fed governor, he was vocally against Bernanke's QEIII, and his first act running the Fed was to reduce the Fed's balance sheet.

But then he blinked. Although the unemployment rate was 3.9% and falling, though the official inflation rate was only 0.2% below the Fed's 2% target, though real GDP growth was 2.1% and rising, the stock market fell 18% in Q4 of 2018. Powell revved up the presses: first pausing rate hikes in late 2018, lowering interest rates by mid-2019, then QE by late-2019, the so-called Powell Pivot.

The only question now is: when will Powell pivot again. Some more Fed history may aid in forming a view. From 1986 to 2001, oil prices could not stay above $20 per barrel—by late-2005, oil was trading at $60 per barrel, feeding broad-based inflation. As currently, Federal Reserve staff economists blamed supply disruptions and global demand for soaring input prices, ignoring the monetary causes. The staff economists predicted that "crude oil prices will be about flat next year and edge down in 2007 and, given that, the effects of previous increases in crude prices on inflation will wane and then end."[2] Similarly, when CPI was below where the Fed wanted it in 2015, (partly because oil had fallen 80%), Fed chairman Yellen told the FOMC that inflation in the U.S. would rise "as the big declines in energy prices recorded a year ago drop out of the index."[3]

In other words, Fed economists (and politicians) don't care so much about the price level—they care mostly about year-over-year changes in the price level. This is the reason why last year Powell was so fixated on "base effects" when arguing that inflation was transitory. And it is also the reason why the Fed's current panic over inflation may pause a few months from now.

As noted above, some prices (like trucking rates) are already plunging. Lumber may be at 2018 all-time highs, but it is down 50% compared to a year ago as the housing market collapses. Copper is near its all-time high, up 60% from 2018 levels; but it is down marginally compared to a year ago.

Other prices are about to plunge as stores liquefy excess inventory. Many retail prices spiked last April (the Biden regime sent $1,400 to most Americans in March, and by June Powell was forced to accept that inflation was real), so the year-over-year decrease in the prices of retail goods over the next few months should be pronounced.

A full 32% of CPI is shelter. The BLM's "owner's equivalent rent" is calculated by surveying property owners with the question: "If someone were to rent your home today, how much do you think it would rent for monthly, unfurnished and without utilities?" It operates with a lag because owners generally do not follow the real estate market with precision as it increases in price—but with rates spiking and mortgage applications

1 https://www.marketplace.org/2022/05/12/fed-chair-jerome-powell-controlling-inflation-will-include-some-pain/

2 Federal Open Market Committee Meeting Transcript from November 1, 2005: 18.

3 Meeting of the Federal Open Market Committee, December 15–16, 2015: 97.

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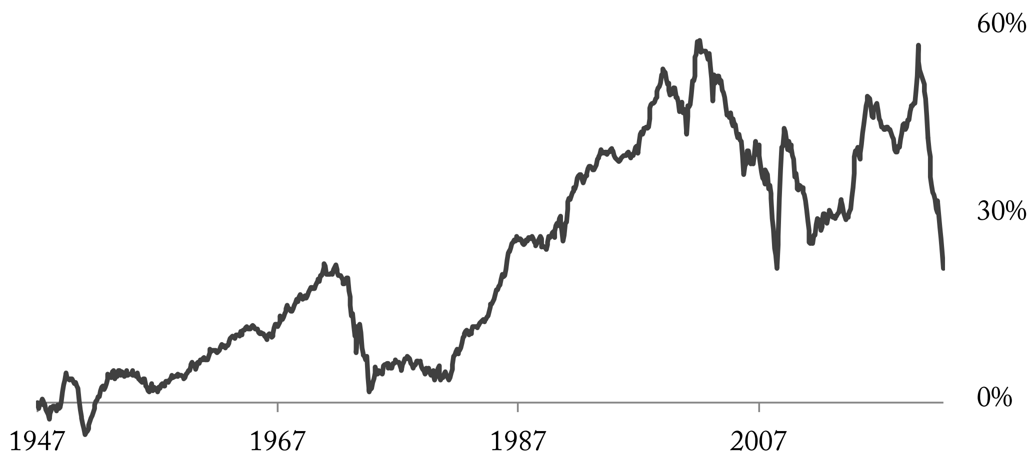
crashing to a 22-year low, housing prices cannot be far behind, and survey respondents are probably more attuned to collapsing prices. In other words, the lag may compress on the way down.

Energy and food commodities are high and rising and will almost surely continue to rise from regulatory and geopolitical causes, but "Food at home" and "Energy" each represent only 8.3% of the CPI basket. Pause to consider that the prices listed above that look toppy or falling are those involved in capital formation: lumber and copper. Commodities that are roaring higher involve consumption: food and energy. A feature of late-stage inflation is that asset prices fall, making people poorer, but living cost soar, making people poorer still. To the extent that CPI encompasses both kinds of inflation, the decline in the former offsets to some extent the increase in the latter and masks the real destruction of wealth.

CPI figures will fail to capture the full extent of economic decay also because some of the increase in raw material costs will result in profit margin erosion and falling product quality *en lieu* of higher CPI. The chart below shows the increase in consumer inflation compared to input prices. As the chart demonstrates, the great bull market in stocks has been driven partially by the ability of large firms to raise retail prices faster than costs. The chart and recent earnings announcements suggest this trend has ended, losing in the past year over half of its gains since 1947.

CUMULATIVE INCREASE IN CPI COMPARED TO PPI



Meanwhile, Revelio data shows that new job postings tumbled by 2 million in April. There have been over thirty announcements of mass layoffs in the past three months. Facebook (now Meta) has announced a hiring freeze. Amazon does not need to fire workers, given that its average annual turnover rate is 100% (which doubtless reflects working conditions), but it did report it was overstaffed and announced it is trying to sublease 10 to 30 million square feet of warehouse space.

Under orthodox Keynesian and monetarist theory, these manifold signs of economic stress are supposed to prompt the Fed to loosen financial conditions, not tighten them. But the Fed is as yet oblivious. A couple weeks ago, Federal Reserve Bank of San Francisco Fed President Mary Daly nearly parroted Greenspan's error from 2000: "Going up in 50-basis-point increments to me makes quite a bit of sense and there's no reason right now that I see in the economy to pause on doing that in the next couple of meetings."[1] Fed governor Waller said recently: "the U.S. economy continues to power along at a healthy

1 https://www.bloomberg.com/news/articles/2022-05-12/fed-s-daly-says-strong-economy-can-tolerate-50-basis-point-hikes?sref=lsNUbNMA

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pace."[1] Powell clings to the hope that "we have a good chance to have a soft or softish landing."[2]

The Atlanta Fed's GDPNow Q2 model, on the other hand, has plunged from 2.5% real growth in mid-May to a current estimate of 0.9% (this following a GDP contraction of 1.5% in Q1). JP Morgan Chase CEO Jamie Dimon told a banking conference last week: "Right now, it's kind of sunny, things are doing fine. Everyone thinks the Fed can handle this. That hurricane is right out there down the road coming our way. We just don't know if it's a minor one or Superstorm Sandy."[3]

It is the latter. As described by the passage above concerning Wiemar hyperinflation, a rising dollar is toxic to business activity in a bubble economy: "Trade orders rapidly diminished." The senior bankers know that the Fed is tightening into a slowdown. Given our highly progressive tax code and the major contribution of capital gains taxes to federal revenue, a recession will severely impact tax revenues at the same moment that politicians will demand additional stimulus.

Looking forward, then: the late Autumn promises rising unemployment, plunging asset prices, soaring deficits, a temporarily softening official CPI number (even while the costs of living continue to increase), and more war—and, if the adjustment is quick enough, all in the context of a looming mid-term election. It will be like the Autumn of 2008: everyone, from the Left to Right, from Elizabeth Warren to the *Wall Street Journal*, will be clamoring for Fed intervention. Is the Fed really so independent as to crucify the market and the economy and the government on the cross of a strong dollar? Deflationary shocks are the handmaidens of hyperinflation. As in 1970 in the U.S. and 1922 in Weimar, the pain will be too much: the Fed will print again and faster. Listen carefully and you will hear Senator Schumer beginning to growl: "Get to work, Mr. Chairman." As it did in 2009 and 2020, gold will get the message first.

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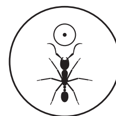
1 https://www.federalreserve.gov/newsevents/speech/waller20220530a.htm

2 https://www.wsj.com/articles/transcript-fed-chief-powells-postmeeting-press-conference-11651696613

3 https://www.reuters.com/markets/us/fed-would-struggle-achieve-soft-landing-wells-fargo-ceo-warns-2022-06-01/



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