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Omicron has arrived and is quickly spreading, sending global markets into panic and free fall. Are we approaching a dark winter for the economy and market? This was predicted last year, but both the markets and economy remained resilient in the face of the latest strain of the coronavirus that year. Mutating viruses are not uncommon, but the early response to Omicron feels very different. Countries are closing their borders over fears that the virus will rage as it did in March 2020. Stocks were lower by 2% or 3% globally when the new strain was identified in South Africa. Oil and other commodities were crushed under the weight of expectations of a return to global lockdowns just as travel was normalizing and returning to 2019 levels.

While Sunday morning talking heads discuss the 'perpetual pandemic,' the real risk is whether or not the global economy will be derailed by government health policies. It seems almost a certainty that the complex supply chain issues wracking key industries will be further weakened by new restrictions. A dark winter, however, might present a great buying opportunity for equities just as April 2020 did for investors. The concern that the Fed, and other Central Banks, were going to start the process of removing excess liquidity through bond buying, and gasp, consider rate hikes, will likely be taken off the table. Generally speaking, certain varieties of the "Fed to the rescue" trade worked well in early 2020 and may again in 2022.

The economy today is far more vulnerable than most of the sell side analysts suggest. We face multiple risks that could result in a recession:

a dramatically slowing China as their real estate and debt bubbles begin to burst, inflation at multi-decade highs forcing the Fed's hand to tighten monetary policy, and political dysfunction that could result debt defaults and policy uncertainty if we go back into lockdowns.

The China risk is a global risk, as a slowdown will create lowered demand for Europe and higher interest rates in the West. The credit markets appeared to have weathered the Evergrande fallout, but the magnitude of the problem is much greater than Japan faced decades ago and still has not recovered from.

The Fed will certainly respond to the Omicron threat and the Treasury futures indicate that. The first rate hike in the U.S. was forecast for June 2022, but was instantly pushed back to September when news of Omicron hit. The Bank of

England was poised to hike in December and that has been pushed to February, according to futures, and the ECB currently shows no chance of a rate hike for all of 2022. The policy response from Central Bankers is likely the least of our worries -- they will almost always favor policy accommodation regardless of the risk of long term inflation.

A dark winter, however, might present a great buying opportunity for equities just as April 2020 did for investors.

The political risk in the U.S. is very different than in early 2020 when Trump was still in office and the GOP controlled the Senate. Some almost have the feeling that Biden is a lame duck President just one year into his Administration. The Democrats are divided between Progressives and Moderates, making it quite easy for Republicans to score political points. Current polls suggest an overwhelming win for the GOP in the midterm elections and a likelihood that the GOP will control the House and Senate in the last two years of the Administration. It is likely that the political left is going to have to compromise on many issues just to get the debt ceiling passed and avoid a debt default on their watch, even though they currently control the White House, Senate, and House.

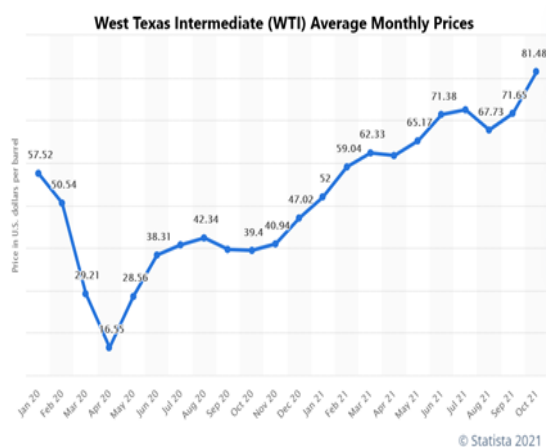
At the end of the day, virtually all recessions are the result of a reduction of spending by consumers. Supply chain issues lead to deferred spending, but when a fall in demand

occurs we experience a recession. A look at the current Labor Participation Rate from the Bureau of Labor Statistics reveals a significant problem for which there may no longer be a political solution. The government responded to the lockdowns of 2020 with unprecedented stimulus to pay people when the companies they worked for were forced to close. That appears very unlikely to repeat given the challenges that created for small businesses facing massive labor shortages. As the chart suggests, the labor participation rate had been falling for decades but looked to be recovering around 2016 before falling off a COVID cliff in 2020. After a rebound, we have begun to move lower -- a bad sign for businesses in desperate need of workers.

Some expect the markets to be fully reliant on the Fed to come to the rescue to avoid the next Bear Market in equities in 2022.



Over a Barrel



The energy markets have been whipsawed like characters in a Tyler Perry movie. Political pressure and policy resulted in reducing the flow of oil from North America and put OPEC in a position of power they had not enjoyed in almost 10 years. Not surprisingly, the price of crude jumped and resulted in gas and diesel as high as \$6/gallon in some coastal markets like California and New York. The Biden Administration responded by releasing approximately 50 million barrels of oil from the Strategic Petroleum Reserve (SPR) in hopes the price of gasoline would fall. Their policy is likely to be form over substance since 50 million barrels only represents about 3 days of use in the U.S. alone, not likely enough to bend the demand curve to lower prices.

- China, Japan, India, South Korea, and the U.K. all announced similar measures to flood the market with oil reserves in an attempt to reduce prices of gasoline and the influence of OPEC.
- The policy had little impact on trading as oil prices initially retreated but actually finished the trading day \$1 higher than they started, suggesting the markets do not believe the release matters.
- Omicron did accomplish what politicians could not as oil fell 13% when the mutant virus was announced. Concern over lockdowns and lower demand led to the sharpest decline since April 2020.

Meltdown in China



This year has not been kind to emerging markets. The MSCI Emerging Markets Index is down roughly -2.0% for the year (through 11/26), compared to a gain of approximately 26.7% for the S&P 500 Index. Much of the downward pressure on emerging markets is due to weak performance out of China. The chart to the left illustrates the value of the MSCI China Index, which has declined roughly -16.6% so far for the year. China represents roughly 33% of the MSCI Emerging Markets Index. The decline stems from increased regulatory oversight from Beijing as well as contagion fears over the developer China Evergrande Group.

- In particular, the Chinese government has cracked down on U.S. listed IPOs. Earlier in the year, regulators affirmed increased regulation on dual-listed companies (i.e., companies listed in both the U.S. and China). Increased regulatory oversight could also put increased pressure on the Chinese ADR market.
- Still, from a valuation standpoint, China could present an opportunity for investors with long time horizons and high risk tolerances. With this year's declines, by many metrics such as price-to-earnings, China looks more attractive than the U.S. However, there is significant volatility around potential future returns, not to mention the spectre of geopolitical tensions between China and the West, so allocate with caution.

Federal Reserve Tapering



Source: CNBC

The purchase of asset-backed securities to stimulate economic recovery is one of the many tools available to the Federal Reserve to manage the health of the economy. With Jerome Powell's re-nomination as head of the Federal Reserve, the Fed's plan to reduce its \$120 billion monthly pandemic bond-buying program remains in place. In contrast to 2013, Chairman Powell and other members of the Fed have continuously said they would provide clear communication well in advance of the actual tapering. During his press conference on Nov. 3, 2021, Fed Chair Powell insisted that, despite tapering, the Fed's stance will remain "accommodative," and will still seek to keep interest rates near zero. Given Powell's transparency, many economists and other experts do not foresee a repeat of the 2013 "taper tantrum".

- Tapering refers to the process of a central bank scaling back its asset purchases when economic conditions improve, and such stimulus is not required.
- Tapering impacts debt markets but can also have ripple effects on U.S. and emerging stock markets.
- If the history of the taper, and the much longer 60-year history of market sentiment is the judge, there are more gains to come, potentially across all sectors, styles, and sizes of equities in the S&P 500 and S&P Composite 1500 Index, according to CFRA Research data.

Macro View – Warehouses

With the holidays upon us, workers in warehouses are hard at work packing up soon-to-be presents for our friends and family. Warehouses are usually a requirement for most businesses that manufacture, import/export, or transport goods to customers. They allow for timely delivery and optimized distributions, which in turn, lead to greater customer satisfaction and increased productivity. However, due to the increased demand for e-commerce, more warehouses may be needed. According to the commercial real estate company JLL, nearly 96% of existing industrial space is in use and the U.S. may need an additional 1 billion square feet of new industrial space by 2025 to keep up with demand. This demand can likely be attributed to retailers increasing e-commerce operations amid the online shopping boom and investing in faster delivery times. If new space for warehouses is not secured, businesses could face challenges getting their products to customers in a timely manner.

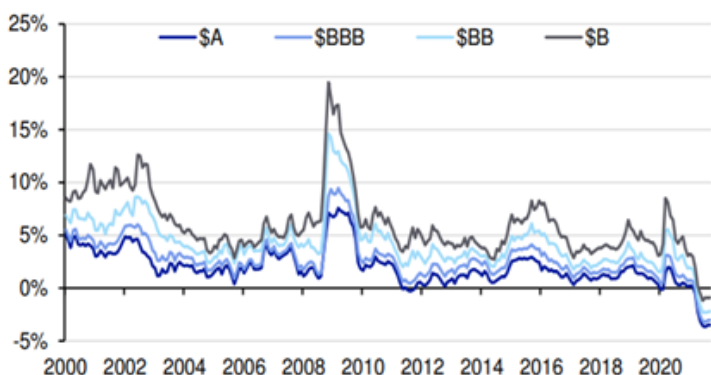


Source: NPR

Fixed Income - Spread Rather Thin

Just prior to the arrival of Omicron, bond market spreads were hitting levels we had not seen for many decades. Real yields on investment grade debt fell into negative territory when inflation rose last year, but in October we saw single-B debt also go negative. To have a negative risk premium on single-A debt has occurred in the past because of the incredibly low probability of default. Debt rated B, on the other hand, has almost a 30% chance of default according to S&P Global Ratings Research. Investing in debt with a yield below current inflation that has a 30% chance of default should be the very definition of a bubble in my opinion. While concerns over a repeat of lockdowns will likely drive non-investment grade debt to higher yields, it is difficult to believe those yields will be sustainable for very long.

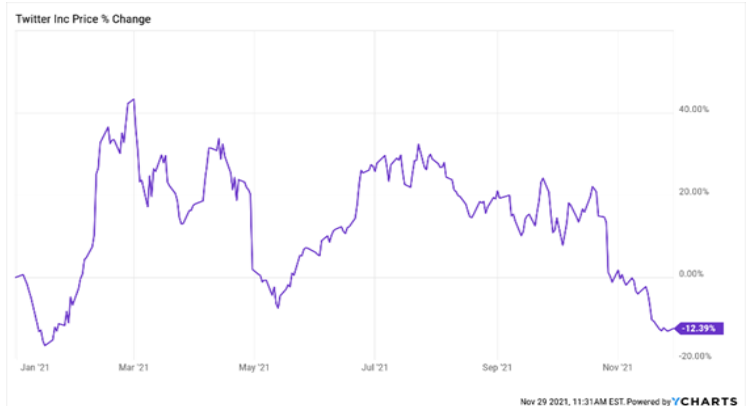
Spot Real yields from single-A to single-B ratings



Source: Deutsche Bank, ICE Indices. CPI based on headline inflation

Taking Stock – Twitter

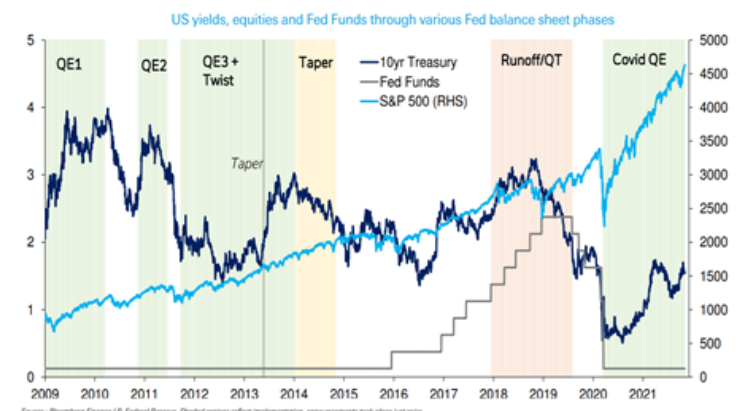
On Monday, Twitter Inc. (TWTR) CEO Jack Dorsey announced that he would be leaving his role and will be replaced by Parag Agrawal, the company's now former Chief Technology Officer. Following the report by CNBC, Twitter shares soared 11% and then quickly turned negative. As shown in the chart below, performance this year for Twitter shareholders has been less than stellar and is down more than 12% YTD. The initial price increase could be a sign from investors that they are optimistic about Agrawal's future as CEO, given he will be able to solely focus on running the company as compared to Dorsey who also serves as the CEO of Square (SQ). Agrawal, while optimistic about the company's future, will have a tough road ahead given both the stock's poor performance and scrutiny amongst those in Washington.



Source: Ycharts

Technical - Charting the Fed

This chart shows just how powerful a role monetary policy can play with the equity and fixed income markets. Since the Great Recession in 2008 when the Fed went to extraordinary measures to support the U.S. economy, there have been six identifiable Fed programs with varying results. QE was generally greeted with a market rally for equities and bond prices, while tapering and quantitative tightening (QT) caused markets to trade mostly flat. The COVID QE was by far the largest and most expansive and was accompanied by fiscal stimulus as well, sending equities to highs in the face of unprecedented economic turmoil. With the new variant of the virus appearing more virulent than prior strains, we will need to see if Central Banks have the will to continue growing their balance sheets and flooding the markets with excess liquidity which leads to risk asset appreciation.



Source: Bloomberg Finance LP, Federal Reserve. Shaded regions reflect implementation, announcements took place just prior.

Asset Class Performance Review

Clint Pekrul, CFA

Despite the many headwinds this year – higher inflation, another wave of COVID – equity markets in general have been fairly resilient in 2021. Over the past three years, the flagship S&P 500 Index has delivered a compound rate of return of roughly 21%, and is on pace to deliver an annual return over 20% for the second time in the past three years. These returns have sent valuations to extremes.

Conversely, higher interest rates have pushed most fixed income indexes lower for the year. Yields have edged higher since their historic lows from march of 2020. Inflationary pressures could continue to push rates higher.

Below is a review of asset class performance for the year (through November 26th). Performance is based on index total returns provided by S&P.

U.S. Equity Factors

Factor Index	Return
S&P 500 Momentum	21.1%
S&P 500 Value	22.2%
S&P 600 Small Cap	24.2%
S&P 500 High Quality	23.3%
S&P 500 Low Volatility	15.3%

Returns have been fairly strong across the U.S. equity factors for the year. Compared to 2020, performance across the factors is fairly similar, with the exception of low volatility stocks. Value has rebounded after underperforming last year. As the economy recovers from the COVID pandemic, we are seeing broader participation in the equity markets and less concentration in momentum stocks.

International Equities

International Index	Return
S&P Global BMI x US	5.9%
S&P Europe BMI	10.2%
S&P Asia Pacific BMI	1.7%

Overall, returns for international equities have lagged domestic equity indexes for the year. On a relative basis, European stocks have outpaced equities in the Asia Pacific region. Growth prospects overseas aren't quite as robust as in the U.S. In addition, the COVID pandemic has hit international markets particularly hard. Still, from a valuation standpoint, overseas markets aren't quite as expensive as domestic equities.

Fixed Income

Fixed Income Index	Return
S&P Aggregate Bond	-1.1%
S&P Mortgage Backed Bond	-1.0%
S&P Investment Grade Credit	-1.2%
S&P High Yield Bond	2.3%
S&P Long-Term Treasury	-3.4%

Interest rates have increased in 2021, which has resulted in a decline for most fixed income indexes. The benchmark 10-year Treasury yield began the year at roughly 0.9% after falling after the onset of COVID in 2020. The yield rose quickly in the first quarter of 2021, but then receded and is now trading at roughly 1.5%. As a result, fixed income recovered some of the losses from earlier in the year.

The major components to the aggregate bond index – mortgage backed and investment grade bonds – are lower by roughly -1.0% for the year. Longer-duration Treasuries, which are more sensitive to changes in interest rates, are lower by a wider margin. However, credit conditions remain favorable. High yield bonds, which carry higher coupons than investment grade bonds, are actually higher for the year despite an uptick in rates.

Dividend Paying Equities

Dividend Equity Index	Return
S&P Dividend Aristocrats	19.9%
S&P INTL Dividend Aristocrats	11.0%

After underperforming in 2020, dividend paying stocks have rebounded in 2021. The current yield for dividend stocks in the U.S. is roughly 2.3%. Likewise, dividend yields overseas are roughly 4.8% due to lower valuations.

In summary, equities are on pace to deliver double digit returns this year, despite inflationary headwinds and the potential for another outbreak of COVID. Performance across U.S. equity factors is more balanced this year compared to 2020 as the economy recovers from the onset of COVID.

International equities continue to lag their U.S. counterparts, mainly due to lower growth prospects. However, overseas markets could present a value opportunity.

Fixed income, while lower for the year, has recouped some of the declines from the first quarter. However, inflation could likely be a headwind for bonds in 2022. Dividend paying stocks could be an attractive alternative for current income.

Q: What do you expect the impact to be of a 2nd term for Powell as Fed Chair?



I think it was smart of President Biden to re-appoint Chairman Powell at this time. Everything has become so politicized in the world and there is no way for the Fed to remain 'apolitical' at this point. However, had he not followed the customary path of providing a 2nd term for the Fed Chair it would have appeared to be politicizing the Fed to a greater degree. Powell remains a steadying hand between the wish lists of the progressives (think Modern Monetary Theory) and the fiscal conservatives/moderates who are still concerned our borrowing today will saddle future generations with a crippling debt burden. Powell has the respect of both parties and like a good referee, that means he angers both sides of the Fed policy debate from time to time. Maybe the best word to describe Chair Powell's leadership is sensible. I expect he will continue to lead the Fed in a sensible way, willing to err on the side of accommodation over short-term inflation, but with the will to take decisive action if inflation warrants.

The other impact of Powell serving a 2nd term as Chairman is who will not become the Chair, at least for now. Lael Brainard was aggressively promoted by progressives as their preferred choice for the Fed Chair. A Harvard educated economist, Ms. Brainard refused to provide an answer to Congress when asked if she was a Capitalist or Socialist.



If there is one thing investors look for out of the Federal Reserve, it's continuity. Biden's pick for Jerome Powell to serve a second term dismissed concerns that the president would select an unknown to run the nation's central bank. Continuity at the Fed is critical now, particularly with the recent uptick in inflation and the prospect of higher interest rates. Prior to Powell's renomination, there were concerns that Biden would fold to political pressure and partisanship from Congress to remove Powell, but by nominating Lael Brainard as vice chair, Biden appeased the progressives on the left.

One of the biggest challenges that Powell will face in his second term is deciding when to remove all the stimulus support enacted during the pandemic. While the Fed has slowed the pace of its bond buying program to provide liquidity, it has held interest rates near zero. With inflation ticking higher, the Fed may be forced to raise rates, which would likely hamper growth. Lower growth expectations coupled with higher rates would likely put downward pressure on financial markets. Likewise, any move from the Fed that is seen as a detriment to the economic recovery will be likely met with fierce political opposition. So, Powell has a balancing act in front of him in the years to come. He's shown in his first term that he can rise above political pressures and do what he thinks is in the economy's best interest.

Q: What should be on every investor's Christmas list?



It is indeed that time of the year when lists are made in hopes that Santa will come to the conclusion that we were more nice than naughty this last year. Most investors have enjoyed 2021 with a few notable exceptions, so let's consider what we think every investor should be asking for this Christmas.

#1 – A Fed Chairman who fears inflation.

Inflation is the enemy of savers and excess savings is used to provide capital to bring about economic opportunity and growth. As noted in the prior question, I believe investors received an early Christmas present with the re-appointment of Jerome Powell as Fed Chair, given the policy uncertainty of the Fed Governor most believe was the alternative.

#2 – Volatility to go into hibernation.

The wicked smart team at Crestmont Research published data on just how important it is to understand the impact of volatility on investment portfolios. When volatility is muted, it historically has meant a great time to own risk assets like stocks. When volatility rises, particularly in the top quintile, risk assets tend to perform poorly.

#3 – A slow leak in the Chinese real estate bubble.

Bubbles need to be deflated so we do not wish for an expansion of the bubble, but that air will slowly leak out instead of a bursting. There is enough global liquidity if everyone plays nice, while an abrupt ending to the China debt bubble could send the world economy reeling.



Well, I think the first item on any investor's list should be an end to the Covid situation. The pandemic has brought havoc to people's lives and turned the global economy on its head. Effective vaccinations will hopefully bring the virus under control and allow people and business to return to normal. From an investment standpoint, there are two things of critical importance that investors should wish for. First, the Federal Reserve needs to get their inflation call right. Obviously, inflation is ticking higher, and if the central bank raises rates to quickly to combat rising prices, we risk an economic slowdown and possible stagflation. Conversely, if the Federal Reserve is too slow to raise rates, inflation could become more of a problem. If the Fed gets the call correct, investors will be happy.

Second, investors should hope that forward earnings will ultimately support current valuations. The S&P 500 is trading at an extreme multiple based on historical averages. This could continue if companies report solid earnings. The risk, however, is that we've come too far too fast with respect to valuations. The risk to the downside seems to grow with each passing year. So, hope for strong earnings support in the year ahead. In summary, if the Fed can successfully balance the interest rate and inflation equation and earnings meet or beat expectations, 2022 could be a promising year.



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