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2022 Economic Forecast

Is America's Democracy and Mankind 's Extinction Imminent?

The pandemic induced inflationary spiral is a temporary phenomenon

Preamble: 2021 was the year of survival. This 33rd edition of my annual forecast is designed to inform my readers of my assessments of the state of the domestic and global economies and forecasting the Outlook for 2022. My findings are predicated upon employing demographic theory and analysis as they relate to the economy and the effect on the financial markets. I will begin by discussing geopolitical risks, climate change and political roundup before moving forward onto the actual economic forecast.

Geopolitical Risks: A World of Turmoil and Uncertainty

The pursuit for peace and democracy persists in a year fraught with intensifying danger and extreme anxiety in a more unstable world. Domestically, we have witnessed a violent insurrection, an unreconcilable political divide, distrust in government to the extent one third of America remains unvaccinated, FCC unregulated cable news and social media promoting fake news in exchange for better ratings and profits, foreign cyber-attacks, voter suppression, gun violence and school shootings with no antidote in sight, hate crimes and all American lives matter, the rise in white supremacy, unrelenting racism, and political obstruction along with the death of bipartisanism. **So, how can the world look upon us as the greatest democracy in the world?** The time has come where political parties need to cease grabbing power at any cost, play by the rules and support legislation that will help all the American people rather than themselves. **Globally**, we are facing the headwinds of the evolving coronavirus, the disastrous repercussions of climate change, an aging population, food shortages, fake news and interference in elections, and the Iranian nuclear expansion. Russia needs to invade Ukraine, with the support of China, because they need their industrial capacity and women to support their dwindling birth rate. Finally, we are facing the challenges of China's economic powers of influence and potential conflicts with Taiwan and control of the South China Sea. China rules with an iron web fist. Their president, Xi Jinping has replaced their social media with their propaganda machine, taken over the press, and fully activated facial recognition and surveillance systems on their citizens. Just like Chinese billionaires are known to have disappeared, so will any dissidents. The US military has determined we would be unable to defend Taiwan under any war scenario. On an alarming note, China has developed forty-two ports in thirty-four countries that can be used to house their military might. Enough said, these world disorders raise both the climate and environment for future crisis, chaos, and conflict. The cost of controlling these disorders depletes our global resources and impairs our living standards. **There is no prosperity without world peace.**

Climate Change

Welcome to the 21st century where humanity may be approaching extinction. Climate change will be the greatest challenge to humanity in this century. Jim Morrison of the Doors 1967 lyrics from "When the Music Is Over" seems proper today. "What have they done to the earth, yeah? What have they done to our fair sister? Ravaged and plundered and ripped her and bit her, stuck her with knives in the side of the dawn and tied her with fences and dragged her down." Climate change is defined as long-term shifts in temperatures and weather patterns primarily caused by human's burning of fossil fuels. On the downside, the greatest rise in global temperatures have occurred in this last decade and is growing exponentially. Members in the scientific community claim that if this trend does not reverse by 2030 the world would be approaching the point of no return. The tragedies associated with this global dilemma, amongst others, are extreme droughts, uncontrolled massive fires, inadequate drinking water, devastating flooding, polar ice severely melting, cataclysmic storms and contracting biodiversity. Life on earth cannot be sustained without our forests given they convert carbon dioxide into oxygen. It is estimated we have lost one third of our forests which equates to an area two times the size of the United States. Siberia, the planets largest continuous forest has been on fire since the summer of 2019 with forty million acres already destroyed and no end in sight. These fires have consumed more land than the fires in the US, Canada, Greece, and Turkey combined. This enormous part of frozen Russia has suffered a 150-year drought with summer temperatures reaching triple digits since 2019. The primary cause to these fires lies in the fact that their permafrost (frozen soil) is thawing and releasing enormous amounts of greenhouse gases into our atmosphere. Bankrupt Russia does not have the financial means to contain this apocalypse. The effect of global warming is particularly acute at the North and South Poles where temperatures are rising at more than twice the global average. Warm ocean waters are weakening the ice shelves from below. More specifically, scientists are predicting the Thwaites Glacier in Antarctica could collapse within 3 to 5 years with drastic implications on our sea levels. On the other hand, Greenland is no longer for sale. In the past year it lost approximately seventy-seven trillion pounds from its ice shelf which is the second largest on the planet. It has never rained at this ice shelf summit until this past summer. The world's top four polluters are the US as number one followed by China, India, and Russia. The 2015 Paris Accord agreement between 196 countries was designed for climate change mitigation, adoption, and finance. This agreement is not binding, no country wants to pay for it and their projected end goals when completed will be well past our point of no return. This is ridiculous and it's no joke. The longer we wait the more it will cost.

These global challenges and costs to protect our future are astronomical and our current state-of-affairs lacks worldwide commitment. We are witnessing Mother Earth's revenge and when we add in the devastation of the Covid viruses, mankind's future becomes more surreal. To further worsen the climate issues, the world's current population is at 7.9 billion and expected to rise to 9.8 million people by the middle of the century. People are the polluters and unsustainable population growth will derail our climate changing efforts. **Demographics have always determined the rise and fall of civilizations and, possible our own extinction. This is "When the Music is Over."**

Political Roundup

Our American democracy is under assault. This deterioration started well before Trump, but he brought it mainstream. To make his fake news believable it must be repeated, over, and over again. This is the basis to his big lies. The International IDEA's Global State of Democracy 2021 report, a European think tank, states for the first time the United States democracy is falling from grace. Their conclusion was based upon "Trump's factually baseless questioning of the legitimacy of the 2020 election results, a historic turning point that undermined fundamental trust in the electoral process and culminated in the January 6th insurrection at the US Capitol". The aftermath of this big lie will have a detrimental effect on all future elections. **Donald Trump, along with his political co-conspirators and media supporters are a clear and present danger to our American democracy.**

Our political divide has deteriorated under the Biden administration. His Infrastructure Bill passed with the aid of only 32 Republicans, who Trump demonized. This bill was great for the nation and the American people and clearly proves Trump's hold on his party. On the other hand, the Democrats in the majority of both the Senate and the House were unable to become organized with deep division between the progressives and conservatives. We should all thank Sen. Joe Manchin. Their Build Back Better Bill was destined to die on arrival against the backdrop of the Congressional Budget Office calculating the bill would add $3 trillion to the deficit. There are key essential elements in this bill. The largest appropriation is $555 billion for climate change and alternative energy. They will bring a cutback version to the floor, break it up into smaller bills and utilize executive orders attempting to meet some of their objectives.

The Democrats appear delusional. Their primary agenda needs to be the protection of our fundamental right to vote. Republican state legislatures are gerrymandering, passing voter suppression laws, and even enabling themselves to have the power to overturn elections at the local level. Without federal protection our democracy is in jeopardy**. Joseph Stalin's famous quote was: "Those who vote decide nothing, those who count the votes decide everything."**

State of the Economy

The Domestic Economy: Against the backdrop of our unprecedented deficit financed fiscal stimulus, extremely accommodative monetary policies supplemented by quantitative easing, elevated revival of corporate earnings, the US economy when tallied should produce a spectacular GDP of 5.5%. On the downside, to finance these pandemic fiscal costs, we can expect an increase of $1.9 trillion in our national debt. Our unmanageable debt trajectory will be $29.5 trillion for the year and is one of our greatest threats to our future growth, prosperity and living standards. **The Fed:** Under the direction of the renominated Jerome Powell has kept the Fed rate between 0% and .25%. Investors with their high inflation expectations believe there will be three rate hikes in 2022. The Fed, with their policy of transparency has assured the public there would be no increases until they reached full employment. As such, I tend to believe they will end their quantitative easing in the first quarter and have one rate hike in the fourth quarter of 2022. On the other hand, should unemployment fall to 3.8% in the first quarter, the Fed may react prematurely with a 25-bps point rate increase given the inflationary upsurge. **Inflation:** The pandemic induced inflationary spiral is a temporary phenomenon. The current rate of 7% is the highest level since the ninety's and surpasses the Fed's target rate of 2%. This rate is more likely to rise rather than fall in the near-term. The advance in consumer prices is due to the mounting demand fueled by household excessive savings, stimulus checks, pent-up-demand, rising shipping costs, supply-side shortages, and cost-push inflation caused by labor shortages. As these issues subside, prices should start falling in the second half of the year bringing the inflation rate to 2 1/2% by year-end. **Labor**: When calculated our unemployment rate should approximate 4.2% even though we have 5.5 million more pre-pandemic jobs. This cycle has produced wage growth of about 5% but it remains at the bottom of the pay scale. This is the tightest labor market I have seen in my lifetime. During the pandemic, we have seen almost three million workers quit to collect state and federal unemployment, 4.5 million quit their jobs in November alone, 1.5 million workers chose early retirement, and a mass exodus of women left the workforce due to a lack of childcare and school closings. I expect by midyear we should overcome Omicron and this trend should reverse. The economic expansion should bring the unemployment rate to 3.8% which the Fed considers full employment. **Consumers**: We are a consumer driven economy and their consumption on a pre-pandemic basis normally stands for 70% of all activity. Their household balance sheets have improved and reflect excess savings. Once we overcome Omicron, both consumer confidence and spending will become the catalyst for persistent economic expansion. **Corporate America:** Earnings were spectacular with profits expected to be 50% more than the prior pandemic year. The second half of the year will surpass the first given their ability to overcome their labor and supply-side shortages. Their profit margins squeezed primarily due to their rising labor costs. Either way, their bottom-lines will climb to their historical averages of 7% and energize our equity markets. **Housing:** The seller's market will expand in 2022 as escalating demand continues to outpace supply. This market direction will be supported by the migration of city dwellers to the suburbs given the pandemic generated remote working. Although interest rates will rise, they should not have a negative impact in this sector. Residential development will continue to be an engine of growth but will still fall short of meeting our demographic needs. However, builder's margins will suffer due to rising material and labor costs in addition to supply-chain shortages. On the downside, rents are persistently heating up effecting core inflation and debasing housing affordability.

The Global Economy: The entire world synchronized in their war against the global pandemic. Most central banks stay committed to ample liquidity however the fiscal side of the equation is expected to be more limited in the new year. These actions when determined should generate Gross World Production (GWP) of almost 5%. The ongoing pandemic recovery will clearly fluctuate by region. **China:** Their growth has contracted against the backdrop of massive deleveraging and their intensifying energy crisis. Their manufacturing export sector primarily supported the economy. It is more probable their central bank will aggressively lower their interest rates. As such, they may very well become the economic engine to drive a post-pandemic global recovery by midyear. **Euroland:** We can expect continued robust growth even though **t**he stimulus from the European Commission's Recovery Fund has been fully implemented. The European Central Bank may stop their quantitative easing by year-end with any future interest rate increases scheduled for 2023. It is possible their growth may surpass that of the US given the delay in their first recovery. **Japan:** They have finally broken their protracted deflationary stagnation cycle reaching economic normalization of 1.9% GDP. Given their crippling demographics consisting of a shrinking labor force and the oldest population on the planet, the odds still favor continued growth to 2.5% GDP. **In sum, despite the Outlook is still entrenched with escalating risks and uncertainties, global economic activity is destined to produce a post-pandemic above trend growth of 4-5%.**

2022 Economic Forecast

The Bull Market remains intact with all indexes throughout the year continuously surpassing their historic highs. The **Dow** miraculously closed the year at 36,338 producing an incredible return of 18.7%. The **S&P 500** reached sixty-four new highs in the year closing at 4,766 generating an astounding 26.9% yield. Finally, the tech heavy **NASDAQ** had an incredible run up closing the year at 15,644 showing a remarkable 21.4% rate of return. The equity markets have climbed a surrealistic wave of optimism fueled by liquidity, accommodated monetary and fiscal policies, corporate earnings prospects, and the expectation of reaching a post-pandemic normality. I suspect the intensifying core inflation is temporary and will deflate starting mid-year trending down to 2.5%. As such, the Fed's monetary policy will remain biased to ease with one rate increase of 25-bps at best by year-end. On the upside, consumer and business spending should be able to replace the aggregate demand benefits of the nonrecurring fiscal stimulus. Any economic advantage from the Infrastructure Bill is more likely a 2023 event. The continuation of these factors along with a global recovery in the second half of the year will bode well for equities. On the downside, the equity market has reached an overvaluation extreme, specifically in the US. Even though the highly elevated P/E ratios are justified by our low interest rate environment, it is destined to become a drag on equity valuations. We have seen the longest bull market in our history after discounting the pandemic as a mere interruption. **The question becomes is this a brand-new bull market or the extension of the existing one?** Even with corporate margins squeezed, equities tend to do very well when the economic cycle is in its latest stages and accordingly, rewards investors. In this pandemic recovery, global central banks will remain biased to an accommodative monetary stance. This encourages investors into reflation trade strategies, ones that favor equities over bonds and therefore, taking on greater risk in this world of unpredictability.

Now let us discuss sectors, asset allocations and diversification. Equities should clearly outperform all other asset classes. In most cases, international equities will outperform domestic ones, small caps will outpace large caps, and value will surpass growth in the context of a global economic expansion, a weakening US dollar, and rising bond yields. Corporate America tends to surprise on the upside. Even though the US market is overvalued, it still is the safest place to invest. Cyclical sectors, such as hospitality, consumer discretionary, financials, industrials, auto, real estate, and technology should continue to outrun defensive sectors that include utilities, consumer staples and healthcare. However, I still recommend healthcare against the backdrop of an aging population. Even though I suspect the overvalued tech sector will contract in the first quarter, I would entertain larger caps and ETF's, in the second half of the year. On a country basis, consider Euroland equities by midyear since they are at bargain prices and the US dollar is destined to fall. Weigh in on China only if there is clear and convincing evidence of their economic turnaround which I expect will occur. Contemplate Japan as a contrarian play given the US currency fluctuation and the fact that they finally have reached positive GDP. Investor asset allocations always needs to be adjusted based upon their age and risk tolerance. Employing an aggressive market growth asset allocation approach would consist of; 70% in equities, 20% fixed income, and 5% each in commodities and alternative investments. Equities should be made up of at least two thirds, US-based with the rest in global stocks and to a lesser extent, emerging markets only if China has turned around. Diversification is key and cash flow is everything. Investors should consider managed accounts and/or exchange traded funds and equities that have proven a consistent record of increasing dividends**. In sum:** it is more probable to expect a contraction in equities during the Omicron crisis, especially if the Fed raises rates early in the year. This would be a buying opportunity along with rebalancing a part of your portfolios from fixed income to equities. **We are learning to live with the virus and are approaching a post-pandemic economic cycle that could extend the bull market for years to come in a world of otherwise lower returns.**

Forecast assumptions: Absent any geopolitical and or natural disasters, the forecast assumes we will learn to live with Covid and any future variants, we will overcome supply-side and labor shortages and China will ignite its economic engines, all by midyear. These give rise to a synchronized global expansion, all of which will benefit risk assets.

- **Equities:** The Dow will trade between a range of 34,500 and close the year at 40,000. The S&P 500 and NASDAQ may close the year at 5,000 and 17,200, respectively. The equity markets will start the year with moderate volatility and contract in the first quarter in response to the Omicron uncertainty. The second half of the year will be less turbulent and will trend higher in a choppy pattern reaching multiple new historic highs.

- **Bonds:** The Belief That the Fed intends on multiple increases is without merit. It is more probable to expect a 25-bps increase in the fourth quarter. Yields will advance moderately, given the expected global recovery. The 10-year Treasury Note closed the year at 1.51%. Rates should not exceed 2.25% by year-end. US high-yield bonds will outperform treasuries in this environment.

Either way, fixed income investors should consider short-term durations against the backdrop of rising rates.

- **Currencies:** The US dollar (USD) bull market has a bit further to run. The USD is up approximately 7% against a basket of foreign currencies. The USD is a countercyclical currency meaning it rises during periods of economic contraction and falls during periods of economic expansion. In the instant case, it should continue to rise until the Omicron crisis abates. Its direction will start reversing when global growth picks up possible by midyear.

- **Cryptocurrencies:** These technology-based currencies are highly competitive with the likes of Bitcoin, Ethereum, Polkadot, and others. Most central banks are now in the development stage of their own digital currencies which will eventually crowd the playing field and effect valuations. Per the publication, The Bank Credit Analyst, "The easy profits in this sector have already been made. Bitcoin has doubled in price seven times since the start of 2016. If it were to double just one more time to $120,000, it would be worth $2.1 trillion, equal to the entire stock of US dollars in circulation." **Future profits have a limited upside. AS such, it may be time to get out.**

- **Oil**: Brent oil closed the year $75 per barrel producing a spectacular 55% increase against the pandemic all-time lows. The expected global expansion supports an upward trend with the price per barrel closing between $80-$85.

- **Gold, Silver and Metals**: Notwithstanding investors inflationary expectations, gold and silver lost their luster falling 11% and 3% respectively and closing the year at $1,828 and $23 per ounce. The dollars expected decline will bode well for both precious metals. There also appears to be an inventory shortage of silver to meet the rising demand. Gold and silver have an upside of $1,900 and $29, respectively. Metal inventories, especially copper is at extremely low levels and with China's predicted acceleration by midyear their prices will fall but are destined to move higher.

- **Commercial Real Estate:** This is the best investment for inflationary protection given leases have standard annual increases that are usually greater than core inflation. Investors benefit from both sides of the equation consisting of values rising by inflation and paying down fixed debt with depreciating dollars. This sector will continue to attract capital and perform well on a cash flow perspective rather than based upon valuations. Investing in Real Estate Investment Trusts (REITS) like the Vanguard REIT Index (VNQ) an ETF, can give you diversified exposure in this sector. Other non-ETF companies consist of Simon Properties (SPG), Vornado Realty Trust (VNO), and Realty Income Corp.(O). Currently pricey, investors should consider these when the values pullback.

- **Metaverse:** This is technology in virtual and augmented reality and considered the next-generation version of the Internet. This futuristic platform will enable people to meet in the virtual world to work, play, meet friends and more. This sector is in its infancy stage. Notwithstanding their excessive valuations, investors should consider buying into these companies on pullbacks for the long-term. Five players are Google (GOOGL), Snap (SNAP), Roblox (RRBLX), Nvidia (NVDA), and Facebook (FB) who changed its name to Meta.

In sum: the direction and extent of the global economic recovery is contingent upon the world learning to live with and eradicate the pandemic, the revival in China's growth and a synchronized global expansion. The future will be a lower return world. Are we facing the end of the bull market in one or two years, or are we in a new cycle spawned by the pandemic that may last for many years to come? Most certainly time will tell. **I believe we are on the precipice of healthier times ahead and am more optimistic about the Outlook.**

When everything around you appears to be failing and chaotic, it is time to revert to prayer. So, let us pray. Let us redefine what it is to be an American. We are a nation of immigrants with the mutual belief in our Constitution which guarantees us the right to pursue happiness. Our children should not have to attend school in fear of being shot or infected by the virus. Minority parents should not have to fear whether their children will not return home alive. Our citizens should not fear their votes will not be counted. If we do not have a peaceful transfer of power moving forward, we will have lost our democracy. **We need to look at what unites us rather than what divides us.** Our American society is rapidly deteriorating against the backdrop of fake news spawned by politicians, social media, and cable news. The problem is when fake news is repeated over and over, and over again, people believe it. This should not be a free speech exception, and this danger needs to be eradicated immediately before it gets even worse. Somehow, we need this regulated and fact checked. The solution to political obstructionists and liars is to vote them out of office. Lying can no longer become a national standard or acceptable practice. **We are Americans, we need to be virtuous, and we need to work together for our common good.**

Amen

All investments recommendations must be discussed with your own personal financial advisor/broker.