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Conference Call

What Does the Fed Do Now?

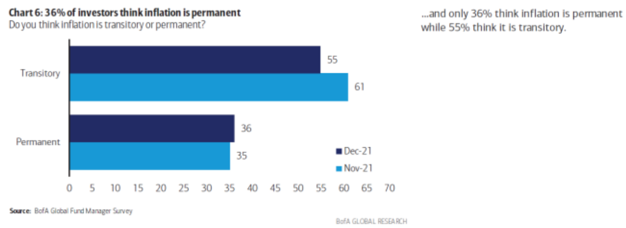
December 2, 2021, Conference Call

(This transcript has been lightly edited)

Good morning, everybody. "What does the Fed do now?" is the topic. By the way, I did update the handout. It's on the website. If you downloaded it before an hour ago, it has been updated. And that's the one I will go through as well.

So let me give you the bottom line here, by starting off with this transcript from Mohamed El-Erian, over the weekend on Face the Nation. "The characterization of 'inflation is transitory' is probably the worst inflation call in the history of the Federal Reserve. And it results in a high probability of a policy mistake." Now, I think he is correct in that, if this is not in the worst call by the Federal Reserve, it's definitely on the podium. I've heard people say, "Oh no, it was Roy Young in 1929. It was Arthur Burns in the late 70s." Okay, the Young Organization's 114 years old, and we're just deciding what medal of bad calls are going to get gold, silver or bronze, which is what transitory is. It's been that epically bad. And I would argue, it is continuing to be that bad.

And I would argue, and this is the basis of what I want to go through, everybody still thinks inflation is transitory. That is still the consensus opinion. That is the opinion of all the central bankers, the ECB and the Bank of England today have made it very clear. That is the opinion of the Federal Reserve. The reason I think that you've seen the risk market rally, over the last 24 hours or so, is, "Good. We all think it's 'inflation is transitory'. We all think that our primary goal with the market is to not upset risk markets, so risk on. Inflation is just a bunch of words that we need to say, but not actually any actions that we need to do." I'm going to argue it is actually actions we need to do. And it is actually going to be the defining issue of '22. Do we deal with inflation? Do we see the Fed raise rates three or four times in the next year?



Do we risk financial markets crumbling? And if we don't, is there a consequence? And I would argue not dealing with inflation has a bigger consequence than tanking the stock market. And I want to say this bluntly, to get my point across. So let me start off some of my charts here and let me highlight some of the things I'm talking about. This is from the Bank of America fund manager survey that came out two days ago, so this is this week. "Is inflation transitory?" 55% said yes, 36% said no, down from 61%. According to this survey, the consensus opinion is, inflation is transitory. Even though Powell retired the word, that is the consensus opinion. CNBC, this is from CNBC. They did a survey that was also released on Tuesday, "Is inflation," they used the word "temporary?" 59% down from 64%, "Is inflation permanent?" 31%.

Their survey said that the consensus opinion is inflation is transitory, as well, too. So, it's not ... I think, just so we know where I am, I think we're looking at ... You have to be maybe 80 on this call, not to say this, but if you're under the age of 80, I think we're looking at the worst economic forecast that we've ever seen. That inflation is definitely not transitory. It is definitely a real thing. And I'll explain that as we go along. And it's going to mean ... Do you know what? Just to tease where I want to go with this. The Fed's got a choice here, that they can either deal with inflation by raising rates, potentially risking the stock market falling, or destroy the Democrat party. Because they're getting wrecked by the public because they're so unhappy about inflation.

So, it's not just a bunch of words, you've got to do something about it. And the path of least resistance might be falling risk markets. So as a tease there, let me go on and explain it a little bit more. Powell said this yesterday, and this is what I think kicked off the rally, "So on the first part of your question, which is why should we not stop purchases now? Why taper 30 billion a month? Why not go to zero immediately? I would say this, we have learned in dealing with balance sheet issues," and he's referring to 2018 when he set automatic pilot and it blew up in his face, "we learned that it's best to take careful, short methodical approaches to adjusting. Markets can be sensitive to it, as we thought it was. This is doubling of the speed, we're basically two meetings away from finishing the taper and we thought that that was an appropriate way to go. So, we announced it, and that's it, that's what will happen."

Translated, "We're going to talk about inflation. We're going to taper, maybe raise rates. But don't you worry stock market. You are a petulant little child, and if you want to stammer your feet and complain, we'll stop immediately, and we'll apologize, and we'll turn the printing press back on." That's why you've got the rally that was going. The market is thinking that the Fed will not do anything to upset it, because the market is thinking that the Fed's primary choice is to deal with the markets first. I'll challenge that in a second, but I want to just highlight where we are. So, let's go back to that B of A survey, where 55% said that inflation is transitory.

When Does The Market Expect The Fed To Hike?

As of December 16, 2021

Probability of a Move

Green Hike Probability over 50%

FOMC Meeting	No Hike 0% -0.25%	One Hike to 0.25% - 0.50%	Two Hikes to 0.50%- 0.75%	Three Hikes to 0.75% -1.00%	Four Hikes to 1.00% -1.25%
26-Jan-22	93%	7%	0%	0%	0%
16-Mar-22	57%	**43%**	3%	0%	0%
4-May-22	37%	63%	17%	1%	0%
15-Jun-22	16%	84%	**43%**	10%	1%
27-Jul-22	11%	89%	56%	20%	4%
21-Sep-22	7%	94%	70%	35%	11%
2-Nov-22	5%	95%	76%	**44%**	17%
14-Dec-22	2%	98%	88%	64%	34%
1-Feb-23	1%	99%	90%	69%	**41%**

Source: The Chicago Mercantile Exchange Bianco Research LLC

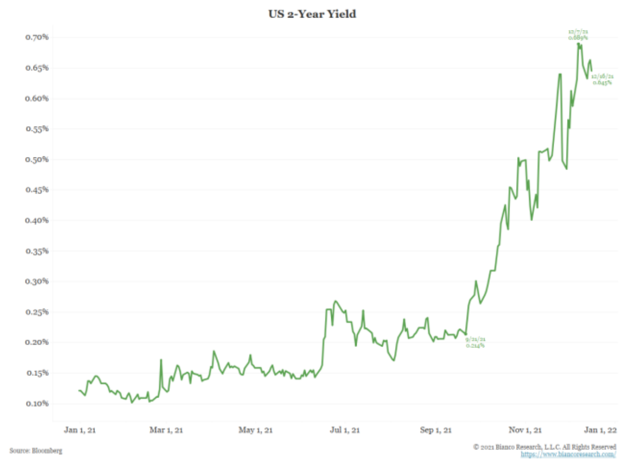
https://www.cmegroup.com/trading/interest-rates/countdown-to-fomc.html www.Biancoresearch.com

6% said that there will be no rate hike in '22, 17% ... No, 6% said there'll be no rate hike in '22, 23% said there would be one rate hike in '22, 49% said that there will be two. That adds up to 78%, said that there will either be zero, one or two rate hikes in 2022. In CNBC's survey they said that next year, a year from now, the funds rate will end the year at 0.72. Rounded, that's three rate hikes, so it's a little bit less than three rate hikes. So, the consensus thinks inflation is transitory. They think zero, one or two rate hikes, maybe three. Where's the market? So here is, this is from the CME, there's the link. And here are the probabilities of a move. Anything that is in green is the probability of a move is over 50%. There is a 93% chance and a 57% chance of no move at the next two meetings, January, and March.

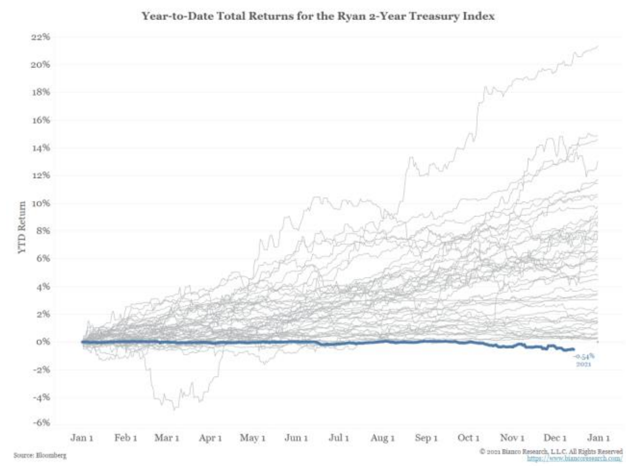
March actually has a 43% chance of the Fed hiking at the March meeting, the day they finish the taper. And then the main meeting is at 63%. So, the first meeting, the first hike is either going to be in May, or the 43% chance of March. That's what the market has priced in. The second-rate hike is either going to be in July, or 43% chance of the second-rate hike being in June. I've highlighted these 40s, because they're not that far away from 50%. The third-rate hike is expected to be in December, with a 44% chance that it would be in November. And the fourth-rate hike, February of '23, is at a 41% chance that it's February '23 and a 34% chance that it's December, that we'd have four rate hikes next year. So, the market is pricing in about three and a half rate hikes.

What's interesting is yesterday in my Bloomberg, there was a red headline that, "Oh, yes. Market is discounting three rate hikes for 2022." As if this was, "Holy crap! Look at this, the market's got three rate hikes priced in." It's had that for almost a month now. The problem is no one believes it. Everybody ... In fact, for the first two weeks, whenever I would show these tables, I would have to get into these mind-numbing discussions with people. "Well, that's wrong. Table is wrong. Market doesn't think that the market Fed's going to raise three or four times." No one believes that. Well, that's what's priced in. And this is a rare instance when you want to be an outlier. And Chris asked a question, "At least three for rate X by the Fed are currently priced in, and 10-year yields are at 140." I'll get to the yield curve in a second.

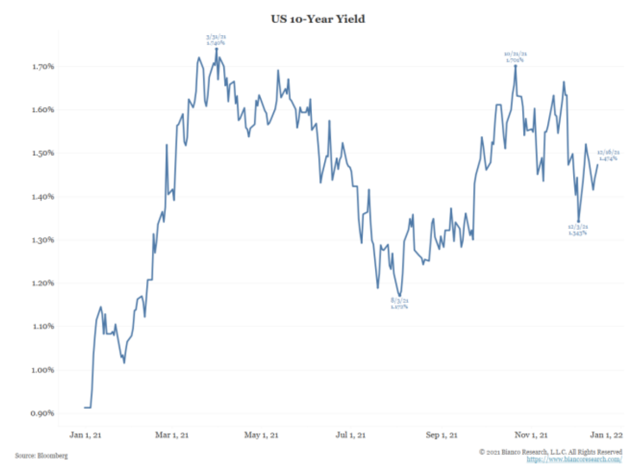
But if you want to ... At least three rate X are priced in. You want to be an outlier? Make your call at least three rate hikes next year. You are telling me exactly what the market is priced in, and you're an outlier. This is a rare instance when no one believes what the market is priced in. "No one" meaning, fund manager surveys, strategist surveys, they all think that ultimately, "Yeah, that's what's priced in, but inflation is transitory. It will go away. And the Fed and the ECB and the Bank of England will all find reasons to undershoot what they've been talking about." So, what about 140 yields on the 10-year note? So, let's talk about a couple of things. Here's the two years note yield, September 21st was actually two Fed meetings ago. We were at 21 basis points in the two-year note, before we shot up to 65 basis points.



We actually ... Today, we're above 70 basis points yesterday. As I look right now, we're still at 63 basis points or so, on the two-year note. But there's been a big rise in the two-year note. I would argue that this rise in the two-year note is one of the biggest surprises in the bond market this year. And it's been a lot of ... Caused a lot of pain. The two-year notes supposed to be tied to central bank policy. And by the way, two-year notes. In previous calls, I've talked about the two years note in Australia, the two years note in Europe, they've all done something similar. They're supposed to be low, with very little to no volatility. Central banks control them. Central banks have forward guidance. They will tell you months in advance when they're going to move. There's no reason for there even to be a bidding offer on these things, they're just locked in by the central banks.

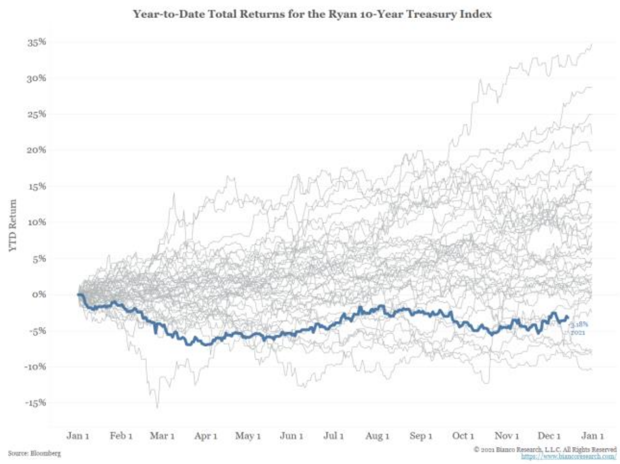


So, the fact that the two-year note has moved up has caused a tremendous amount of pain. How much pain has it caused? Here's the total return of the two-year note. It is down 54 basis points with two weeks left in the year. Here's all the years back to 1973, so that's 48 years of data. This is 1981, by the way, right here at the top. There's never been a year that the two-year note has wound up losing you money. With two weeks to go, it looks like 2021 is going to be the first year, or restate it, the worst year to own short rates ever. The combination of longer durations, because the durations around 190 in the two-year note, and the small coupons as well, to a quarter of a percent, means that owning a two-year note has been very painful.

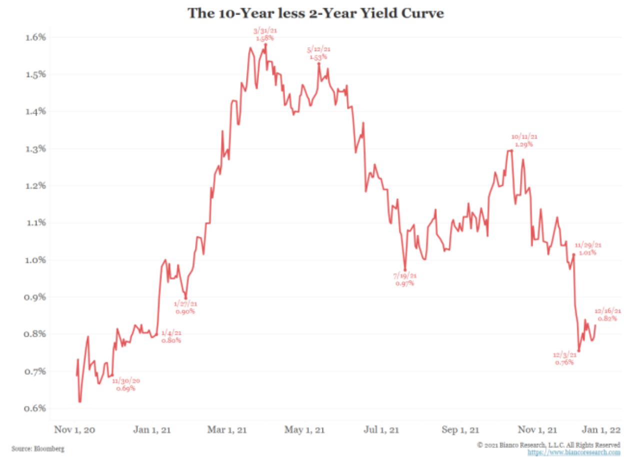


Hold that thought and get to Chris's question here. The 10-year note. The 10-year note has been meandering sideways, all year long. It hasn't been doing much of anything. It's at 147 when I updated this chart earlier this morning. It is at a little bit lower now, 143 right now. All right, so it's right there or so on the chart. But yet, it's just continuing to meander sideways.

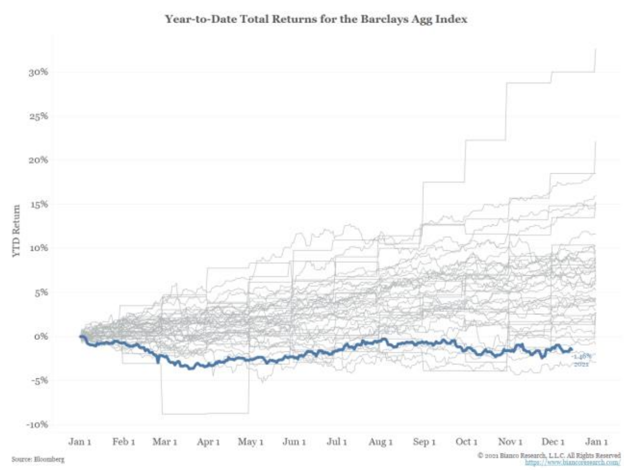
The result of that, and its total return, it's total return is -318. It's one of the worst among ... Not the worst year, but it's in the lower quintile, the lower fifth of all years back to 1973 that you can own bonds. So, I always find this curious, "Well, if inflation's a problem, what's wrong with the bond market?" Okay. So, the worst year ever in the two-year note, and one of the 20% worst years ever in the 10 years note not enough? You want to know why there hasn't been total destruction in the 10-year note? It's been an extraordinarily painful year.



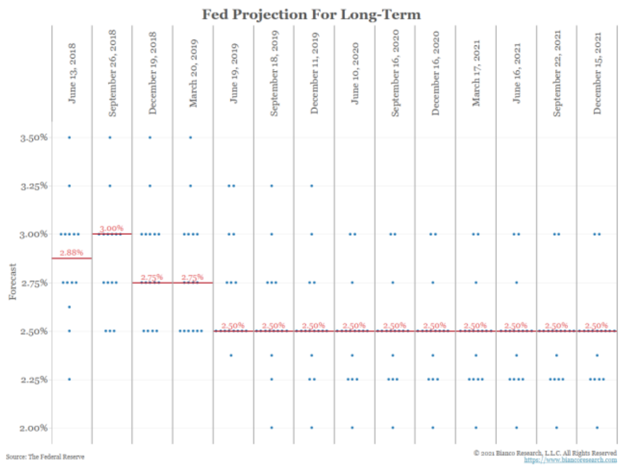
Ask Brevin Howard, ask a lot of macro hedge funds that never thought short rates would move up and flatten a curve. They've been burned badly by this trade. Most everybody who's got a trade with the yield curve, has been burned on it, because they never thought we would see the yield curve flatten to the degree that we've seen, especially since October. The curve is down roughly 50 basis points since October. And oh, by the way, what's wrong with the bond market if their inflation is an issue? Everybody's aggregate is the ... The most popular benchmark is the Lehman-Barclays, now Bloomberg, I've got to update that title. Bloomberg aggregate index. Again, data goes back to 1973, 48 years. Right now, at -146 through yesterday, it is the third worst year ever to own the aggregate. Your benchmark is having its third worst year ever. Only 2013 and 2009 have been worse.

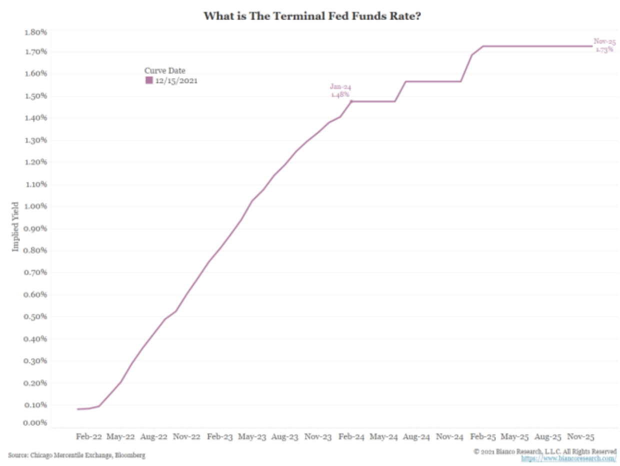


Now why is it the most recent years have been worse? Again, complexity. Longer durations, bigger sensitivity to price movements, smaller coupons. So, by the total return measure, been a disastrous year for the bond market. And like I said, the macro hedge funds have told you it's been a disastrous year, but those outside the bond market want to know, "Why hasn't it been so bad that we're not bankrupting brokerage firms?" That's what would happen if we went to 3% or 4% on the 10 years. And hold that thought because that's going to come into play in a little bit. Let's talk about that, in terms of interest rates. And that it's been a very painful year, but most people that aren't involved in the bond market don't think it's been a painful year in the bond market.



Let's talk about the other thing, and then I want to tie this together. And that is the long-term rate or the terminal rate for the funds rate, I can get my words out here. The Fed updated their dot chart yesterday, here's December 15th, here's September. And the terminal rate is still 250. The dots are identical to the September dots, not one change in the terminal rate, as well, too. The market. You're looking at the forward curve, yesterday's forward curve. So, 173, the market's a little bit lower than that, as well, too. So, let me tie this together now. We want to go back to the yield curve. Why is the yield curve flattening? Well, the yield curve is flattening as a function of short rates booming, because the Fed's going to raise rates three, maybe four times, even though the consensus doesn't believe it.

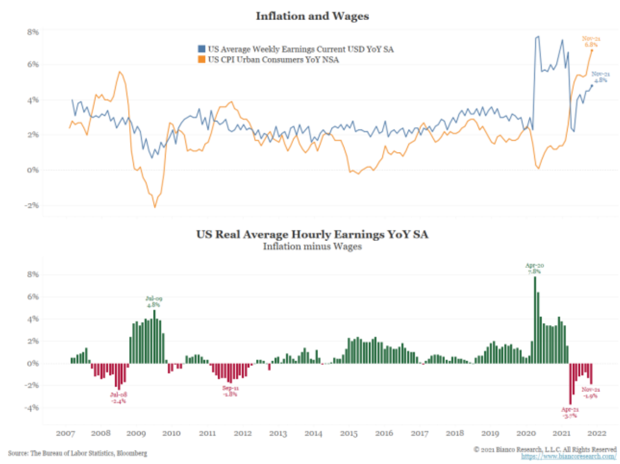




The Fed has a very good history of ... They're very skilled at one thing, they raise rates too much and they break something. And so, what does the long market tell you? They're going to break the economy. They're going to raise rates so much; they're going to break the economy. And that's why the yield curve is flattening. And what is the measure that tells us that they're going to break the economy? The terminal funds rate at 175. What does that mean? You want to put the economy on its knees? A 175 funds rate. "Well, that can't be. That's just 175." Yeah. After the pandemic, after the leveraging that's been going on in the market, after the amount of debt that has been borrowed. I think what the message of the market is, is the Fed is going to raise rates. They're going to raise rates in a big way, and they're going to wind up doing what they're very good at, breaking something.

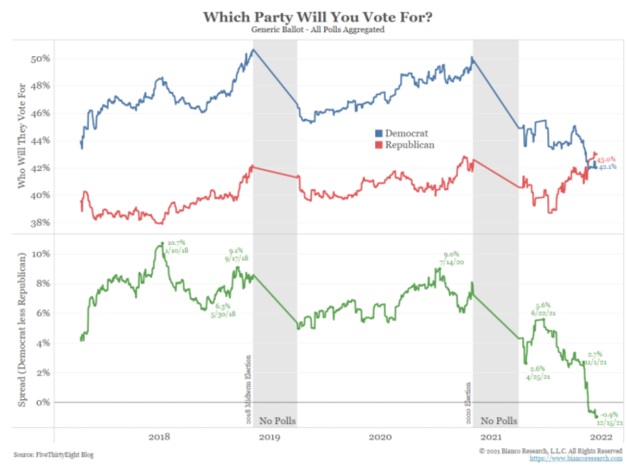
And that's what long rates are doing. That's what the yield curve is doing. So as one forecast, the yield curve, I believe, tends to be one of the most trending things in the market. It doesn't go overbought, oversold nearly as much as everybody thinks. Since the March high, there you go. If you want to be an Elliott Wave-er, it's an ABC pattern, or maybe it's a one, two, three pattern as well. But I think what you're going to see, is you're going to see the curve continue to do that. And I wouldn't be surprised if by midyear, we're talking about an inverted curve, or at least a flat to zero curve, as well, too. In other words, the trend on this chart is down. It's just going to stay that way. I don't think it's going to change anytime soon as well. And why? Why is it that the Fed ...?

So, what I've argued here, the Fed has no choice but to get aggressive in raising rates. And if they have to sacrifice the stock market, so be it. Now why? Why would that be the case? They would never ever do that. Everybody on Wall Street thinks that's a ridiculous statement. So let me explain why. Here's the chart that matters, wages and inflation. So, the top panel here, the blue line shows you weekly earnings growth, 4.8%. That's how much wages are up in the last year. But the orange line shows you that inflation is up 6.8%. So, the difference between these two is the bottom panel, real average hourly earnings. They're negative. The last time they were negative was September of 10 years ago. The public is getting a raise, but they go, and they find that, even with the extra raise that they're getting, their paycheck is buying less and less every month.



That's why you've seen the negative real earnings. They are unbelievably upset about this. We have now found, or we've rediscovered, might be the better word, the one thing that upsets the public more than a falling stock market. And you're seeing them take it out on it, over this past weekend. These are just from this past weekend. CNBC survey, the public's view of Biden's handling of COVID and economy take another hit. His approval rating was down to 41%, which is not good. I'll show that in a second. But here's the key phrase, and this has shown up in a couple of surveys. Inflation has now firmly eclipsed coronavirus is the number one concern for the country.

Let me explain, let me restate that for emphasis. Inflation is a bigger deal than COVID. With two issues following, immigration, crime, and climate change. Inflation is the number one issue in the country. Two thirds of Americans, 69% of Americans, disapprove of Biden's handling of inflation. So, here's Biden's approval rating, it is tanking. It might be tanking for more than one reason, but it is tanking. And the latest reason it is tanking ... There's a little uptick there, but we'll see if that lasts as well. Couple of surveys came out that were very favorable for Biden, and then a couple more that came out that weren't. So, we'll see whether or not it's bottoming in the low 40s, which is probably what it's doing. Or if it's actually making some kind of a bottom and on its way back up. But his approval rating is down. Inflation has really become an issue in the last 60 days. And this is what's most alarming about inflation, this is the generic ballot. They ask this question, "In the next election are you going to vote for a Republican or Democrat?" No name, just which party are you going to vote for?



So, this chart goes back four years. So, in blue is the Democrats, in red is the Republicans. And you can see that over the last few months, the Republicans have been gaining, the Democrats have been falling. The spread here is, that's the spread between Democrat less Republicans, so a positive number means net Democrat. They have collapsed in the last six weeks, and the number's negative. More people are saying they're going to vote Republican than vote Democrat.

Now, this is not a partisan statement. What this is is the public is unbelievably, they're pissed off beyond belief about inflation. They are really angry about it. And they're saying, "who's in charge? The Democrats are, they're the majority of the House, the Senate and the president, it's their fault."

If the Republicans were in charge, they'd be taking it out on them too. So don't think that this is a partisan comment as much as this is a reality.

Last week, December 8th was the 40th anniversary of an event that has largely been forgotten. And if you don't remember it when I tell you about it, you're going to think I'm making this up and I'm not.

December 8th, 1941, a guy broke into the Eccles Building at the Federal Reserve Building in Washington, DC. He was armed with a shotgun, a pistol, and a knife. His goal was he was going, and I'm not making this up, he was going to take all of the FOMC members hostage and force them by gun point to lower interest rates. And then he wanted them to be put on trial for treason.

The then of course, fortunately security caught him on the second floor, down the hall from the boardroom where they hold the FOMC meeting. Fortunately, they caught him without any incident, but it was symbolic of how irate the public was.

You think they're angry now because the stock market might fall 25%? You have no idea how angry the public was, ask Jimmy Carter in the late seventies, how angry they were about inflation.

And the reason is 40% of the public does not own their home and has no stock portfolio. So maybe you and I, and everybody else, our wages might go up 5%, like the average, and I'm speaking in averages, and we see that things at the supermarket go up 7%, so our paycheck is giving us a little bit less, but our stock portfolio and our home price went up way, way more than that. And so, we're happy with it.

But for 40%, they don't have that, and they are extraordinarily upset about it. And they're taking it out on the Democratic party. So, you've got this.

Felix Salmon over at Axios, "Biden could be the first president since Carter who wants to make the Fed more hawkish." So let me bottom line this for you. There is a terrible consequence to dealing with being to the worst call ever, being way too late on inflation. You can either upset risk mark markets by raising rates and trying to rein in inflation, or you could let the Democratic party get buried in the 2022 election. So, what is the cost of not dealing with inflation? The end of the Democrat party.

And I don't want to be partisan about it. The end of the party that is in the majority. Because I joked with somebody yesterday, I said, "Yeah, well the Democrats will get wiped out in 2022. If they don't deal with inflation, the Republicans will be in charge for about one week, they'll get a very good approval rating. Then their approval rating will tank because now you're in charge and you suck and it's your problem, fix it. And only once you fixed, will we actually... Otherwise we'll kill you in 2024."

So, in other words, this is not partisan. You were put in charge, it isn't working, and you got 11 months to fix it, or convince me that you're going to fix it in 11 months, or you're going to get wrecked in the election. The Fed has to deal with inflation, or the Democrat party is going to get wrecked.

Felix Salmon at Axios is telling you that the Biden administration is basically telling them, "Do something about inflation." Oh, but it might upset the stock market. Most of the 40%, and even a lot of stock investors think the economy's terrible anyway.

So, if you make it terrible by have having the stock market go down, because that's the definition of terrible of the 1%, you're not going to make it any worse for them. And I'm not saying that what they want is they want punished, they want prices to be reined in. They don't want to see these alarming prices continue to rise and push them further and further back.

So, the Fed has to deal with inflation. Wall Street thinks, "Oh that's a bunch of words, but not action because we're Wall Street and you would never let us go down, never let a bear market happen." Well, the Democratic parties out there.

And one last thing on this before I jump to the next section, there are rumors in Washington that Janet Yellen's on her way out, and that she actually earlier, about 10 days ago, she addressed them, and she said she's happy in her job and she has no plans on leaving. Well, if you are in Washington and you say, "I'm happy in my job and I have no plans on leaving," that's code word for, "I'm cleaning out my desk," is what that is.

Why is Yellen on her way out? She's going to get blamed for inflation. She is a proxy. I've joked about this, that Jay Powell's boss is Janet Yellen, Janet Yellen has two jobs, she's the treasury secretary and the head of the Federal

Reserve. Okay, everybody's fine with that because she agrees with Jay. It's not like when Trump tried to run the Federal Reserve, we were horrified because he wanted policy that Jay didn't agree with.

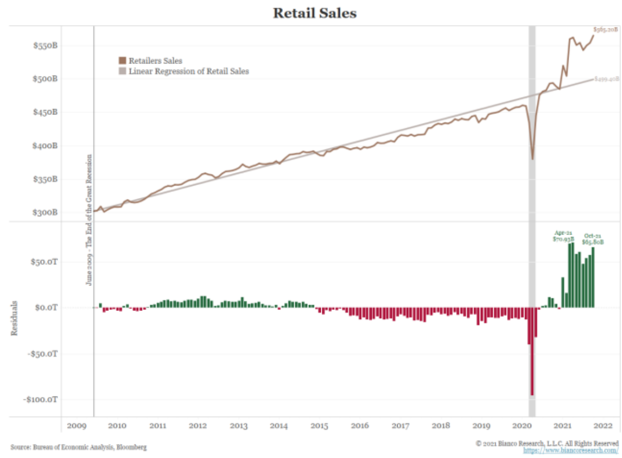
But nevertheless, the downside of that is, "Okay, good we have inflation, so Janet you're going to be the fall woman, it's going to be all your fault and we're going to throw you out as well."

And if I was to go off on one other quick little tangent on this, for those of you that care, Gensler is already positioning himself to be the next treasury secretary, the problem with Gensler is he's a white guy. So, he needs the progressive wing, read Elizabeth Warren, to endorse him in order to be treasury secretary, or a white guy has no chance of being treasury secretary.

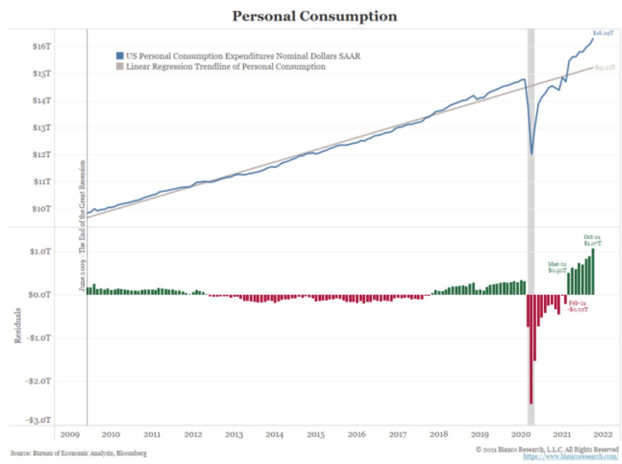
So, how's he going to get Elizabeth Warren on his side? You watch how strident he's going to get on crypto over the next three to six months in order to basically warm up to Warren. He's going to do everything he can to make crypto's life miserable, because it's all about getting her to approve a white guy to be the next treasury secretary. That's my cynical take on him, and my cynical take on Washington as well.

So let me skip COVID for a second. I'm going to come back to COVID. What can the Fed really do about? Oops, let me get to the right chart. I'm going to take these a little bit out of order.

About inflation, you hear this quip that I think is very disingenuous, "Well, the Fed can't print ships." Because what the implication is that, and this is a failing of economics, we have an inflation issue. Inflation is up. Well, it's either a supply fault or it's a demand fault. Could it be both at the same time? Greg Ip wrote about this, I highlighted this a couple days ago in news clips, yes, it can be both at the same time, but everybody wants it to be a supply fault. So, we all joke, "Well the Fed can't print ships so what can they really do about inflation?"



There's a demand issue too. Here's retail sales. And so, here's the total amount of retail sales, $565 billion of retail sales, here's a least squared linear regression, just if you took a ruler and just tried to line it up.



The bottom chart here is the residuals and you could see that we're running way above, we're running way above the trend. Retail sales were never anticipated to be this high above trend. Personal consumption, the bigger number of 16 trillion, way above trend, almost a trillion dollars above trend as well.

What's happened? To explain what's happened let me go back to that great event in the spring of 2020, the great toilet paper shortage. Why did we have a toilet paper shortage? And it plays into this, it's a microcosm of this. 50% of all toilet paper production went to residential use. In other words, it was shipped through the supply chain of grocery stores, and we would buy it for home use.

50% of toilet paper production was sent to commercial use. It's those big rolls you see in the public bathrooms or that kind of thing. And it went to the big office buildings, it went to stadiums, it went to malls. It went to places where people publicly gather and there's public restrooms.

Well in 2020, everybody was told to go home. Okay, now 50% of toilet paper usage is not just for home use, it's more like 90% of a toilet paper's going to be used at home and they can't change the supply chain fast enough. And we're all at the store trying to buy toilet paper, because I'm not spending half my day away from the house in a public building, either work, or a mall, or something else, I'm spending my whole day at home, so I need my whole usage home. And yet we couldn't change the supply chain fast enough and we have a tremendous shortage.

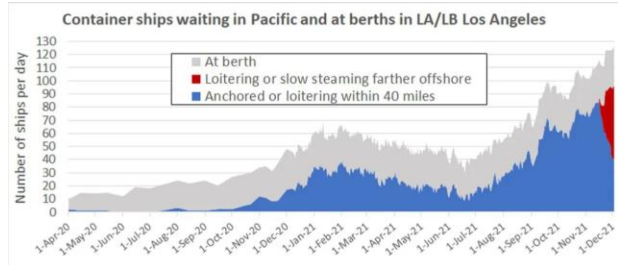
Same thing here, rot and big. In the last 18 months, we have changed our preferences for what we want. Our preference has now shifted towards stuff and online purchases, Amazon boxes. And so, we are all, here's my phone, picking up our phone and going to the Amazon app, and we expect that stuff to show up on our doorstep in a day or two later.

If you live in a neighborhood like I do, probably all of you do, and you walk down the hall, you walk down the street, all I see is Amazon boxes at everybody's stoop. Big apartment buildings like my adult kids live in, you almost have to wade through the lobby with all the Amazon boxes in them right now.

So, we have changed, and we are buying stuff, and huge. Why? We've been home for a year, we didn't spend, we got stimulus checks, we got unrealized gain in the stock market, we got unrealized games in our homes.

Quick word about retail and personal consumption. A one percenter will spend 12X on retail stuff, retail sales, then somebody in the bottom 50%. So, in other words the visual image I was given is if two women are in a mall and they're both in the 1% income, they will spend more money than 24 women that are in the bottom 50% in the same mall.

So, everything is really stacked towards the higher end. We're ordering online, we're doing Zoom conferences like this is, or this is GoToWebinar actually. We're all comfortable with this. We want stuff because we haven't bought stuff for a year or so. And so, consumption is off the charts. The Fed could do something about consumption by raising rates and cooling consumption as well.

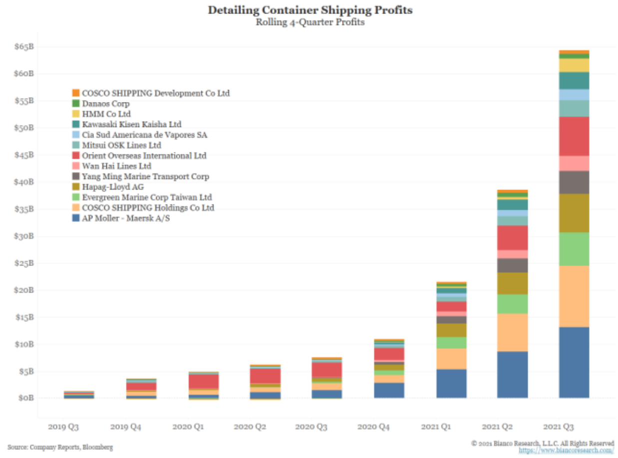


What about supply? There's a big argument to be made when it comes to supply that the problem has been fixed, anchored shipped. So, I talked about this a lot in the last conference call, so I'm not going to go over in detail, but the number of anchored chips blue, this is from FreightWaves, has gone down quite a bit. And you hear a lot of strategists and economists, "Oh, look at this, the number of anchored chips off San Pedro Bay, off of Long Beach and Los Angeles has gone down, supply problem fixed. Hmm, I wonder if we're going to have a glut next year and falling prices?"

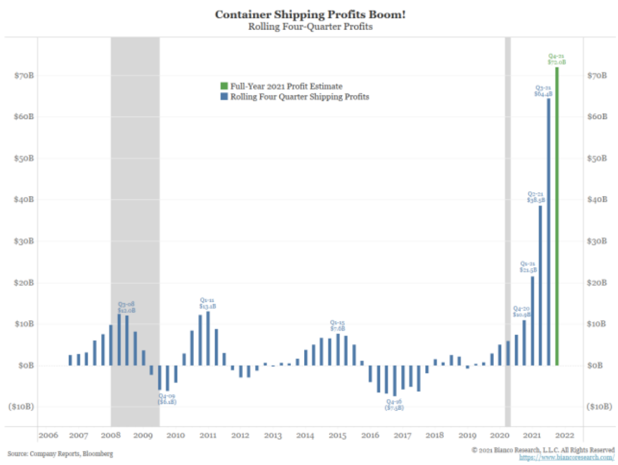
And now that's what everybody's worried about on Wall Street. Well, the administration is manipulating the numbers. And Gene Seroka, who the head of the Port of Los Angeles at least says it, says the quiet part out loud, "You guys all look at these ships anchored off San Pedro Bay and take pictures of them and put them online and say, 'Here's a visual image of the problem with the supply chain.' So, we told the ships to go 100 miles offshore, there they're over the horizon, you can't see them."

So now all of the smartest economists can look and say, "Oh, the number of ships in San Pedro Bay are down, supply chain fixed." But if you do as FreightWaves did, and you get the number of ships at berth and the number of ships that are at least 40 miles offshore, the backlog is the highest it's ever been.

And I've been saying this for a month or so. What's the worst day of the supply chain crisis? Today. And the new worst day will be tomorrow. It is not getting better. Now that's not to say it will never get better. It just isn't yet. And we're way too early to be talking about a glut next year, as well.



One of the reasons it's not getting fixed, who's incentivized to fix it? So let me let start with this chart. Here are the 12 largest container shipping companies. None of them are American. They're Chinese, they're Dutch, they're Japanese, they're Korean. COSCO, which stands for not where you go buy toilet paper, but that's China Overseas Shipping Company, is far and away the largest. This chart shows you their rolling four quarter profits.

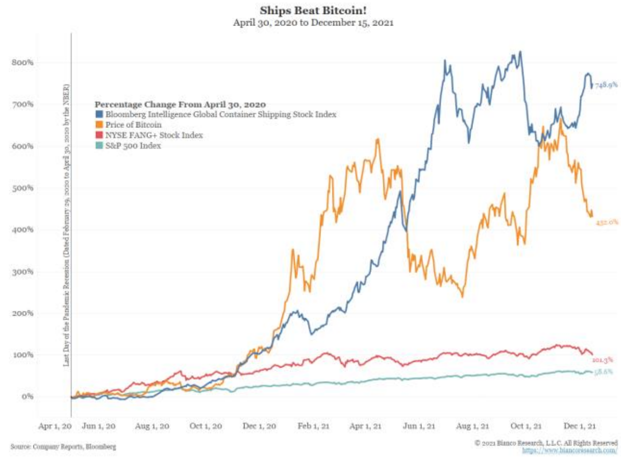


In the third quarter of 2019, they were making somewhere around $3 billion a year. They so far have made nearly $65 billion a year.

So, if you look at it in a longer perspective, look at the profits that the shipping companies are making. This is beyond their biggest Christmas dream ever. They are making more money than they ever imagined they could make. They've made more money in the first 10 months of this year, than the previous 10 years.

Why? Because if that ship is 150 miles offshore and it's just going in circles waiting to berth in Los Angeles to unload, they get paid every day. The shippers get paid every day. So, all of a sudden, their usage of their ships is running at a utilization, they used to rush over the Pacific in a number of days, drop their load, turn around and rush back to China and wait to get another load. And they weren't getting paid to rush back, and they weren't getting paid to wait.

Now they're getting paid to wait. And that's why they've got this. And the market knows this. Remember none of these companies are American companies.



So, Bloomberg has a global container shipping index, since April of 2020, the end of the pandemic recession, the shipping companies are up 749%, Bitcoin's up 432%. Is there something that has outperform cryptocurrencies in the last two years? Yeah, shipping companies. None of them are American, that's why nobody knows it, but they're outperforming cryptos.

Why, what is the incentive of the shippers to fix any of this? Nothing. There's no incentive whatsoever to fix this. So, the only fix is going to be higher prices to cool demand and to bring supply back into line as well. This is why I keep harping, there's nothing, this shipping crisis we're just manipulating the numbers, send the ships over the horizon, there, so now strategists can come out and write their pieces and say, "Supply chain fixed because the number of ships is going down," as well.

Or incredibly, Gene Seroka, the head of the LA port came out and said they have slowed down the number of ships that they've been unloading so they could get rid of the backlog of containers, hundreds of thousands. There's 42 miles of coastline for the Long Beach and Los

Angeles ports, just to give you an idea of how massively large this is, there's six rail yards, not one rail yard, six rail yards going into those two ports, just to give you an idea of how incredibly large it is; they move a million containers a month, they've slowed down. And the reason they've slowed down is they want to get rid of the backlog. And they've said, "Hey, we've gotten rid of the backlog. The backlog's going down."

And again, strategists and economists go, "Ooh, the backlog's going down. The supply chain's getting fixed." No, it's not. They're manipulating the data and you're buying into it because you want that narrative that it's being fixed, but it's actually not being fixed.

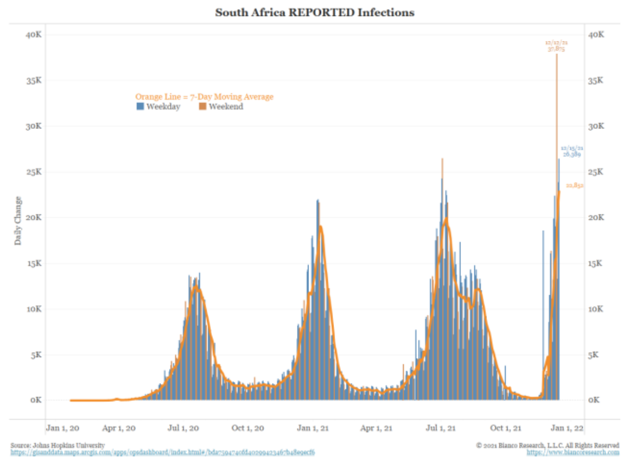
And the only fix I think ultimately is going to be that we're going to have, let me fix this here really quick, we're going to have to have higher prices. The port of Long Beach and LA, they have been running at 100% capacity before this month when they started to lower it as well. So that hasn't been fixed. And it's largely because we've changed our habits and we're buying stuff, like when the toilet paper supply chain changed, our preferences have changed and now we want stuff, and we can't seem to get that stuff.

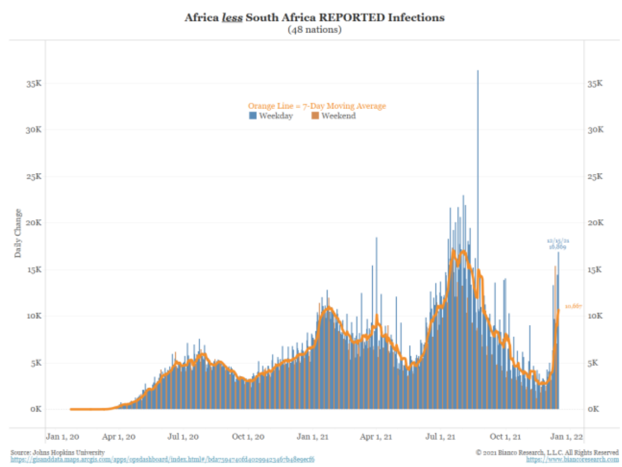
Now, let me throw in another issue that I want to talk about. And that's COVID omicron. I don't want to say omicron, I want to say omicron as well. And that this is, as I talked about in the last call, the damage is already done on this. I know that Wall Street doesn't want to believe this. They want to believe that they're the center of the universe, that the Fed would never upset them by hiking rates too much to deal with inflation.

The problem is we found a constituency more important than Wall Street that wants the Fed to hike rates and deal with inflation. It's called the Democratic Party. And they desperately need, the Democratic Party, I want to come back to this chart, this chart here, they desperately need these buyers to get positive. They need wage growth to be above inflation.

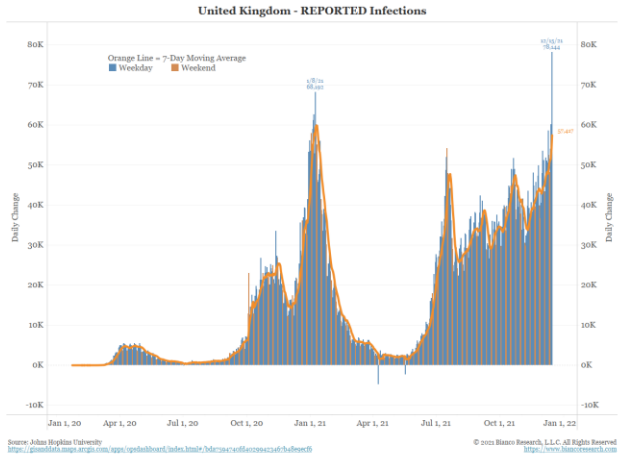
So, while inflation will probably peak in the next couple of months, maybe as high as 8%, that's not the issue. The issues going to be how fast does it come down, and how long is it going to be before we start seeing green bars again? So that the public says, "Oh man, my paycheck this month bought as much if not more as last month."

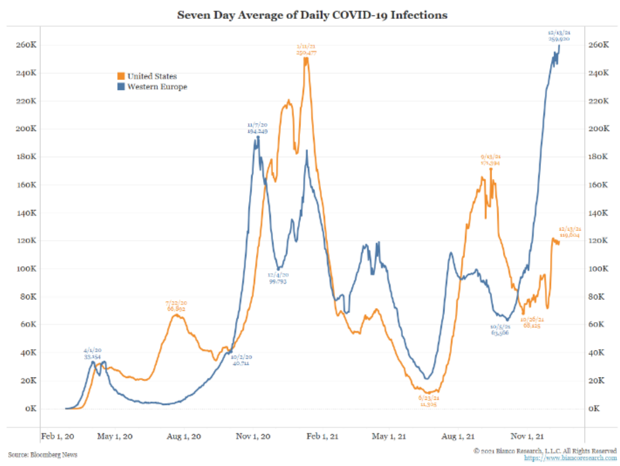
That's not what they're seeing now. And they're taking it out on the Democrat Party. So, the problem you face with the Fed will never upset the stock market so they're going to destroy the Democratic Party. And again, it's not partisan it's because they're in charge. I'd say the same thing if it was Republicans too, but they're not in charge. It is the Democrats that are in charge now. So that's why there's an important constituency there.



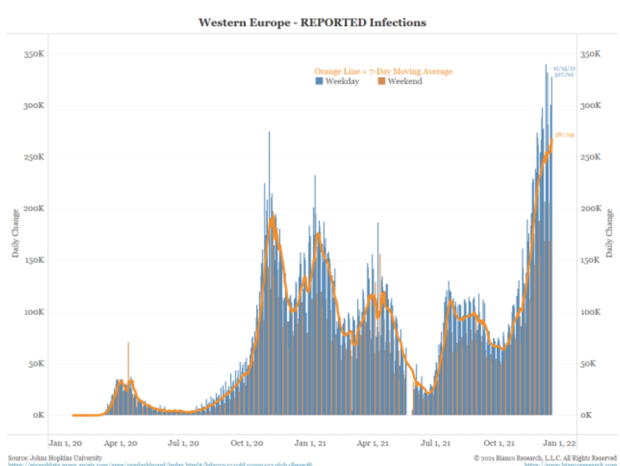


Now let's throw into the mix COVID. South Africa, omicron went from 200 cases a month ago to 22,000 cases today, over a 100X rise is what we've seen come out of South Africa, highly, highly infectious. We're seeing out of the rest of Africa, Africa less South Africa, it's starting to go vertical too. Yesterday it made its highest level since July as well. And case counts are going straight up as well.

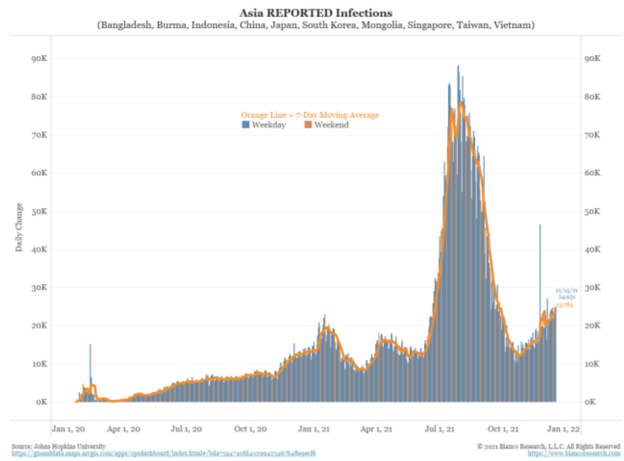




The UK shot out to a new high yesterday, and the health secretary in the UK has warned that number could go, that's 76,000, that's the whole pandemic, that number could go to 200,000 a day in the UK is what they've warned. And Western Europe, their orange line is the seven-day average, the orange line made a new all-time high on the seven-day average, third highest individual day reading was yesterday out of all of Western Europe, over 300,000 cases a day.

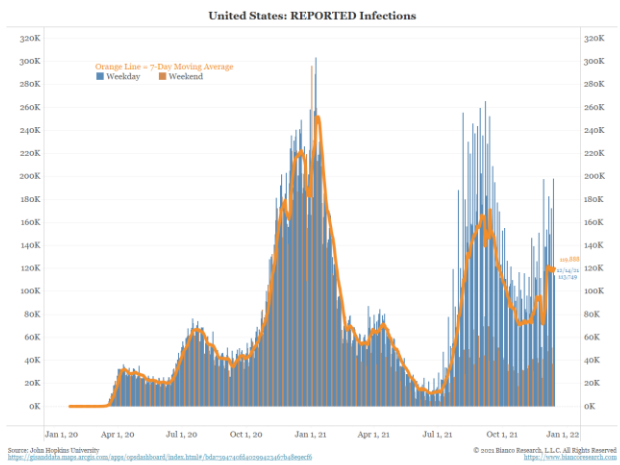


So, in some respects, Omicron came at the worst possible time because we were already at records and then we found a way to make this thing more infectious or more contagious. Not infectious. More contagious as well.



Now, what does it mean? Two things. First of all, in Asia, which includes China, we're seeing cases start to head up. The big problem in Asia is they use Sinovac as their vaccine. That was the vaccine that was developed by the Chinese. A study done in Hong Kong says, and I'll read right from the story here, "The vaccine made by Sinovac Biotech Limited, one of the most widely used in the world because it's heavily used in Asia, doesn't provide sufficient antibodies in two doses to neutralize the Omicron variant and boosters, and will likely need improved protection, initial lab finding show." It doesn't work. You're still going to get the cases.

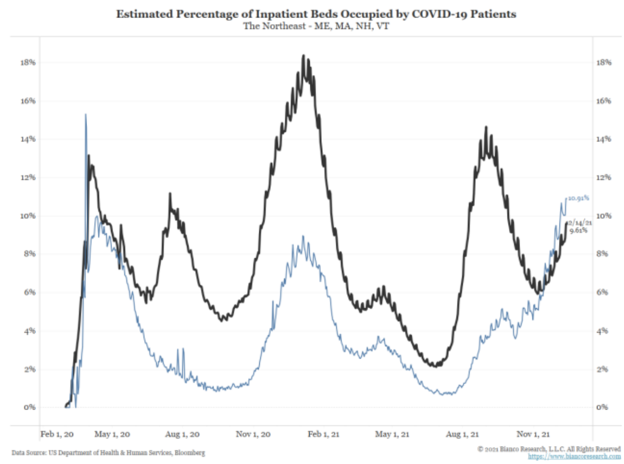
The problem with Asia is, especially China, they have a zero COVID policy. You get one case; the whole province is locked down and everybody's welded into their basement. And two weeks ago, Ningbo is the third largest port in China. One person got COVID. 300,000 people work in the Ningbo port. 300,000 people work in the port, that's how big it is. 50% to the port was closed for 10 days and all 300,000 people were tested. And if so, much as another one came back positive, they were going to close the whole port. None of them came back positive, they reopened. But this is how strident they are: if this case count continues in Asia, the beginning of the supply chain, the production of all the stuff that's in the Amazon boxes that we're ordering, it's going to slow dramatically, and it's going to slow because of their zero COVID cases and we're going to see even more squeezes on us.



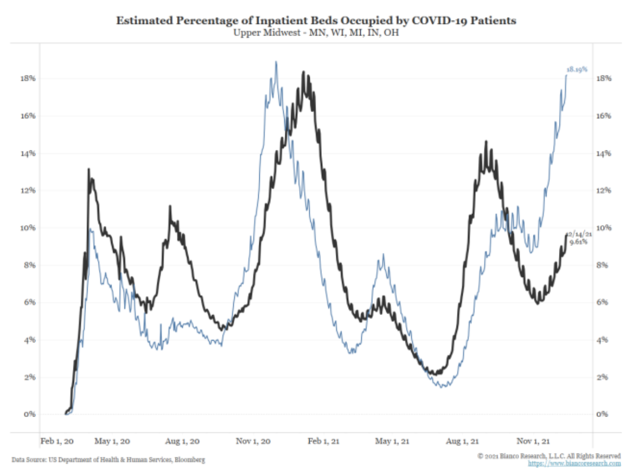
What about the United States? Cases are running around 120,000 a day. And they've sort of kind of stalled out in a middling range. But keep in mind, this chart I've been using, the blue line is Western Europe. Western Europe is at a new all-time high. Whenever one goes up, the other goes up. One plunges, the other plunges. Now sometimes the US leads, sometimes Europe leads. But what would be unusual is this rise in cases, not to see the US do something similar. As a matter of fact, the Biden administration has already said that they're expecting cases to go up. So, by the Super Bowl, first week of February, we could be pushing 240,000 cases a day in the United States as well to now. About the time you say that you get a lot of people, "Well, hospitalizations and treatments and the public won't tolerate it." Well, the public won't tolerate it here, just like the public in Europe wouldn't tolerate it when it was there. But now that we get up here, things are starting to change.

As I've pointed out, economic policy is made off of one thing: case counts. That's it. That's all it's made off of. And so, when case counts go up, restrictions come in. Mass mandate in California. Everybody over the age of five has to be vaccinated in New York City. Apple and Fidelity have both said that the return of the office has been put off. Fidelity said to 2023. Apple said for a time to be determined later as well to. We're seeing more and more of these kinds of restrictions. Why? Why are we getting these restrictions? Cause cases are going up. So, you could talk to me all day long about hospitalization, treatments, death rates, and you're a hundred percent, right. But when we're done with the argument, we're going to put on more and more restrictions because of rising cases.

And before I get to this chart, and oh, but America public won't deal with it right now. Yeah, because we're here. Let's see where they think if we get there. Let's see where they think they are.



Before I say that, let me say this here. Let's look at hospital usage. And this is really starting to become a concern. So, there's two spots where cases are really starting to surge in the US, the Northeast: Maine, Massachusetts, New Hampshire, and Vermont. So, the black line is the percentage of people in hospitals from the Health and Human Services, they up update this every day. Percentage of people that are in hospitals with COVID is 9.6% as of two days ago. In these four Northeast states, it's almost 11%, but notice the blue line: it's the highest it's ever been. COVID hospitalizations in Maine, Massachusetts, New Hampshire, and Vermont, it's the highest it's ever been. In Maine, it is so bad the Governor's called out the National Guard to assist in the hospitals.



The upper Midwest: Minnesota, Wisconsin, Michigan, Indiana, Ohio. 18% of the people in hospitals now are COVID cases. They're at the peak they were in January of this year, and well above anything that they saw in 2020. Way above the national average.

These are the types of things that are going to get people to think restrictions are going to be the case. We've got Canada talking about putting on restrictions on Americans going to Canada. France announced today that anybody traveling from the UK to France needs to show a negative test within the last 48 hours. When you get to France, you must get tested again and be negative, and then quarantine for 48 hours. That's what it's going to take now to go from the UK to France on the train, through the channel. You see, first you got to bring a negative test, then you got to get tested again, then you got to quarantine for two days in order. These restrictions will continue as we go forward from here. Probably not back up.

And again, I'm going to say this to be blunt: policy is made by two types of people in the United States: blue state Karen’s and red state Ron’s, if you want to use the vernacular. The red state Ron’s, Texas, Florida, the SEC country: Alabama, Mississippi, Louisiana, Georgia. If cases rise, they're not going to put on restrictions. Okay, fine and well. But the blue state Karen’s and Gavin Newsom might be in there, JB Pritzker in Illinois might be in there. De Blasio is in there. We'll see whether Eric Adams is in there. They will put on restrictions. And the cumulative of restrictions might be one or two or 3%. It won't be as draconian this last spring. And that's all we need to basically drive inflation even higher.

So, no, I'm not saying that the restrictions are going to hurt the economy. I'm saying the restrictions are going to be a tailwind for even higher inflation. And that higher inflation, we will still peak in the next three months, but it's going to be very slow to come down and that higher inflation is going to lead - let me go find my chart here - to continued negative bars of real earnings being below the inflation rate, continuing to hurt the president, continuing to hurt the majority party. Instead of calling them Democrats, I'll call them majority party, and people thinking that maybe they should wipe out the majority party and put the minority party in charge. That's what you're dealing with.

Well, the Fed will never upset the market. Then they've got to deal with, they're going to throw Janet Yellen out in 2022. They're going to blame her for inflation. Gensler wants that job. The Fed has been told, "Do something about inflation." Well, what if we upset the financial markets? The people that vote for us, the 40% that don't own a home or stock portfolio, they think the economy's terrible anyway. So, if they wake up one day and see the stock market's down 15 or 20%, their answer is, "Yeah, well of course. Why hasn't it been?" Because they think the economy's awful to begin with. So, you can't really hurt that anymore.

And this is why I think rates are going up a lot more than people think. They can't believe the Fed will raise rates three or four times, because they're all stock market centric, risk market centric as well. We all know the Fed has a very good history of going until they break something. Long rates are betting that is going to break, and that's why the yield curve is pancaking.

That's what I think the story is now. I think people are having a difficult time getting their head around that story because the driver of everything, and I know, this is why financial Twitter's so great: I've put up hundred-year charts of demographics on financial Twitter, and made cases about what I think they mean, and the replies are always the same. "Okay. So, what do I do with S&P futures tomorrow morning?" Because everything is the next 90 minutes in the S&P. Well, the S&P's at all the time high. So, I'm wrong. There's no problem because the S&P's at an all-time high. The S&P goes down 5% next week, not one thing will change, now I'm right because the S&P's down.

Everything starts with the S&P because everybody's got this belief that the Fed starts with what Paul said at the beginning here, let me go, "That we have learned in dealing with balance sheet issues, we've learned best to take a careful sorted methodological approach to making adjustments." Code word: we will never upset the stock market. Okay, that's been correct for 13 years. But now we've got somebody on the other side of that that might be bigger than the stock market: the majority of Congress. And the public is taking it out on the majority of Congress. It's been 40 years. We forgot how upset the public gets over inflation. And, like I said, it's nothing compared to how upset they get over 20% decline in the stock market.

I'm not predicting a 20% decline in the stock market. I am saying that as we roll into '22, there is going to be enormous pressure to not just talk about inflation but do something about it and get off this idea that it's transitory. Everybody's on this idea that it's transitory, it's going to go away. That it's going to be more persistent, and you're going to have to do something about it, and if the stock market has to get sacrificed, or partially sacrificed to do something about inflation, because we're going to toss Yellen out, and we're going to put the screws to Jay that he's got to stop this now. And here's how we'll put the screws to Jay: "Jay, you don't stop this now, in '24 Trump's going to be president and then you're going to be out and Judy Shelton's going to be the federal reserve chairman. Is that what you want, Jay? You better stop inflation right now, Jay" is what we're basically going to tell everybody at that point.

By the way, I like Judy and I don't think she would be a bad choice. That's a different issue for another day. But in official Washington, that is a scary, scary thought. And they will do whatever it takes to not make that happen.

So that's what I want to emphasize: there is another side to the inflation story. What if you're wrong, and what if inflation is not transitory? The public is going to murder Washington at the ballot box and that the Fed is being gleaned on to do something about, but the Fed can't print chips. It's much about demand as it is about supply.

So, with that, let me stop and let me open it to questions. First name only basis. I know who you are and that's all that matters. I'll take the questions as they came.

Q&A

Charles asks, "How would a property sector collapse in China, like in Japan in the '90s, affect your Fed rate outlook for inflation?" Let's think about what China is right now and what China is not. China is not a supplier of funds to the world financial markets. They are supplier funds to wealthy people to get them to think certain ways. So, when you were write books named "Principles, and you're asked about weaker detention camps, you can't come out and say it's a bad thing. I'll just let that die right there. But what they are, China is, is the production. It's the factory of the world. So, if the Chinese economy is going to take a hit, and into some degree because of the property sector or anything else, the likelihood is production out of China slows at a time when we are demanding record amounts of stuff. And again, even if you lock me down, I still got this and I can push a couple buttons on this, and I expect a box on my stoop day after tomorrow with all the goodies that I want.

And they come from China, and therefore, I don't think demand slows down initially, because the Fed isn't even going to raise rates until May, maybe March. So, we're still 90 days away from a rate hike as well. And because of that, I think it's going to lead to less supply, higher inflation.

Not sure if the long end is telling you anything. Is it just being brought up by foreign central banks, liability hedgers, building globally, Japan? No, this is what the long end typically does is when the Fed begins to raise rates, the curve inverts because the Fed is very, very good at raising rates too much and breaking something. And right now, I think they're going to be under enormous pressure to raise rates too much and break something. That's why my official call when people ask me, "What's your call on the Fed?" What I like to say is that: I just put up the chart of what the market thinks. I'm an outlier because nobody thinks that's going to happen. I think we could potentially have four rate hikes by February of '23. So, in 14 months we could have four rate hikes. I wouldn't even be surprised if we have four rate hikes by the end of '22. There's a 44% chance of that. I'm just describing what the market is pricing in but yet that is an outlier call. There was a red headline on Bloomberg saying, "Oh my God, the market has been pricing in three rate hikes." It has for a month. We just don't believe it. It was only yesterday that it finally came into consciousness that that's actually what's been happening.

So, the curve is flattening. The long end is railing because we've seen this picture before: Fed's going to break something. They're going to raise rates too much, break the market, maybe they're going to fix the inflation problem by causing a recession in '23. I'm not there yet on causing a recession in '23, but that risk is going up every day. And that risk is 30% on its way to 40. It's not 10 on its way to 10. And if the curve does hit zero by midyear, I'll put the odds of a '23 recession at better than 50%.

And of course, if the curve hits zero by midyear, all the smartest PhDs will come out and do what they always do: "Here's some study you don't understand that says this time the yield curve inversion will not lead to a recession." They do that every single time, and every single time a yield curve inversion does lead. The last time they did was 2019 as well. And then we had a recession in '20. Yes, it was pandemic led or inspired, but we don't know what the kind actual would've been. I still think there might have been one anyway, just not as severe because we seem to have been lining up for that at that point.

Ramon asks, "What do you expect to happen to the yield curve if the Fed raises rates and inflation remains high?" Invert. I expect the yield curve to invert because if the Fed starts raising rates, and inflation stays high, and the public screams louder, and Biden's approval rating goes into the thirties, and we're now talking about a hundred seat switch in the House of Representatives, a 60 to 100 seat switch in the House of Representatives because the public is so worried about inflation. Again, do not underestimate how upset they get over inflation. We haven't seen it since the late '70s, so we've all forgot it. But again, people with guns go through the Eccles Building trying to force the Federal Reserve to lower interest rates and put them on trial for treason. Now that's an extreme example, but believe me, the public was that upset. No one that crazy was going to go through the building like that. But beyond that, they were that upset in 1979, 1980 and '81 about inflation and about high interest rates.

So, what will happen is if they start raising rates and inflation stays high, they're going to be under unbelievable pressure by Treasury Secretary Gensler, cause they've already sacked Yellen, in order to do something about it right now. "The election's in November. Now, Jay, stop it right now." And so that's why I think that the bond market has been leading up to it.

I'll try and dust off a study I did a couple of years ago. I called the stock market, "the slow kid," because if you go back to the invention of the ETF in the mid-90s when it really took off, every cycle turn, you can look at commodities, currencies, interest rates, the yield curve in stock prices. What turns last? What turns last is the stock market. Every cycle, you can look at commodity markets, the yield curve, interest rates, the dollar, and they're saying, "Man, things are bad." And every cycle's, "No, stock markets at an all-time high."

October '07, yield curve was inverting, the interest rates were plunging, everybody's saying, "Man, there's something going on here." "Nope, you're wrong. The stock market just hit a new all-time high. It's fine." And then '08 happened. '09, interest rates started shooting up January of '09. The yield curve started steepening. "Hey, it's telling us things are getting better." You're wrong. The stock market fell another 20% into March of '09. The stock market's telling you it's not getting better. It did as well.

You go back to January of 2020, interest rates started to plunge. The yield curve started to steepen. I'm sorry, the yield curve started to flatten. Yield curve was inverting. The message was, "Something's not right here." "No, you're wrong. The stock market at an all-time high." Then March of 2020 happened.

The last market to turn is the stock market. So, stocks are at an all-time high, yeah, well the combination of all time high and commodity prices, the flattening of the yield curve, surging short term interest rates, and a sowing dollar is telling you that I think, in total, inflation is a big problem. "No, it's transitory because the S&P's at an all-time high." This is the problem we face in 2021: 51% of all analysis is, "The stock markets at an all-time high. Everything's okay." 49% of all analysis is the sum total of everything else. So, we always start with the conclusion that we have to explain the stock market as well, too.

And this time, the difference is there is a very important constituency that's on the other side of the inflation story: the majority party in Congress, the majority party in the White House, and public is taking it out on them in a big way and they're instructing the Federal Reserve to do something about inflation. We just don't want to see it. We still are of the belief that they will never upset the stock market.

Well, they've never had a reason to fight the stock market before. They might now, because we haven't seen inflation in 40 years and that's what's different now than what we've had since 2008.

Brian asks, "Will the yield curve continue to flatten given falling demand for bonds from the Fed due to tapering and less demand from banks giving rising credit growth?"

I am not a buyer, or I am not a subscriber to the idea that the supply situation, how much demand there is for bonds versus the supply of bonds, how many of bonds we're issuing, is a big driver of interest rates of the yield curve. I have looked at these six ways to Sunday for 30 years, trying to find a relationship between the supply, how many bonds we issue and interest rates, and I can't find one. One thing you've got to keep in mind about the bond market, a lot of these questions about the yield curve ... Remember in 2003, Greenspan? He was 100% right about this.

When he called the bond market a conundrum. It's always a conundrum. It always seems to do things that make you scratch your head and go, "What's going on here? Why is it doing that?" I think it's telling you that the Fed, the flattening yield curve and surging short rates when they're supposed to be anchored, is telling you that the Fed's going to have to fight inflation and they're being instructed by a higher authority than the stock market to fight inflation as the majority party.

Rachel asks, talk about retail sales exploding while consumer confidence is low, wages are negative. Is that spending coming from the very top earners?

Yes. Consumer confidence is low because most people think the economies bad. If we had a 15% correction in the stock market, of course, why didn't it occur earlier is what the public's reaction is going to be to it. The reaction of people that own stocks, it's not going to be that. But the 15% is going to be that. Is the spending coming from the top earners? Yes. The statistic I gave before. A one percenter spends 12X more than a bottom 50 percenter. So yes, all of that is heavily weighted towards the top end is where it's weighted right now.

Why do you think you get, if you're like us, you get five pounds of glossy catalogs in the mail almost every single day and stuff, because they know who spends money? They're trying to appeal to those people spending money.

"Can falling stocks have a negative wealth effect?" Yes. They can have a negative wealth effect. Well, first of all, they got to fall. They're at their all-time highs right now. They're not falling for the moment, but yes, if they fall then they could definitely have a negative wealth effect.

Taking a couple of more questions. So why is Schumer pursuing Build Back Better, BBB? That's the ethos of the Democrat party. The progressive party. Is government spending, government control. I might add, why do you think Liz Warren who hates the banks and has blistered the banks is so anti-crypto? You would think being that it's young progressives that are all involved in the crypto universe, that she would have been embracing crypto like never before, because what crypto suggests is not government controlled. And so, Build Back Better is part of the ethos of government control and that everything flows from the top. That's why I think that they're pursuing the Build Back Better bill. Now I might add, it is December 16th and they got to get the bill done by the end of the year, otherwise it resets. They haven't written it yet. They have not written it yet. They are still negotiating.

One of the other issues that the Democrats have done and why the public, you might be taking it out in the Democrats. You asked about Build Back Better. What do you never see a headline about ever? That Joe Biden met with Schumer and Kevin McCarthy, the minority leader in the house. And Schumer ... I'm sorry. And McConnell, the minority leader in the Senate to say, "Guys, how do I get Republican votes for Build Back Better?" Not even in the conversation. Not even in the consciousness. This is about Democrats dealing with Democrats. The New York Times actually did a story that, can one man control the Senate. It was about Joe Manchin saying no to everything. It's not one, man. You got 50 Senators that are called Republicans that are against all this, because you're not asking them for any input whatsoever. Zero input. Okay?

That's your right to do it. You're the majority party. If you lose one of your members, then they become as important as the president. You could ask the Republicans, "Guys, what do I need to get five Republican votes? How about wall funding?" Just to throw out one argument. "Oh, God no, we can't have wall funding." So, they're doing it all on their own. So why is Schumer pushing Build Back Better? Why is Biden pushing Build Back Better? It's the ethos of the Democratic Party, is what it is.

That's fine. That's what they are. That's their right as the majority party to shut out the Republicans completely. But now they're of finding out how difficult it is when you want to shut out the Republicans. Then the New York Times stands on their head and goes, "One guy controls the Senate." No, it's 50 plus one that controls the Senate. Because you told the Republican Party, there's no need for you to be here. You're not involved in any of this stuff, That's why it's that way.

David asked this, the natural transition of the consumer back to services from goods as economies normalize sort out the excess demand of supply chains.

Yes. If you believe that that's going to happen. I understand ... Let me go back to this comment and you know what, this applies to me too, but at least I'm going to say it applies to me too. We have gotten everything wrong this year. This has been an epically bad year. You go back and you read what everybody said in January, and oh my God, that is exactly what did not happen. Except the stock market went up. That's about ... but I'm talking about the economy.

Inflation growth. How all of that other stuff. That is exactly what has not happened. What are we going to do now to say that we've got record demand? Just say we're going to go back to services. Why? Why are we going to go back to services? I don't know that we're going to go back to services. I don't know if anybody else does. I will argue this to you. The biggest event of this generation. I was going to say our ... but this generation. The single most important event was we were all sent home for a year. That changed everything.

I'm not going to tell you how it changed. I don't know how it's all changed, but I'm recognizing it's changed. And if everybody wants to dust off their 2019 models and keep saying nothing has changed, this is how the world works. Then we will continue to get epically bad forecasts like we have this year. Now, that doesn't mean that I'm going to get it right. I'm probably not going to get it right. But at least I'll recognize, that stop using the 2019 model.

The idea that we're going to shift back to services is the 2019 model. Is what that is. I don't buy it. If we do get a surge of COVID into January and February, and we do get people, especially in blue states, worried and restricted and being told that they got to get boosters and the rest, we are not shifting back to services. And, so yes, the answer is in theory, if we shift back to services that will fix the problem, but I don't see an argument to be made other than to just say it, that we're going to shift back to services.

Greg asked, "With 60% of the US population vaccinated, why are COVID hospitalizations higher than before there was a vaccine?" That's a good question. The information on that has been very spotty. How many of those people in the hospitals are un-vaxxed? How many people in the hospitals are breakthrough cases? And it's hard to say because you get stories both ways. You get a bunch of stories that say, "Oh, they're all un-vaxxed in the hospital and that's the problem. Then you get Jim Kramer saying that we should put the military on the streets of the United States to have them forcibly vaxxed, everybody. He tweeted again last night for his call that we should have the military at gunpoint, because that's what the military is, forcibly vaxx everybody that hasn't been vaxxed, as well. Boy, talk about something that won't go over well.

But then you get stories in the opposite. Cornell University shut down because 900 students tested positive for omicron. Cornell has a vaxx mandate. 100% of the students on campus are vaccinated. 100% of those students that got omicron, those 900, were vaccinated. Most of them were boosted. It's hard to say why we're seeing such a surge of hospitalizations. Now, remember it's only in a handful of states is where we're seeing it. The upper Midwest and the Northeast. By the way, the low point is Florida. They're among the low. And SEC country of Georgia, Louisiana, Alabama, they're at the low end of the scale. Texas is at the low end of the scale. The upper Midwest and the Northeast are at the high end. So, I have not really found a good argument for why that is.

What do you expect to happen to the yield curve if the Fed realize ... Oh, I already read that question? I'm sorry. Why will the yield curve flatten? Oh, I'm sorry. I already read these questions. Let me move down the list a little bit more here. Dan asks, "You should talk about the Fed. You should talk about what the Fed should do to fight inflation in '22. Do you think that they will do rate hikes?

Yes, they should. My argument if you want to ask me what they should. I always talk about what they will because that's all that matters. But what they should do is recognize inflation is persistent. It really hurts the bottom 40%. You're seeing that in the public polling. Then it's their job to deal with it because it's as much a demand problem, an excess demand problem as it is a supply shortage problem. They need to bring things back into line. That having the stock market go up and then these people find that their paycheck doesn't buy as much at the grocery store this month as did last month is, I frankly think, an untenable situation for this country to last in.

I'll go you one step further. If the argument is going to be yes, inflation is up and yes, it's up. And yes, if you're in the 40% that don't own stocks or a home, every month your paycheck loses. But look at the stock market at 5,300 \on the S&P, it's all good. You think the inequality problems bad now? Wait until that happens, as well, too. I think we're going to have an untenable situation in 2022. Inflation, again, will peak early in the year. That's not the surprise.

Oh, it's peaked. It's over. It's done. How fast does it go down? And when does it get ... Again, I'll go to this chart again. I want to know when inflation ... Let me see if I can get there. I want to know when inflation is going to get below wage growth, and that's going to be the real problem that we're going to have to face as we go forward from here. This chart right here. I want to know when these green bars are going to get negative. That inflation goes below the blue line. My fear is that's 18 months away. I've heard many economists say that that might be 18 months away. That might be the middle of '23 that we might see that. I think that that would be untenable.

Can you help me understand what this means for the dollar and '22 '23? I think the dollar is bid. I think the dollar advances. Why do I think the dollar advances? Because I think two things. One, the US has the highest interest rates in the developed world and will continue to have the highest interest rates. If you want carry, if you want income, you got to come to the US. Two, it is a safe Haven currency. Whenever there is a problem in the world ... we saw this in the spring of 2020. Run to the dollar first, then start asking questions later. Now, that's against other fee odds. You could ask, "Well what's the dollar going to do against commodities or against cryptos. It's going to lose value. Which is what it's been doing against commodities and cryptos. It will continue to lose value, but against other fee odds.

If we have an inflation problem and a COVID spike, you want to be in Europe? You want to be in Japan? You want to be in emerging markets? No. You want to be in the dollar. So that's why the dollar has been strong, and I think will continue to stay strong.

Carl asks, "Is the current inflation dynamic, not only putting a dent in the Democrat's popularity, but also MMT at the same time?"

Yes. I definitely think it's putting a dent in MMT. Just follow Joe Wiesenthal on Twitter and watch how contorted ... He's a big, big, big proponent in MMT. Everything he's argued about the economy this year has not worked out and he's getting more and more desperate in trying to defend MMT. So yes, it is definitely put a big dent in that too. Should we expect MMT to fade from the discourse? Unless the Stephanie Kelton's of the world come out and say ... Because remember, there was an argument on MMT is, there is a point when we can have inflation. That there's too much spending. That things are too high. When that happens, we need to address it.

They think addressing it is raising taxes as well. Well come out and say that. We've hit that point. They've been so adamant that that point is so far down the line we could do Build Back Better and Build Back Better times two and times three, and we still wouldn't have inflation is where they would be too. What impact would Bill Back Better have on the Fed and the bond market? It will just be more stimulus when we don't need more stimulus. We're already at 100% capacity with the ports. We're already at 100% capacity. We're at record demand and it's just going to push higher prices. Really, if you're asking me when's the economy going to slow? When we get inflation so high, it becomes untenable. Yes.

I again, I'm not talking about how high inflation goes. I'm talking about it peaks in the next few months, but how slow it's going to be to come back down. That's where I think the real story of inflation's going to be in '22. It's how slow it's going to be to come back down.

A couple of more questions and then I got to run. Jay asks, "Do you agree that the Democrats support Build Back Better, notwithstanding its potential to be inflationary because the Democrats believe that the free things, which the bill proposes to give voters will cause voters to perceive themselves as better off and hence less concerned about inflation?"

Good. Yeah. The problem with the bill, I understand that argument and that's probably the argument, but I'll come back to what I said a few minutes ago. The bill hasn't been written. It's all about concepts. We want to spend this much on this and this much on that. The specifics haven't been written and the list of goodies in the mailing data, the goodies, has not been determined yet. We'll have to see whether or not that list of goodies is going to come in time for the November election. I might add, the list of goodies that we gave you last year and this year with all the stimulus, and some of that was justified because of the pandemic shutdown, has resulted in all this inflation. It has not made people more ... it's not end endured people to the majority party to date.

The infrastructure bill. "Oh, this is a turning point." The infrastructure bill passed a month ago. How's that worked out? Is anybody thinking that that's a game changer as well, too? Nope. As well. Okay.

Couple of more quick questions here. Scott asks, "How can the Fed justify continuing to accommodate through asset purchases, even at a reduced pace?" Because of that statement that Powell made. That they sit there ... If you go and read the headlines on Bloomberg, some of the Bloomberg stories. Masterful job by Powell. Threaded the needle. Did very well. Why? Why did he do that? Because the stock market went up. Everything starts with, "How's the stock market going to view this?" I don't care if a nuclear bomb went off and three quarters of the country was incinerated, if the S&P's at an all-time high, that was a good move. That was a good move. If we cured cancer and the S&P fell 20%, that was a bad move. That's the mentality that we have in 2021.

Yeah. If you read, everybody says that Powell did a good job. Why did he do a good job? Because he did something and the stock market went up, as well. So, when you ask the question, "How can he possibly accommodate through asset purchases at a reduced pace?" Because everybody thinks it's brilliant because this the stock market's going up. It's when the stock market goes down, that they stop thinking it's brilliant.

I got to end this call. Let me take one more question and then we'll put out the transcript on Sunday. What do you think the Fed will actually do next year? The number of rate hikes priced in three to four.

Yeah. That's what I think. Between three and four is what I actually think the Fed will do next year. Because my basis is, this inflation is much more persistent, it's going to peak in the first quarter and it's going to be very, very slow in coming down. Then the Fed is going to get under more and more pressure to do something about it.

Okay. With that, I got to wrap up this call. Merry Christmas. Happy New Years. Happy Holidays. Thank you for being a customer of ours again in 2021. Although my story here is not optimistic for 2022, I'm hoping for a prosperous 2022 for you and everybody else. Again, thank you for your business, and we'll talk to you in this format again on the other side of the new year.

Bye. Bye.

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