Inflation Hits Home

We have been bombarded with news that inflation is rearing its ugly head, and prices are shooting up at the highest pace in over 13 years.

During much of the pandemic and in recent months, I have hardly felt any inflation. This may be because, in my area, there are dozens of farms that produce fruits, vegetables, beef, chicken, pork, you name it. Locally produced beverages are plenty as well. Food prices didn't change. In addition, even at the larger grocery stores, there's been plenty of goods on sale.

I have not been on a plane in nearly two years. Therefore, I have not traveled far. However, to the extent I have traveled, prices have been very stable in my area. I'm sure innkeepers have been excited to have guests in the first place.

Ski tickets increased sharply. However, that could have been for various reasons related to the recent sale of the mountain where I ski. The food and beer prices at the resort didn't budge.

I'm paying less money to play golf this year.

However, this week higher prices finally hit home.

The other day I was a bit hungry, and I didn't want to cook. I went online and looked up a local causal eatery menu that I have gone to and brought food home in the past. They make basic food in a high-quality fashion. Burgers. Chicken sandwiches. Soups. Salads. You can also have a great local craft beer while waiting for your order.

Prices have ranged from $7.99 to $8.49. The menu now tells a different story. *Everything* was marked up to $10.99.

That's a massive increase in percentage terms—all in one fell swoop.

I decided to stay home and cook some rice that cost me less than 30 cents.

I don't blame the restaurant for raising prices. I have no doubt they are getting squeezed in all directions.

That doesn't mean I have to pay those prices blindly. I do have choices. This was the first significant price jump I have seen. I decided to stay away.

Last October I had to buy a new car. I typically buy gas at Costco. My vehicle requires a bit higher octane, and back then, the price was $2.25. This week I paid $3.70. I don't drive much, so the overall impact on my wallet is not huge. However, paying $3.70 a gallon pissed me off.

I fear that a big problem is right around the corner. If I were to pinpoint when that might be, I would speculate in September.

That's when the extra unemployment benefits run out. Some states have already cut off the benefits. States that have cut benefits are now being sued. Let's assume the benefits stay in place until September.

People aren't stupid. If they can make $20 an hour at home or $15 an hour working, they will take the $20 an hour and stay home.

When those benefits run out, though, they are back to making $15 an hour. They'll find a job since there are help wanted signs in every single shop window in my community. There are jobs posted at virtually every company in the area, regardless of what business they conduct.

However, prices will remain elevated. I doubt that restaurant is going to lower the price of a burger back to $8.49. Therein lies the rub.

Every time a stimulus runs out, the economy comes to a grinding halt. By September, more of the supply chain will catch up to demand fueled by reopening the economy.

Some commodities will cool off. Lumber prices have already slid 50%. Chainsaws are working overtime in Canada as they can't cut down trees fast enough. By late summer, prices could fall another 20%. However, many businesses may try to keep their list prices for goods and services elevated.

Right when the economy slows.

The Federal Reserve is regularly buying 25-30% of its paper. The Federal Reserve is doing everything it can to keep this house of cards afloat. That's because inflation hurts poor people, and deflation hurts rich people. The Federal Reserve will do *everything* it can to hold off deflation.

In addition, the $3.5 trillion reconciliation bill that will be voted on in September must be paid for. That can only be done with higher taxes. A minimum tax on corporations will undercut one of the critical aspects of a rising stock market in recent years. Stock buybacks. Buybacks could slow in the face of minimum taxes.

Everyone else's taxes are going to go up too.

We will also have a lame-duck president less than nine months into his term. That's because the Democrats will run as far away from Biden as possible when they start up their re-election campaigns for 2022 later this year. Nothing will get done. All the bullets will have been fired on the $3.5 trillion deal.

That's a lot of forces getting set to collide all at the same time.

Once this collision occurs, there could be many bankruptcies, store closures, weak economic growth, and deflation that might end up bringing the house of cards down. This will play out over months.

In *Unbounded Wealth*, I discussed how I like to spend money when others are fearful and scale back when everyone is bragging about how rich they are. There's plenty of froth in the market for stocks as well as collectibles.

Right now, I am in cut-back mode. In my household, we decided to only eat out for a special occasion from now on. We love to cook, so this isn't a huge deal.

I am cutting back in other areas too. The current environment doesn't feel right to me, and I feel better about being cautious about my spending.

I still need to buy insurance, gas, food, and other necessities. Because I work for myself, my income is very volatile. That's always a reason to be cautious.

My caution can only go so far.

For example, the price of treats for my dog also went up 10% in the past week. Now, let's be clear, my dog eats better than I do. There will be no cutting back on her treats!

It just goes to show, though, that the price of everything is starting to rise, and it's going to be felt in our everyday lives in the future.

I'm curious as to how inflation may be affecting you. What are you doing to cope with it?

I would love to hear from you. Please write me at info@hsdent.com and tell me your thoughts!

Happy trading!

Risk-O-Meter

All hands on deck warning!

The *Risk-O-Meter* stays on a buy this week, but risks continue to increase for now.

All of the credit market trends we analyze in the *Risk-O-Meter* have flipped to a warning sign. This is one of my favorite areas of the market to look at because historically, credit markets have been better at flagging risk in the markets before the stock market.

Volatility is also flashing warning signs and is in the red zone.

Right on the edge is market breadth. Were this situation worsen in the near term, the *Risk-O-Meter* will hit the "sell" button. We are not there just yet. It might take about a 7% decline from here to flash the sell signal based on current conditions.

Market breadth is critical because one of the defining characteristics of the market advance since the COIVD lows over a year ago has been broad participation from many stocks.

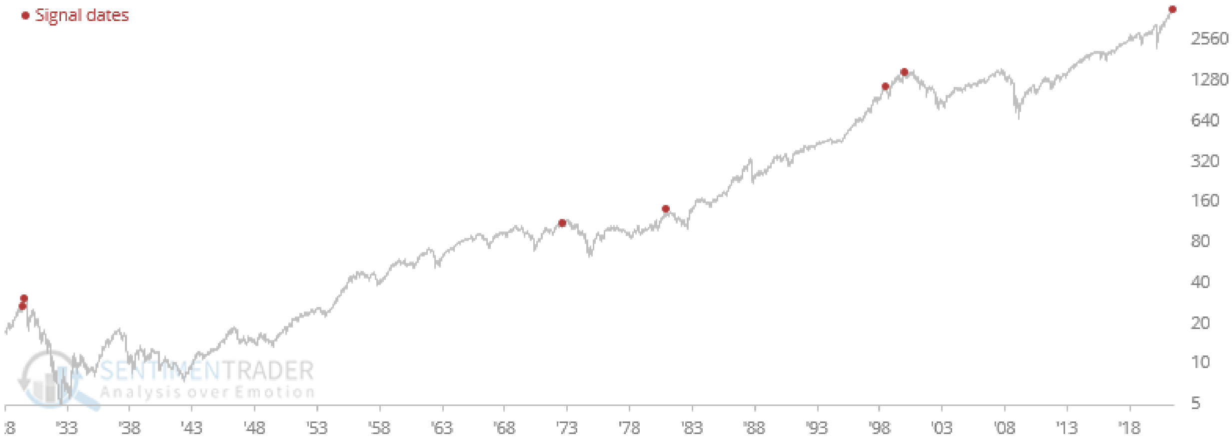
While most stocks have followed the major market trends, there are signs that this massive bullish move may be running out of steam.

The chart below, courtesy of SentimenTrader.com, illustrates what has happened when the S&P 500 continues to make new highs regularly, but many stocks start to trade below their 50-day moving average.

One such signal just occurred for only the seventh time since the 1920s.

The results are sobering.

S&P 500 after 5 days in past 3 weeks with a new high and < 60% of issues > 50-day avg



Signals (7)	1 Week	2 Weeks	1 Month	2 Months	3 Months	6 Months	1 Year
Median	**0.5**	**0.7**	**-3.5**	**-6.6**	**-2.4**	**-3.6**	**-10.0**
% Positive	**57%**	**50%**	**33%**	**17%**	**50%**	**33%**	**17%**
Avg Risk	-0.2	-1.1	-5.4	-9.2	-9.4	-13.6	-18.5
Avg Reward	0.8	1.4	1.4	1.4	3.0	5.6	5.6
% Big Drop	29	33	50	67	67	50	67
% Big Rise	14	33	17	17	17	17	0
Z-Score	0.3	0.2	-2.4	-2.0	-0.7	-1.5	-2.4

© SENTIMENTRADER Numbers are % return after signal; Risk = avg max loss; Reward = avg max gain; Z-Score +/- 2 suggests significance.

As the chart shows, when this rare signal occurs, losses pile up. Over multiple periods from a month to a year, the historical performance is down. The one-year historical performance shows a decline of 10%. What's more, the performance has been positive only 17% of the time.

The average maximum loss is 18.5% compared with an average maximum gain of 5.6%. Poor risk/reward ratios don't get much worse than that.

In fact, in each period, the performance has been positive 50% of the time or less.

It is best not to anticipate sell signals in the *Risk-O-Meter.* Everything could resolve itself too. Last week I noted the market was overdue for a big bounce in smaller stocks.

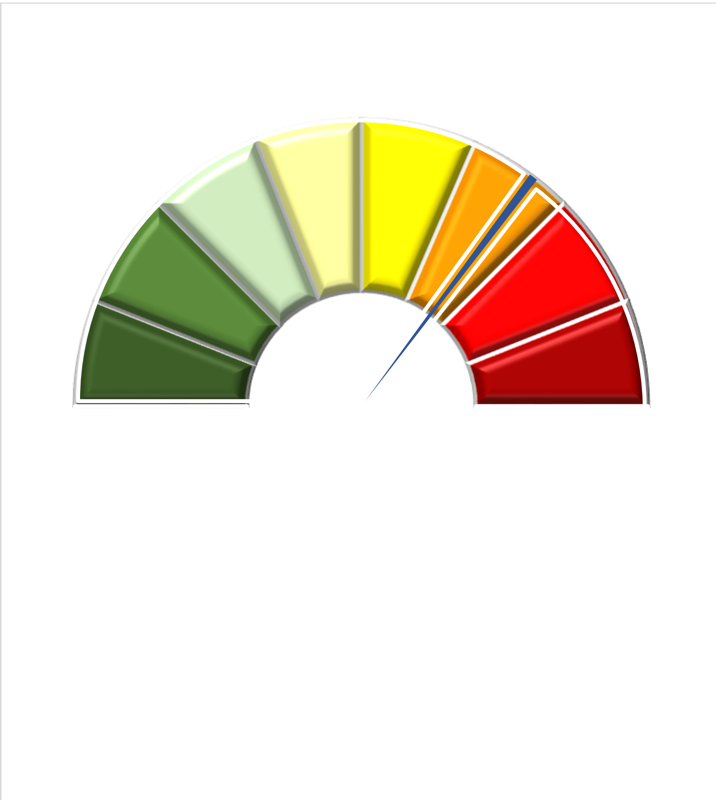
One area that is likely to lag any market downturn is the level of bullishness. The spread between the bulls and the bears is the least predictive indicator we look at over at *Risk-O-Meter* headquarters.

Our analysis shows that most people use it the wrong way. Typically, contrarians bet against heavy bullishness. However, our analysis of the data indicates that those bulls need to aggressively move into the bear camp. As that is happening, there is a lot of selling pressure on the markets.

Of course, those investors (speculators actually) get too bearish, which becomes a signal to buy.

The slight dip in the market recently caused the level of bulls to fall sharply. However, the number of bears didn't budge much. It's still way too low. The current situation leads me to believe that it will be excruciating when the next significant downturn comes because all other indicators will flip first. Then the market sentiment will start to shift. This will accelerate the amount of selling. Selling always overshoots. So, what might be a typical 15% decline in a healthy market could turn into a 40% decline.

For now, we are still on a "buy."



Lastly, Bitcoin is a hot topic, and I wanted to share with you a good article I read on *Advisor Perspectives*. Recently, Nassim Taleb, famous for writing *Black Swan*, has come out negatively on Bitcoin despite being an early supporter of cryptocurrencies.

He lays out his case for why they are worthless. I'm not sure I agree with everything he says, except I do not believe Bitcoin is currency. We agree on that point.

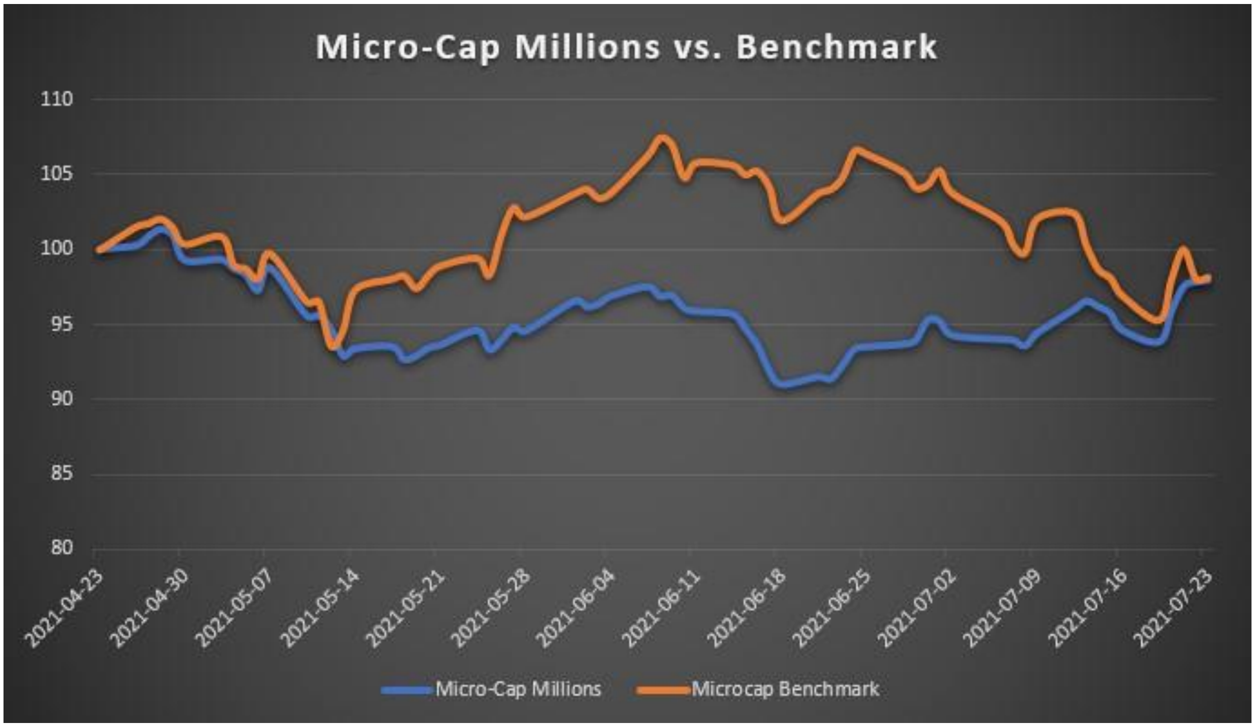
I have condensed the link for you below. If this does not work, type Taleb Bitcoin *Advisor Perspectives* into your favorite search engine, and the article should pop up.

RB.gy/le3rmm

Micro-Cap Millions

Smaller stocks did bounce back this past week. I had suggested that small caps were overdue for a big bounce. This has helped performance dramatically, and the strategies have made up their performance shortfalls.

Here's the performance chart for *Micro-Cap Millions*.



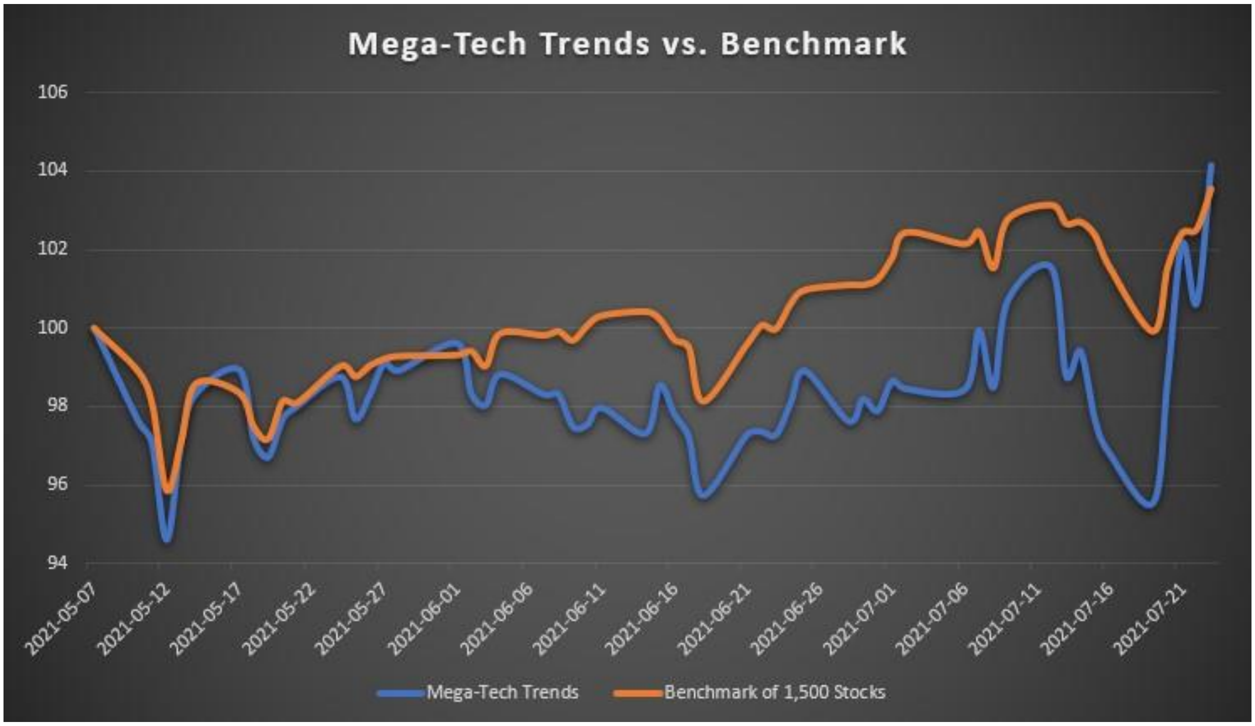
Here's the portfolio for this week:

CRAI	CRA International, Inc.
CRD.A	Crawford & Company Class A
DLHC	DLH Holdings Corp.
FEIM	Frequency Electronics, Inc.
HMTV	Hemisphere Media Group, Inc.
IHC	Independence Holding Company
ISDR	Issuer Direct Corp.
MGIC	Magic Software Enterprises Ltd.
TAIT	Taitron Components, Inc.
WSTG	Wayside Technology Group

No new trades this week.

Mega-Tech Trends

Mega-Tech Trends had an even bigger bounce relative to the market indexes. It was a stellar week for the strategy.



Here is the current portfolio:

AMEH	Apollo Medical Holdings, Inc.
BCOR	Blucora Inc.
BDC	Belden, Inc.
HRC	Hill-Rom Holdings, Inc.
IT	Gartner, Inc.
JBL	Jabil, Inc.
KFY	Korn Ferry
LFUS	Littlefuse, Inc.
MKSI	MKS Instruments
XRAY	Dentsply Sirona Inc.

No new trades this week.

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