



Our Weekly Paid Newsletter

Richard Cluver Predicts

In our 36th year of service to the investing public of South Africa



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06 January 2023

If you are surprised to receive this column which normally goes out only to a few paying customers, it is because I have opted to temporarily open it up to everyone on my personal database in order to give everyone a taste of what my long-standing and loyal subscribers are content to pay for.

Furthermore, I am hoping that more of you might be prepared to participate in the charity project I launched back in November. In a nutshell, I offered everyone a half-price subscription to our ShareFinder 6 share market software in the hope that they might donate a portion of the saving to charity and thus participate in our "Great Experiment" which aims to prove that donors are rewarded multiple times in the great scheme of things. You can read more about that at the end of this column!

Now I am extending that half price offer to those who might like to subscribe to my Prospects newsletter. Usually it costs \$38 a year to receive both the monthly Prospects newsletter and the weekly Richard Cluver Predicts column but during the month of January you can subscribe for just \$19. Existing subscribers who want to take advantage of this can, for the same fee, add on 12 months to their existing subscriptions. Hopefully, those taking advantage of this offer will also come aboard by making a donation to the St Marys Foundation Trust. Go to www.sharefinderpro.com to access the offer.

In case you missed the detail of the December offer, I have added the November Investor column to the end of this one. More important to every reader, I am sure, is how well they have done using the information published in these columns and so I need to explain to new readers that in the Prospects monthly service I maintain four virtual portfolios; one each in New York, London, Sydney and Johannesburg. Whenever I intend either selling or buying new securities in these I provide a proposed buying/selling price and a probable time horizon so every reader is able to mimic the portfolios.

The South African portfolio has been running since January 2011 and our initial investment of R1-million has grown to a current R5.3-million. That is a compound annual average growth rate of 17.8 percent which, together with an average dividend yield of 3.4 percent, represents a world record Total Return rate of 21.2 percent annually compared with the JSE All Share Index compound annual average of 7.1 percent and average dividend yield of 6.1 percent making a total return of 14.2 percent. IE the Prospects Portfolio has done 50 percent better than the index throughout its life!

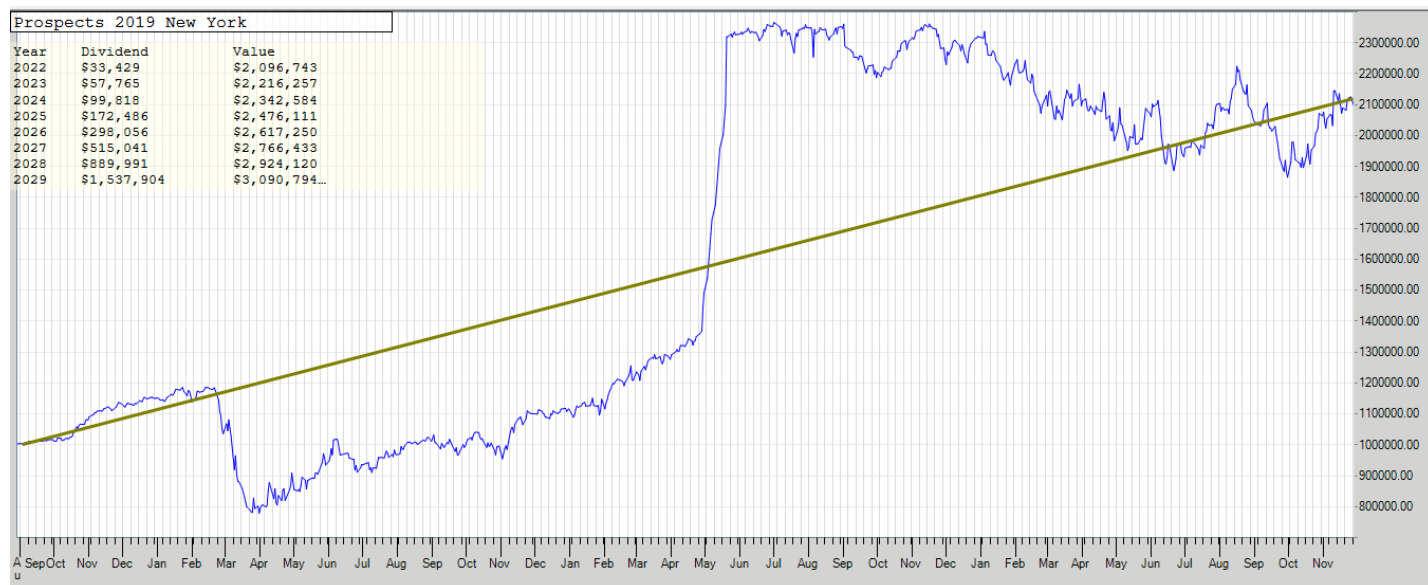
It is illustrated in the graph below by the green trend line. The red trend line superimposes the 4.53 percent average annual gain of ALL South African unit trusts that have existed for ten or more years while the yellow line highlights the 38.8 percent compound average growth rate of the SA portfolio since March 2020



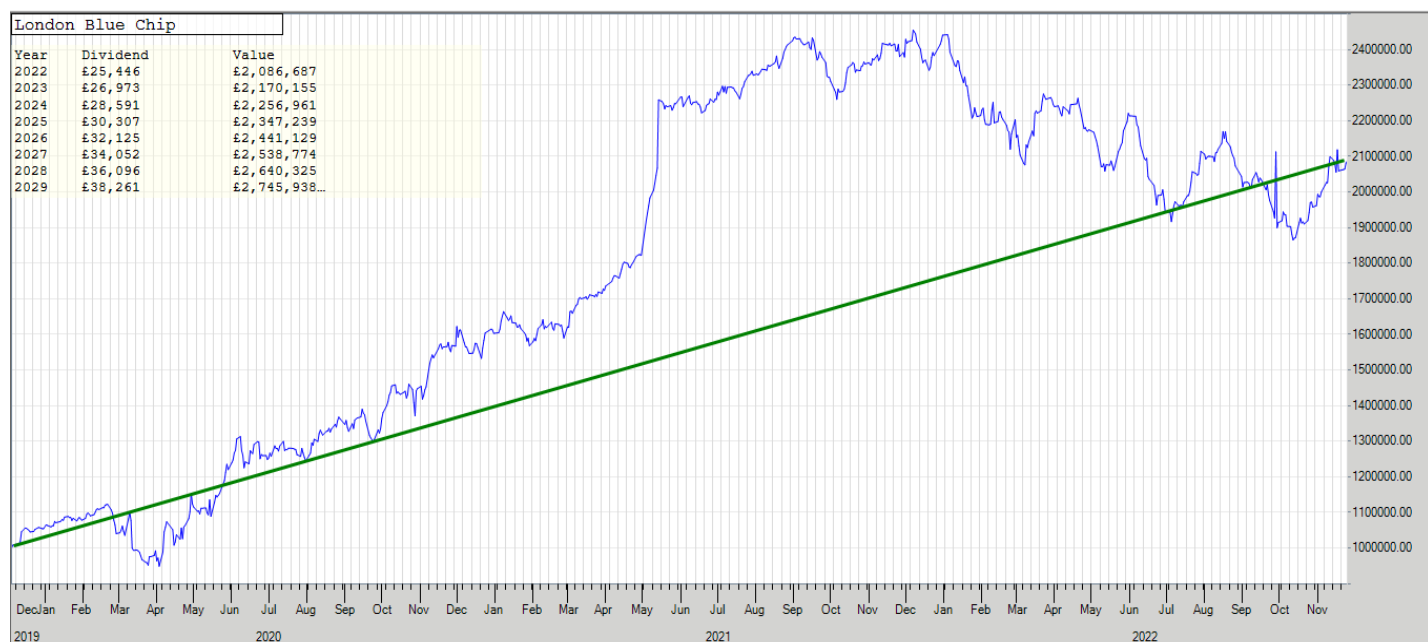
Assuming the SA portfolio continues its past average growth rate it is projected to be worth R21-million in ten years time.

Our overseas portfolios were started much later and so, although they are currently performing much better than the South African one, it would be unwise to put too great a store by their achievements. However, for comparison's sake I have included them so readers can form an idea of how well they are doing.

Let's start with our New York portfolio which we launched in September 2019 and which, despite having operated through the two greatest share market crashes of the past half century has to date more than doubled in value and delivered a compound annual average value growth rate of 25.8 percent together with a dividend yield of two percent making a total return of 27.8 percent. Compare this with the 10.4 percent total return of Wall Street's representative S&P500 Index composed of an 8.7 percent compound average growth rate and an average dividend yield of 1.7 percent.

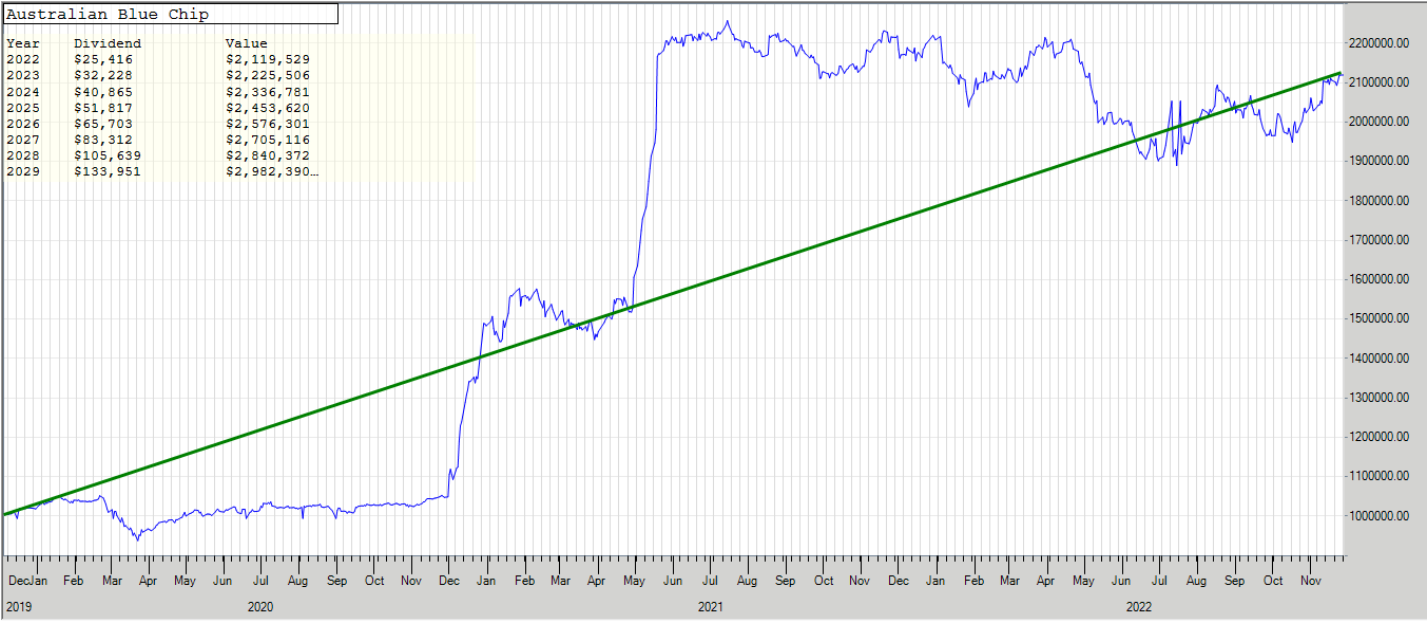


Our London and Sydney portfolios were similarly started in September 2019 and so have similarly existed through the two greatest share market crashes of the past half century. Here we invested one million pounds and one million dollars respectively and have seen our London investment grow to £2.117-million and deliver a composite dividend yield of 1.3 percent. That, as the green trend line highlights represents a compound annual average growth rate of 27.96 and a total return of 29.26 percent. Again the green trend line highlights the London track record.



In contrast London's Financial Times 100 Index delivered a mediocre one percent compound average growth over the same period while delivering a 3.68 percent dividend yield making a total return of 4.68 percent.

Our Sydney portfolio has delivered compound 28.68 percent annually together with a dividend yield of 2.3 percent making a total return of 30.98 percent which is a dramatic five times better than the 6.13 total return of the Australian All Ordinaries Index growth rate of 2 percent compound and average dividend yield of 4.13 percent.

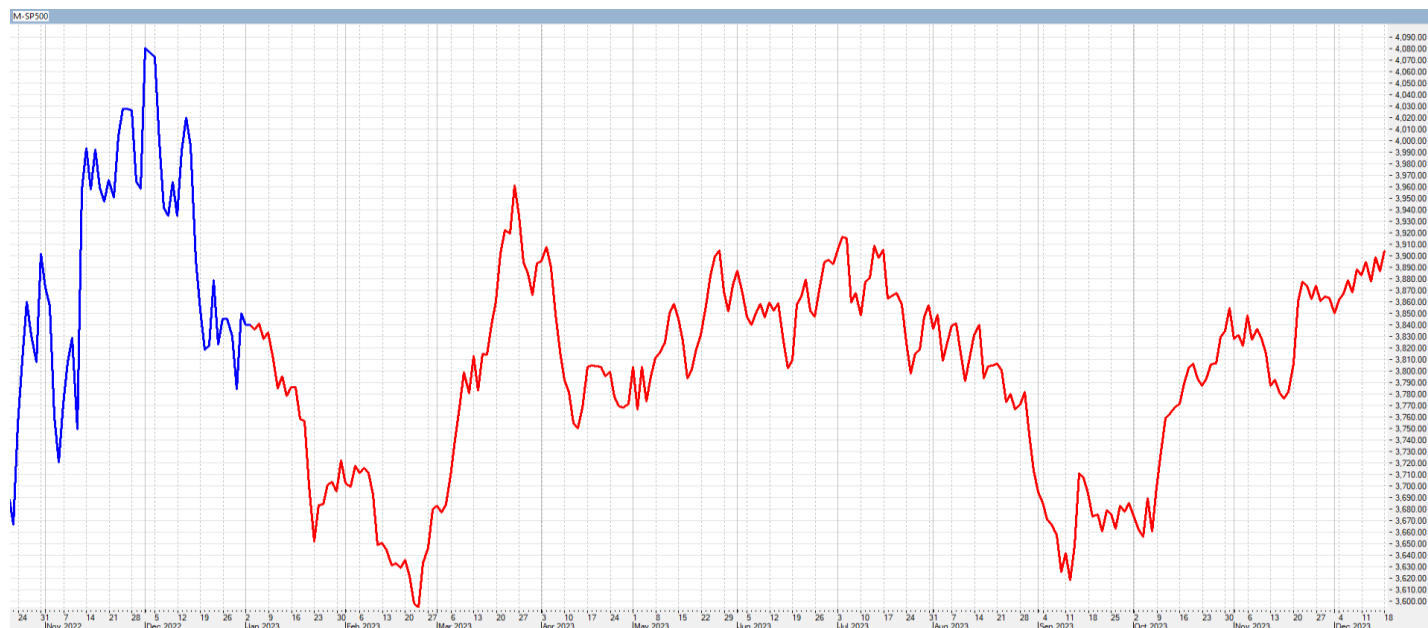


Overall, if you care to calculate it, our four portfolios have done 3.17 times better than the market average which, so far as we have been able to determine from internet searches, is an ongoing world record which conclusively proves the superiority of the ShareFinder computer system which powers them.

But the superiority of ShareFinder does not end there. It is able to forecast the future of both markets and individual shares to guide investors buying and selling strategy which we audit weekly and thus know it averages an accuracy rate of 95 percent. Thus, in the following graph ShareFinder projects the likely performance of the Prospects Portfolio during the coming year with an annual peak predicted for March 30 followed by a decline to the first week of July before a steady recovery begins:



ShareFinder similarly projects that Wall Street will continue falling until late February before recovering in March and then continuing its decline until early September before beginning a fresh recovery lasting until the end of the year.



To end this column, I asked ShareFinder to create a new million-rand South African portfolio for someone who can afford to take considerable risk in order to achieve the highest possible growth in this New Year. This is its offering:

Full Name	Quantity	Action	Price
	0.00	Inject Cash	1 000 000.0000
A E C I LIMITED	1 117.00	Buy Shares	89.4800
ANGLO AMERICAN PLC	150.00	Buy Shares	665.5000
ANGLO AMERICAN PLATINUM CO...	68.00	Buy Shares	1 468.6900
BHP GROUP PLC	190.00	Buy Shares	524.6100
CAPITEC	53.00	Buy Shares	1 878.6800
CLICKS GROUP LTD	364.00	Buy Shares	274.1300
E Media Holdings Ltd	24 154.00	Buy Shares	4.1400
SABVEST CAPITAL LIMITED	1 183.00	Buy Shares	84.5000
TRANSACTION CAPITAL LTD	2 953.00	Buy Shares	33.8600
TREMATON CAPITAL IMVESTMEN...	29 411.00	Buy Shares	3.4000

In turn I asked ShareFinder to create a high growth South African portfolio for someone who could only afford very moderate risk. This is what it offered:

Name	Full Name	Quantity	Price
*Cash		0.00	1 000 000.0000
AFRO-C	AFROCENTRIC I...	33 134.00	5.0300
ANGLO	ANGLO AMERIC...	250.00	665.5000
CAPITEC	CAPITEC	88.00	1 878.6800
INVPROP	INVESTEC PROP...	17 618.00	9.4600
MIXTEL	MIX TELEMATIC...	33 400.00	4.9900
TRANSCAP	TRANSACTION C...	4 922.00	33.8600

Finally, did you know that, despite all of humanity's recent technological advancements, we're still considered to be living in the same geological epoch (the Holocene) as our hunter-gatherer grandparents did nearly 12,000 years ago? That could [soon change](#). By the end of the year, scientists are expected to decide whether there's clear evidence that the Earth has entered a new epoch called the Anthropocene, which would reflect humans' profound impact on Earth's geology through industrial and radioactive materials.

The month ahead:

New York's SP500: I correctly predicted the market would go down-hill and I continue expect it to be negative until late-February when, following a brief recovery it will be down-hill again until September.

Nasdaq: I correctly predicted declines until mid-February when, following a brief recovery it will be down-hill again until September.

London's Footsie: I correctly predicted declines which I still expect to last until mid-February followed by a long recovery to late October.

France's Cac 40: I correctly predicted the market trend would be downwards until late February followed by a long recovery to June.

Hong Kong's Hangsen: I correctly predicted a market peak which I expect to happen at the end of this month followed by a decline until late April before a long recovery begins.

Japan's Nikkei: I wrongly predicted gains until early January ahead of a decline until early May. Now I see losses until late April before the recovery sets in.

Australia's All Ordinaries: I correctly predicted declines which I still expect to last until mid-February followed by gains until late August.

JSE Top 40 Index: I correctly predicted the market would peak at the end of December followed by a steep decline. Now I see the gains being extended to late February before a long decline sets in.

ShareFinder JSE Blue Chip Index: I correctly predicted declines until early-January ahead of a tepid and volatile upward trend to the end of the year.

Rand/Dollar: I correctly predicted weakness to re-emerge but wrongly expected it to last until early-March. Now I see gains to the end of February before weakness sets in to early March. Long term, however, I see extended gains to the end of the year.

Rand/Euro: I correctly predicted a resurgence of strength through to mid-January followed by weakness until late March ahead of an extended period of gains.

The Predicts accuracy rate on a running average basis since January 2001 has been 86.86 percent. For the past 12 months it has been 94.96 percent.



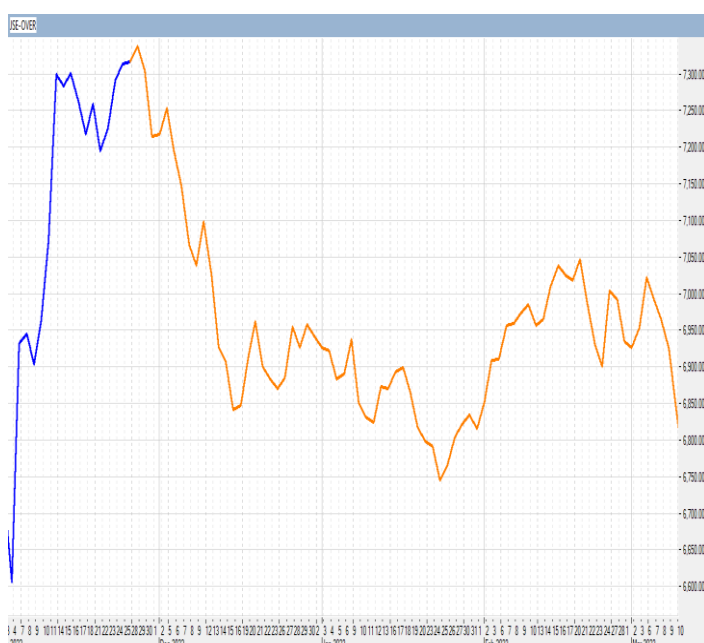
Our Monthly Free Newsletter

TheInvestor

In our 35th year of service to the investing public of South Africa



ShareFinder's prediction for Wall Street for the next 3 months (left) and the JSE (right).



You can help me to test the world's oldest investment theory!

By Richard Cluver

I have long awaited the opportunity to test one of the world's most ancient and most revered investment theories and now the signs are perfect for me to do so. So I am calling on ALL my readers to help me solve one of mankind's deepest mysteries.....and enjoy a **ShareFinder Black Friday opportunity at the same time!**

If the belief is a provable reality, it has the potential to fundamentally change the world we live in and usher in a completely new era for charities which have seemingly forever existed on the scraps of society's goodwill!

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Much older than modern religions, the belief is nevertheless best encapsulated in the biblical book **of Malachi 3:10** which states: *“Bring the whole tithe into the storehouse, that there may be food in my house. Test me in this,” says the Lord Almighty, “and see if I will not throw open the floodgates of heaven and pour out so much blessing that there will not be room enough to store it.”*

But the belief goes back to far earlier times. In the writings of the ancient Greeks there were numerous references to tithes of the annual harvest and to tithes of spoil taken in battle. Delphi, Delos, and Athens are mentioned as recipients of tithe offerings made to the gods. The offering of first fruits and of tithes seems to have also been quite closely associated.

It is a view which kept the ancient Jewish temple flourishing, was at the heart of Roman economics and for over fifteen hundred years ensured that the Roman Catholic Church was the most powerful financial institution on earth. Today, a fervent belief in the principle of giving has furthermore ensured that, for example, among the poorest social groupings in Africa there are pastors who own private jets while, with the rise of Quantum Physics, white-coated scientists claim laboratory proof that what mankind believes fundamentally changes the physical nature of our universe.

Of course it does not only apply to religious belief for it is founded upon the concept of helping one another which is the primary attribute which ensured that mankind became the apex species on Planet Earth. It has, however, been powerfully built into Christian dogma which, as cynics observe, has obviously greatly benefitted the priesthood.

I have long been numbered among the sceptics. However, throughout my life I have encountered so many folk whose opinions I have respected who have sworn to the truth of it in their own lives. So I have never been able to fully ignore their reality. But is it just a religious touchstone or, as the ancients believed, an esoteric reality that has nothing to do with a belief in celestial deities and is in truth actually a fundamental and inexplicable reality of the human condition?

Most importantly, does it really work?

With financial markets in their worst disarray since the onset of the 1929 Great Depression, this seems to me to be the best ever opportunity to attempt an empirical test of the belief because investors really need all the help they can receive at present.

With that in mind I have persuaded ShareFinder International to be the first in a round-robin exercise of charitable giving. Thus, subscribers who take up a subscription to the ShareFinder Professional programme during the months of December and January will receive **a 50 percent discounted festive season price** in the hope that such beneficiaries will in turn give some of the benefit to charity. What that means is that any South African who cares to take part will be able to subscribe to the ShareFinder software at an annual saving of R1 050: that is exactly half the normal cost of R2 100 per year and they will be invited to give, at their own discretion, as much or more of that saving to a registered charity. You can access the special offer by going to www.sharefinderpro.com

There is no compulsion to donate and all who participate will be in line for FOUR additional bonuses which, some might argue, will immediately prove the veracity of the ancient belief....confirming, for example, what we already know about events like the Black Friday discount sales which are known to benefit retailers by, on average, an additional at least 20 percent of annual sales!

- The charity I have chosen is the St Marys Diocesan School Foundation Trust which is able to provide donors with a Section 18A tax credit certificate to offset the donation against their annual income tax liability.
- Furthermore, they will receive a FREE subscription to my Prospects newsletter service representing a saving of R650 a year. .

- In addition, I have just published a new book entitled '**Hope**' which looks at the major challenges facing contemporary society and highlights the many solutions that are already underway. Everyone who participates will receive a free copy which would normally retail as an E-book at R90.
- Finally, for those who participate, these reduced rates will continue to apply for the next THREE years.

If you care to calculate it out, the implication for South Africans who currently pay the top marginal tax rate of 45 percent and elect to donate the entire benefit of R1 050, the latter will be able to deduct that sum from their annual taxable income yielding them an effective bonus of R472.50. In addition, together with the saving on the book cost and the fact that they will not have to pay for a Prospects subscription for the next THREE years nor pay for the book with after-tax money, they will effectively get back a total of R3 915.

Potentially this is a massive saving. I should furthermore add that, in recognition of the weakness of the South African economy, the usual South African subscription of R2 100 a year is already heavily discounted from the normal international charge of US\$49 a month. It also includes ALL daily market data update costs, namely both share price data and the fundamental statistics of all companies listed on the Johannesburg Stock Exchange, the London Stock Exchange, the New York Stock Exchange, the NASDAQ Stock Exchange and the Australian Stock Exchange.

Notwithstanding the obvious cost savings that donors will enjoy, they might take further consolation from the fact that, not only will they be donating to a truly worthwhile charity, they will also be participating in an experiment which could profoundly change global attitudes towards charitable giving. After all, if this experiment can show that the largely religious belief that those who give to charity are rewarded, as many authorities testify, "... at least ten-fold and even a hundredfold," most investors would be foolish to in future NOT give in abundance to charity.

Now my choice of one of South Africa's leading private schools as the potential donor recipient might at first glance surprise some. St Mary's in KZN is obviously an institution serving the daughters of South Africa's well-heeled families. However, in an era in which South Africa's public institutions of education are in terminal decline, private schools like St Marys have become the ultimate custodians of educational best practice. They are, as I so often tell everyone who will listen, akin to the monasteries of the Dark Ages which for over a thousand years kept education and learning alive following the collapse of the Roman Empire.

Without them there would have been no Industrial Revolution and, instead of sitting before a computer each day, people like you and I would have been working the fields from dawn to dusk to try and put food on the tables of our starving families.

The St Mary's Foundation Trusts exists to provide bursaries for scholastically-promising girls whose families cannot afford to pay private school fees. As a trustee of the fund, I have long been involved in guiding its fortunes and so I can confidently say that your participation will give a boost to a trusted and very important South African educational cause.

But how will we conduct this test?

To start with, ShareFinder International will be making a substantial gift to the investment public and so its own revenue stream might be expected to be profoundly increased if the belief is grounded in fact. And that is, of course, easily measurable.

But there is another knock-on to measure. Readers of ***The Investor*** and investors generally who wish to take advantage of the 50 percent discount will be invited to make a gift to the St Mary's Foundation Trust (Details for donating to the trust will be sent to everyone who takes advantage of the ShareFinder offer) whose administrators have in turn agreed to supply ShareFinder with a coded return which will, over the coming year, both protect the anonymity of donors but nevertheless allow them to compare their generosity with the performance of their investment portfolios within the ShareFinder system.

In order to comply with SARS requirements for the issuing of Section 18A tax deduction certificates, charities are required to record the name, e-mail address and physical address of each donor and so when you apply for the discounted package ShareFinder will supply those details to St Mary's. Then, depending on the level

of individual donor generosity, the school will in turn supply ShareFinder International with a coded response which will enable them to link nominated share portfolios to the levels of individual giving.

I should add that in the interests of protecting your privacy, NO curious ShareFinder staff member will be able to determine who gave how much because the process of portfolio observation will be automated in order to ensure that donor privacy is scrupulously protected. Qualified auditors will, however, be allowed to sample this process in order to assure that the results we achieve are above reproach.

We will work in groups of 50 subscribers and so ten percent of participants - that is up to five in every 50 who apply - will be allowed to use the software without donating anything to the charity. These five will represent our control group and, if the ancient belief holds true, their personal portfolios might be expected to continue to decline in value in line with the broadly anticipated declining market trends during 2023.

At the opposite end of the scale, those who donate more than the annual subscription saving of R1 050 to the charity might expect to at least gain tenfold or more if the ancient belief is true.

So, for example, in the case of these first five who elect to give nothing, St Marys will send ShareFinder the code *0. Those who give ten percent of more will be coded *10. Those who give 50 percent or more will be denoted by the code *50 and those who give over 100 percent will be denoted *100.

My long association with the ShareFinder programme has made me confident that participants in this **Great Experiment** will, in the form of the ShareFinder Professional, be getting the finest investment tool available on the world stage, a fact attested to by the proof that ShareFinder's auto-generated 'Prospects Portfolio' has over the past decade delivered the highest compound average investment growth of any fund that our analysis of the worldwide investment fund industry has so far uncovered. Thus they will obviously be off to a flying start.

But the rest will lie in the lap of God!

A new Richard Cluver book

If you are planning on a relaxed holiday season with the opportunity for some serious reading, then Richard Cluver's latest E-book might be just what you are looking for.

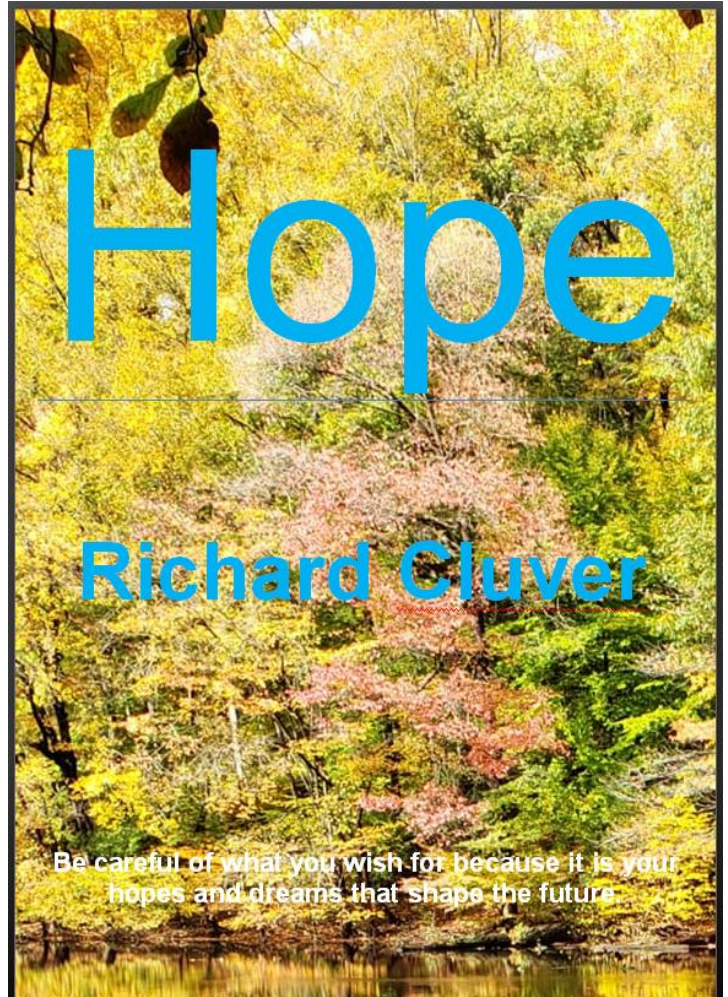
Explaining the genesis of his latest offering, Richard writes: "This study began with the working title 'Apocalypse'. But later, as I came to understand the immutable cycles of renewal which have marked our species since the very beginning, I began to glimpse the new springtime that was overtaking us and I renamed it 'Apocalypse Averted.' Finally, I have begun to sense the truth about mankind's ultimate destiny and so I have renamed it a third time. I have simply called it 'Hope.'"

Beginning as a sequel to his 2019 work '**The Crash of 2020**' which predicted a Black Swan event originating in China which would devastate the world and set in motion the economic crisis that is even now unfolding, Hope is an attempt to trace mankind's journey from hunter-gatherer in the Cradle of Mankind to apex life form and the challenges we have faced along the line: how we dealt with them and how we are likely to solve the major crises we now face, finally posing the question, 'Are we about to evolve into Gods?'

Underlying it all is the imponderable question of why, after ten million years of living as a hunter-gatherer whose lifestyle provided for all his needs in return for just two hours of work a day, around five thousand years ago mankind abruptly abandoned that life and committed himself to the back-breaking 14-hour work-day of the farmer and the inevitable attendant problems of modern society where today global warming and nuclear war offer us annihilation and where political and monetary mismanagement have bound our species into unconscious slavery from which science is pointing ever more strongly to our final evolution.

An intriguing attempt to answer many of mankind's most pressing contemporary problems, the fittingly-titled book points us towards a bright future which, if Richard Cluver is correct in his extrapolation of current social trends, another evolution will lead us to an imminent future in which, in his words, mankind is: "...about to become Gods!"

Hope is available as an E-Book at a cost of \$5 from www.sharefinderpro.com or free for those participating in The Great Experiment mentioned in the previous story.



The folly of a wealth tax

By Garth Zietsman

Government is proposing a tax on the wealth of the richest 1% of individuals (354,000 of them), at rates of 3-7% of wealth above R3.6 million. They expect to easily collect it (because the number of people is small, and the required information is already available) and to raise R143-billion.

The architects justify the tax on the grounds that we need it to start equalizing wealth across the country. I doubt that government will use it to equalize wealth at all. I am confident that already wealthy politicians, and those with political connections, will end up using it to further enrich themselves instead. Still, even if we assume the plan is honourable, a wealth tax is very unlikely to result in long term wealth increases for the poor, or long-term wealth redistribution.

R143 billion is a tiny fraction of the amount needed to even start the process of wealth equalisation. Even if government taxes wealth in such a way that all adults end up with equal wealth after redistribution, the level of wealth gained by the poor would be pitiful. If history is any guide, then they are almost certain to lose that new wealth within a generation. For example, there were eight land lotteries in the US state of Georgia between 1805 and 1833. Follow-up studies showed that the poor who were lucky enough to win land did little to benefit themselves or their families with their newfound wealth, other than use it to increase consumption. Few retained it after one generation.

An approach much more likely to increase the wealth of the poor is to improve their productivity. Many things contribute to their productivity, e.g., their skills, their ability to trade those skills and labour, capital investment, the overall entrepreneurial and technical innovation environment they are embedded in. Note that the last three depend to considerable extent on those whose wealth government intends to tax. If it ends up annoying them enough to leave, it is likely to backfire and worsen the wealth of the poor.

Those who do not go will respond by diverting resources toward professionals who can help them evade the tax, thereby wasting investment and diverting professionals from productive activities.

The architects of this wealth tax plan defend it by claiming that it will not discourage employment because it will make the fiscus more sustainable, and that in turn both spares the vulnerable while the economy recovers from Covid and attracts more investment. A more sustainable fiscus would attract more investment but the prospect of a tax on the wealth generated by investment is likely to discourage investment. There is already an exodus on the go of high tax paying individuals, and a wealth tax will certainly speed it up, with a resulting shrinkage of an already small tax base. Their expected 30% evasion rate supports this view. The result will be a less sustainable fiscus and less employment.

Then there is the question of whether a wealth tax has any long-term sustainability. Some elite economists think it would, at best, be a one-off effort.

That aside, if government is determined to tax wealth gains, they would raise much more money by reducing size and/or privatizing government owned enterprises. The government also owns a great deal of land. The wealth of the poor – at least in the short term – would improve immediately if government parcelled that land out to the poor, in the form of title deeds.

Garth Zietsman is a statistician who analyses and writes for the Free Market Foundation. The views expressed in the article are the author's and not necessarily shared by the members of the Foundation

Corruption and consequences

JP Landman

Once a year, usually in August, I do an update on the fight against corruption. This year I delayed it because the head of the National Prosecuting Authority (NPA), Shamila Batohi, committed in May to Parliament that nine 'high-profile' state capture cases would be brought to court by the end of September 2022.



Below is a summary of the status at the end of September:

1. In June, a month after Batohi made her commitment to parliament, the two Gupta brothers were arrested in Dubai on an Interpol Red Notice initiated by the Investigating Directorate (ID) in South Africa. The ID is a specialist unit inside the NPA set up in 2019 by Ramaphosa to do state capture prosecutions. In July South Africa asked for the extradition of the Gupta brothers, which will now be determined by a court in that country. The brothers have applied for bail on several occasions but are still incarcerated. Given the high life they were used to, their continued incarceration must be cramping their style.
2. In the Vrede Dairy project (aka Estina) case, 17 accused, including former cabinet minister Mosebenzi Zwane and two erstwhile Gupta companies, Sahara Computers and Islandsite, were charged with fraud, theft, corruption and money laundering. Gupta associate Iqbal Sharma was also arrested and charged. He spent a few nights in jail and then got bail. Given his notoriously lavish lifestyle, the few nights in jail must have been uncomfortable. The High Court also issued an unlimited restraint order of R520 million against his assets, his company Nulane and the Gupta company Islandsite. After having been charged, Zwane stepped aside from his positions in the African National Congress (ANC). The step-aside rule is clearly being adhered to.
3. In the Free State asbestos case, Ace Magashule and 18 other accused were arrested and appeared in the dock. Having lost in the High Court, Magashule wanted to 'test certain principles' in the Supreme Court of Appeal, which has led to the criminal case being postponed to 20 January 2023. Magashule was suspended from the ANC in 2021 when he did not voluntarily follow the step-aside rule. Ironically, these legal tactics are taking him out of the ANC elections in December.
4. In the South African Express case, four people were arrested by the Hawks and charged on 34 counts of fraud allegedly committed in the North West provincial government in 2014. It has taken a long time, but it is happening.

5. In the Winnie Madikizela-Mandela museum case, six people and two companies (two firms of architects) were accused of fraud; contravening the Public Finance Management Act, 1 of 199, and the Municipal Finance Management Act, 56 of 2003; and stealing R700 000 between January 2008 and December 2010. It is a puny amount and the alleged offences happened more than a decade ago, but the wheels are grinding.

6. In the Crime Intelligence Division case, both a former (acting) Commissioner of Police, three senior officers from Crime Intelligence, and four businessmen were arrested and charged for irregular procurement processes dating back to 2016. The amounts involved (R33 million and R54 million) are, in the context of state capture, small but the principle speaks for itself. Aside from the criminal prosecution, the Asset Forfeiture Unit also confiscated assets belonging to the accused – 19 immovable properties in Sandton, Pretoria, Boksburg, Springs and Sasolburg, and around 115 vehicles. The high life is over before the prosecution has even started.

7. At Transnet there were some significant criminal and civil prosecution victories:

On the criminal side, Siyabonga Gama, Gary Pita, Phetolo Ramosebudi, Daniel Roy, and Eric Wood were arrested and charged along with former Gupta fixer Kuben Moodley. In August they were joined in the dock by previous heavyweights Brian Molefe, Anoj Singh, Niven Pillay and Litha Nyhonyha – all former head honchos at Transnet and Gupta-related Regiments Capital. Apart from these 10 people, McKinsey was also charged for criminal offences. (Two additional snippets: McKinsey has already repaid R870 million to Transnet.

Moodley was arrested at the airport in September 2021 and had R232 million in assets frozen as part of Transnet's efforts to reclaim excessive consulting fees paid to Regiments and the Guptas.)

On the civil side, Transnet and the Special Investigating Unit (SIU) were successful in having the High Court set aside contracts worth R54,4 billion to acquire 1 064 locomotives from four companies, all original equipment manufacturers. The four include offshoots of one American, one Canadian and two Chinese companies. One of the reasons for Transnet's poor performance is that spare parts for locomotives would not be supplied by the original manufacturers while the dispute about the contracts raged. (Recent news indicates that the spare parts matter may now be close to settlement.)

The Transnet Pension Fund has reclaimed R639 million from Regiments Capital. The Transnet Second Defined Benefit Fund – a different entity – also recovered R350 million from Regiments Capital. As an aside, Regiments Capital was put into liquidation and is fighting to come out, but the South African Revenue Service (SARS) has slapped it with a R700 million claim for unpaid taxes. Nice to see coordinated action by the authorities. The Fusion centre probably played a role in this co-ordination.

Another company action has been taken against the consulting company Bain. Way back in 2018 Bain repaid R164 million to SARS for their nonsense advice there, the CEO resigned and left the country. This September the National Treasury banned Bain for a period of ten years from any public sector contracts in South Africa. Not an arrest, but certainly a consequence for wrongdoing.

8. Just like Transnet, Eskom is one of the biggest sites of state capture. Unlike Transnet, there have been no recent high-profile arrests, but there was one arrest, which may lead to more.

In July two former employees of the South African arm of Asea Brown Boveri (ABB), a Swiss multinational engineering firm, and their wives were arrested and charged with fraud, corruption and money laundering. A contract initially worth R25 million increased to some R526 million following a string of variation orders, awarded to a contractor by ABB (at the behest of the accused, who was at the time working at ABB). Reports indicate the case may involve some former senior Eskom employees, but charges have not been laid yet. Interestingly, ABB has already paid back R1,56 billion to Eskom and as recently as September made a provision for another R6 billion in its accounts to cover possible costs related to corruption probes at Kusile power station. ABB is cooperating with the South African authorities.

Last year I reported that the SIU and Eskom were investigating five companies for over-charging Eskom. The utility recovered R1,1 billion from McKinsey, R150 million from Deloitte and obtained a R600 million court order against Trillian.

The SIU and Eskom have reported to Parliament on misdemeanours at Eskom. It reveals a shocking picture of systemic crime and corruption. The Hawks are investigating 55 cases, 18 more are in the courts, 7 cases have been withdrawn and 3 are still awaiting a decision by the prosecutor. The cases vary from theft of coal, diesel and copper cables to bomb threats, sabotage and tampering with infrastructure.

The SIU investigated unlawful contracts. So far, two contracts worth R10,2 billion were declared invalid and set aside. R3,8 bn is claimed from former directors, managers and private companies.

The SIU investigated 334 employees with links to Eskom suppliers for possible conflict of interest. Some 135 employees were found to have such conflicts. Some were referred to the NPA for prosecution and the rest for disciplinary action. Employees fingered have all left Eskom's employment.

Lifestyle audits were also conducted and 11 employees were referred for disciplinary action. Most were found guilty, others retired or resigned. Where applicable Eskom has applied for pension monies to be frozen. The Special Tribunal has already ordered the monies of several former Eskom employees forfeited or frozen.

It is clear that a lot is happening despite no "high profile" arrest yet.

Puzzlingly, the arrest of four people in 2021 (France Hlakudi, Abram Masango, Mike Lomas and Tony Trindade) on charges relating to a R1,2 billion contract at Kusile has not proceeded further. Lomas was arrested in London at the request of the South African authorities, granted bail of £100 000 by the UK court and is fighting extradition to South Africa. After several postponements and delays, the criminal case here in South Africa is set down for 2 November. We will see whether it then advances to trial. Two of the accused (Abram Masango and France Hlakudi) lost control of their assets when they were hit with R1,4 bn restraint order which froze their assets.

The National Prosecuting Authority

Apart from the above high-profile cases it is worth taking note of the NPA's 'ordinary' anti-corruption work during the past financial year. The Specialised Commercial Crimes Unit in the NPA finalised 388 cases with 344 convictions – a 90,5% conviction rate. The number of government officials convicted of corruption increased by 38% from 86 to 119. Convictions of people in the private sector for corruption increased by nearly 40% from 147 to 205. Freezing orders to the value of R5,5 billion were obtained, a strong 800% increase on the R611 million in the previous year. It is worth noting that in June 2021 more than 800 posts/vacancies were filled in the NPA.

The Special Investigating Unit

The SIU is responsible for reclaiming state resources through civil action. It does not do criminal prosecution, which is the NPA's job. It has the option of bringing civil cases in a High Court, or before the Special Tribunal, also created in 2019 by President Ramaphosa. It cannot put people in orange overalls, but it can deprive them of their ill-gotten loot. The unit has filed at least 50 civil cases to the value of R6,9 billion with the Special Tribunal. When it comes to consequences for bad behaviour, the SIU has been undeniably successful.

It was an order by the Special Tribunal that R150 million can be recouped from various people and entities in the Digital Vibes scandal that led to former minister Zweli Mkhize's downfall. He has not been charged criminally and that is why he judges that he can run in the upcoming ANC elections.

Steinhoff

Since it was probably the biggest corporate heist in our history, the Steinhoff case is worth keeping an eye on.

In June 2020 the Hawks asked PwC to compile a forensic report on the Steinhoff case. At the time Steinhoff said that it would be covering a 'substantial portion of the costs' of the probe. Apparently, the report comprises 31 lever arch files.

In July 2021 the head of the Hawks, General Godfrey Lebeya, reported to parliament that the Hawks were in the process of seeking 14 witness statements from foreign countries, comprising individuals living in Germany, France, Australia and the UK. The Hawks are also in the process of using mutual legal assistance to source 33 foreign bank account statements identified by the audit process. This evidence will be used in a final forensic report that will form the basis of the state's case, should it proceed.

In July 2022 the minister of justice reported to parliament that the 'first leg of the Steinhoff matter has been finalised' and 'mutual legal assistance requests are being finalised'. It is not clear what assistance is being requested from whom, but presumably it will involve the Germans.

It is worth remembering that Steinhoff's offices in Germany were raided by German authorities in December 2015. The Steinhoff bomb exploded two years later in December 2017. More than three years later in March 2021 charges of balance sheet fraud were brought against four accused.

The Germans have a system where a court conducts a pre-trial process to independently assess the likelihood of a conviction. In October 2021 such a court announced the prosecution will proceed against two accused living in Germany and that the other two accused will face the court later. To date no trial has started. It is not just in South Africa where these things take time.

Now the South African Reserve Bank (SARB), has obtained a court order from the Cape High Court to attach assets worth R1,4 billion belonging to Markus Jooste, his wife and his family trust. The court order particularly include the Lanzerac wine estate in Stellenbosch (which Jooste had previously denied that he owned), five vehicles and about R100 million worth of jewellery, art and other assets. It looks like a very comprehensive seizure. The action by SARS is related to suspected exchange control contraventions. Whatever the legal basis, it is no doubt a massive relief for the public that action has been taken. Rest assured that Jooste will fight this order all the way, and unlike the Guptas he is not incarcerated, but the noose is tightening. Now one must watch the criminal process for fraud to play itself out, in Germany and South Africa.

So what?

It is clear that there has been a step change in both the criminal and civil prosecution of state capture miscreants. By the end of September eight new criminal cases had been instituted involving erstwhile very high-flyers.

These former high-flyers include a cabinet minister, a secretary-general of the ruling party, a commissioner of police and several generals, as well as former CEOs. The untouchables of yesteryear are in court.

It is welcome news that not only individuals, but also companies are also being charged. There is no hiding behind a corporate veil as Bain, McKinsey and ABB discovered.

The fact that charges have been brought does not guarantee convictions. Rest assured that the accused will throw everything into defending themselves. But at least the process is being followed as it should.

The NPA itself is on trial as it must now put up a strong performance in getting convictions.

On the civil side, many billions in ill-gotten gains have been recovered. Many people are not in orange overalls yet, but they have lost what they stole.

Preparing for and defending oneself in criminal cases is a major disruption of one's lifestyle and an erosion of status. There is no better example of that than ex-president Jacob Zuma. The country hasn't suddenly become corruption-free over the past year, but more and more people are being held accountable, through criminal and civil procedures. Hats off to the prosecutors.

Why the Fed needs to act to avoid recession

By Brian Kantor



The market reaction to the release of US CPI data shows the extent to which the inflation dynamics have changed. Central banks should take note.

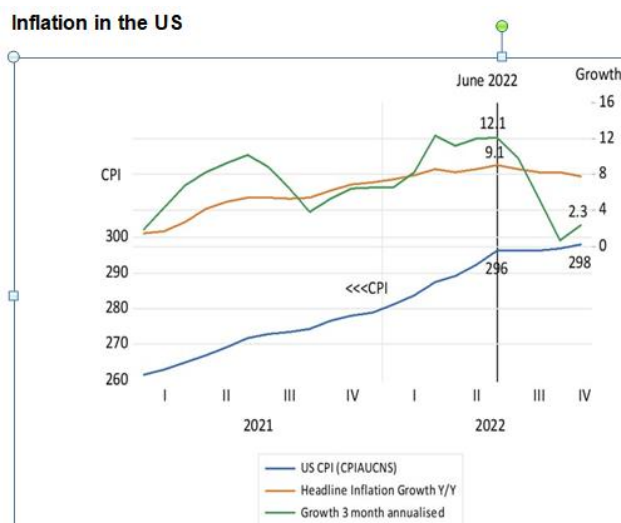
New York on 10 November was one of those days that will be fondly remembered by those with skin in the game in the form of investments in the equity and fixed-income markets. This was the day that the key S&P 500 index added 5.54% to its value by the close of trading and the more IT-exposed Nasdaq added even more, 7.35%. These moves were the largest on any one day since the world came to realistic terms with the damage caused to their economies by the lockdowns of 2020.

Government bonds, which typically make up 40% of any conservatively managed portfolio, also became significantly more valuable as longer-term interest rates receded sharply. The yield on the benchmark 10-year Treasury fell from 4.14% to 3.82, on the same day, the largest such daily move since 2009 (the dollar value of bonds moves higher as yields decline). On the following day, as an illustration, the JSE All Share Index had gained 3.2% by 11h15, while the rand was up 2.7% against the US dollar by mid-morning.

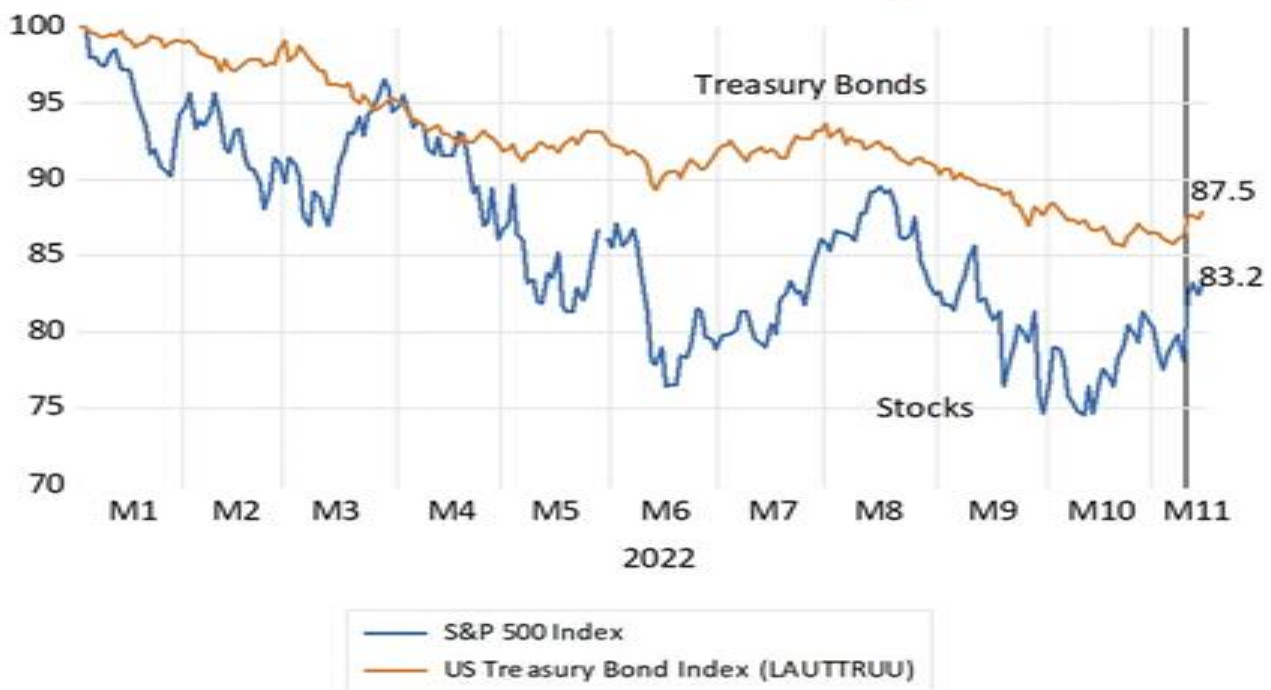
The source of all the good news was unusually obvious. US inflation for October reported that day was surprisingly low. Simply put, the (new) expectation of less inflation implied less aggressive Federal Reserve policies and lower-than-previously-expected short-term interest rates. Furthermore, the higher probability of the US avoiding recession added present value to stocks and bonds. The trend to lower inflation was further confirmed later, with similarly favourable market reactions: producer prices also surprised on the downside with prices rising by a month-on-month 0.2% in October, half the rate expected by the market.

The Fed, having been so completely surprised by the surge in inflation in 2021, seems determined to march the US economy into recession to eliminate an inflation that they seemed unable to forecast with any degree of confidence. Monetary policy has become data-driven, guided by the view through the rear window. This has been accompanied by the fear that persistently high inflation could become a self-fulfilling tragedy for the US economy.

The approach of the Fed seemed to be that, if a recession was the price to pay for avoiding permanently higher inflation, then recession it would have to be, much to the discomfort of the US share and bond markets. For the year to 15 November, the S&P 500 is down by 17% and the benchmark bond index is about 12% lower.



US stocks and bonds in 2022. (1 January 2022 = 100)



Source: Bloomberg and Investec Wealth & Investment, 16/11/2022

But should the Fed and the market have been so surprised? Surely not – if it had been closely following recent trends in inflation and spending by households and firms, then it would have appreciated why inflation had come to a screeching halt since its peak of 9.1% in June 2022. A year can be a very long time for an economy. The consumer price index (CPI), which was 9% higher in June 2022 than a year before, has flat-lined since June 2022. Consumer prices had stopped increasing in June and the increase over a rolling three-month period has slowed to a 2.3% annualised rate. If this trend in the CPI continues, then the inflation rate will still be a high 6.9% at year-end, but will then fall away sharply to less than 1% by June next year. US headline inflation is apparently on a path to zero.

Source: Federal Reserve Bank of St.Louis and Investec Wealth & Investment, 16/11/2022

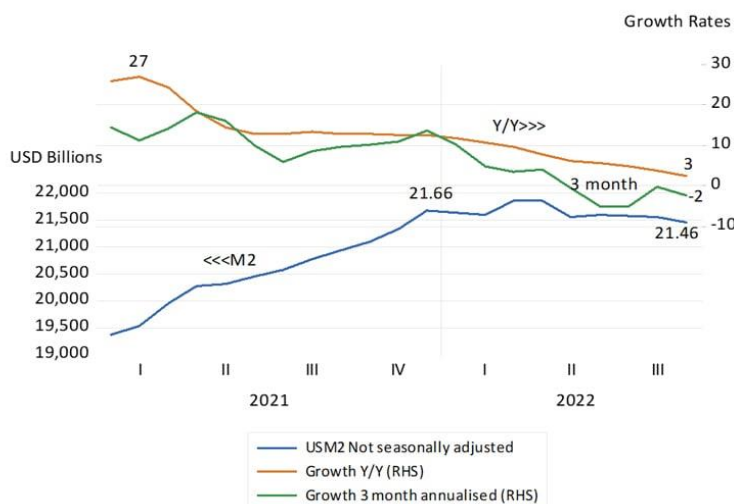
The Fed should be acting accordingly, by recognising that aggregate spending in the US by households and firms has already slowed down markedly and does not threaten higher prices to come. The weakness of aggregate demand is restraining price increases. Higher prices to date have largely absorbed the spending power that was so boosted by vastly extra money supply and Treasury handouts provided in response to the lockdowns. Higher prices have their demand and supply side causes, but higher prices have their negative effects on spending power. Higher prices absorb disposable incomes and spending power. Higher wages – even given full employment in the US – have not fully kept up with higher prices, further restraining spending.

Inflation cannot perpetuate itself unless it's accompanied by continuous increases in the demand for goods, which has not been the case in the US or Europe. The notion, endorsed by the Fed and many other central bankers (including the SA Reserve Bank), that higher prices and wages can simply perpetuate themselves, is a false notion. Inflation expectations soon run aground on the rock of deficient demand and unintended excess inventories. This theory of self-perpetuating inflation will not pass the test of evidence. The Fed and the market should be following the weak trends in spending closely. Ever higher interest rates could in these circumstances turn minimal growth in spending into spending declines – truly the stuff of recessions.

The Fed and the market would also be well advised to pay close attention to the trends in money supply growth. Inflation may be defined as a continuous increase in prices caused by an increase in the supply of money over the willingness to hold that extra money. All inflation is associated with excess supplies of money and the recent inflation in the US is no exception to this well-established rule.

A money supply explanation of the weakness of aggregate spending in the US also helps to explain why the demand for goods and services is growing so slowly. The important monetary facts are that money supply, broadly defined as M2 in the US, is now no larger than it was at the beginning of 2022. M2 amounted to US\$21.62 trillion in January. By September, M2 had declined to US\$21.46 trillion. The year-on-year growth in M2 that had peaked at an extraordinary 27% in early 2021 has slowed to a barely positive 3%, with the three-month growth rates now negative. Growth in commercial bank credit has also slowed down markedly. Year-on-year growth in bank credit was 7.6% in October 2022 while growth in bank credit provided has slowed to an annualised 1.6% over the past three months. The monetary, credit and price trends are pointing strongly to deflation rather than inflation by the end of next year. The market hopes that the Fed will recognise this in good enough time and avoid recession.

Money supply in the US (M2)



Source: Federal Reserve Bank of St.Louis and Investec Wealth & Investment, 16/11/2022

How Inflation Destroys Civilization... and What You Can Do About It

by Doug Casey

According to a recent Newsweek poll, 63% of Americans "strongly support" new government stimulus cheques to combat inflation. In other words, let's fight the effects of money-printing by doing even more money-printing.



The nature of the US has been transformed. Americans have come to see the government as a cornucopia that can kiss everything and make it better—especially since the bailouts of the Biden Administration.

That attitude has become a cultural value and very hard to change. "Panem et circenses," as the Romans said, has become necessary for both the government and its subjects. Remember that the prime directive of any entity—whether it's an amoeba, an individual, a corporation, or a government—is to survive. The present government can't survive without supporting more than half the population, which has become parasites. But the government itself is the biggest parasite of all. Can parasites live on each other forever? No. To use an overly fashionable word, it's "unsustainable."

Where will the US government get the money it needs to survive? It can no longer even remotely survive on its tax receipts; deficits of one to two trillion per year lie ahead for the indefinite future. It can no longer borrow adequate amounts from either American citizens or foreign governments—just rolling over the \$32 trillion of existing debt, forget about trillions of new debt, at anything near current interest rates is hard enough. So there's no alternative left for them but to print more money. And print they will (electronically, of course). The thousands of "economists" at the Federal Reserve and the Treasury Department have no more of a grip on sound economics than government economists in Argentina or Zimbabwe.

Disaster is absolutely written into the government's DNA at this point. There's no realistic way out. As many Americans are now realizing, inflation has a way of perpetuating itself. However, many countries have been down this path before. For example, Argentina has infamously been trapped in a perpetual cycle of hyperinflation and socialism from which it cannot escape.

Is the US now entering that same inescapable cycle?

Money printing makes you think that you're getting something for nothing. It's dishonest, criminal actually, and leads to a moral collapse. It causes a war of all against all, as everyone in the country attempts to get his share of government money—which is to say, stolen money—before the next guy. It's hard to see how you break the cycle short of defaulting on the national debt, cutting government spending very radically, disengaging from foreign wars, eliminating regulations wholesale, and replacing paper with gold as the national currency, among other things.

If those things happened, the economy would boom after a short albeit extremely deep adjustment. But the chances of all that happening are about zero. What we'll likely get is a long-lasting and dismal depression overlaid with a police state and general chaos.

The US became the world's freest and most prosperous country because it was a middle-class society. Middle-class people tend to be conservative, self-sufficient, and family-oriented. They're future-oriented workers and savers. The problem is that the US middle class is being squeezed, as Lenin predicted, between the millstones of taxation and inflation. They're being wiped out.

What's left are the upper and lower classes. Very wealthy politically-connected types live in enclaves far above the plebs, viewing themselves as masters of the universe. These wannabe globalists essentially despise American values and traditions. Meanwhile, the lower classes basically live hand to mouth, assisted by numerous types of welfare. They think they can vote for a living. For that reason, I expect a Guaranteed Annual Income to be a major theme in the '24 elections. "Something for nothing" will become official policy.

As we get closer to a widespread economic collapse, choosing where to put your money is crucial to ensuring it doesn't get caught in the crosshairs.

Historically, the government has fought the effects of excessive money printing by raising interest rates. Today, however, the government's debt load is much higher than in the past. If interest rates were to rise to the level needed to combat today's rising prices, it could bankrupt the US government—and everyone else. What is going on here?

The government's declared debt is around \$32 trillion, and it's growing at the rate of \$1 to 2 trillion per year. That doesn't count gigantic unfunded liabilities like Social Security, Medicare, and Medicaid, which are growing even faster. As are huge contingent liabilities, like student loan, FDIC, SBA, Fannie Mae, and numerous other insurance schemes waiting in the wings when times get bad.

The government still pays about 2% interest on most of its debt. But I suspect that interest rates are headed way up, regardless of what the Fed does to manipulate them. We'll soon see those interest rates at 5% or 6%. Before this misadventure is over, we could see rates at 15%+, as was the case during the crisis of the early 80s.

Even at 5%, government interest payments would be \$1.6 trillion per year. In other words, roughly one-third of the government budget will soon be spent on interest alone. The Fed knows that if they raise rates, there will be less consumer borrowing and, therefore, less credit creation and less inflation. On the one hand, they want higher rates, while on the other hand, they're afraid higher rates will bankrupt an overindebted society. They've painted themselves into a corner. The end of the road has been predicted for decades. But now it's arrived. The inevitable has become the imminent.

Interest rates will inevitably go up just in response to currency debasement. But higher rates will also cause a lot of banks to go bust: Partly because they've made long-term loans with artificially low-interest rates. Like 30-year 3% mortgages that were recently available. Does it make sense to lend money for 30 years in an environment of 10-15% currency debasement and 5-10% rates?

They're caught having lent long at low-interest rates while borrowing short at high-interest rates. On top of that, when they refinance adjustable rate loans they've made, a lot of people won't be able to hack it and will go into default. Of course, a lot of the loans are syndicated and become somebody else's problem. But it's an ugly situation, especially when you add in auto, credit card, and commercial debt.

As bad as the currency debasement is in the US, the situation is worse in every other country. What does that mean for the value of the US dollar?

The US dollar is the world's currency. It's the major asset of most of the world's central banks, along with minor amounts of euros, pounds, yen, and gold. If the US dollar starts losing value rapidly, so will other currencies, which are basically backed by the dollar.

It's like what that horrible US Treasury Secretary, John Connolly, quipped in the '70s when this was drawn to his attention: "It may be our currency, but it's your problem." But it's going to turn out to be our problem, too. We've enjoyed an artificially high standard of living financed by exporting US dollars. They're our major export, by far. We've gotten trillions, in effect, of free goods from foreigners in exchange for our fiat dollars. At some point soon, those dollars will

come back to the US; everything will go into reverse. Foreigners will get title to US land and businesses in exchange for those dollars; Americans' standard of living will go into free fall. Those extra dollars in the US will spike retail prices.

Given everything we've discussed, do you think the average person should still hold a substantial amount of US dollars? What are the alternatives?

I've always been a hard-money person, a gold bug. Gold is money in its most basic form. Only a fool trusts a government with money, especially when the writing on the wall is so clear.

I've always used gold as a savings vehicle, and it worked out well. Gold was about \$40 when I started. It's now in the \$1700-1800 area. Gold is reasonably priced by historical standards right now relative to other forms of real wealth. But since we're on the edge of one of the greatest financial, economic, and social upsets in history, it makes sense that gold is headed up in real terms. Don't treat it as a speculative vehicle; own it for safety, prudence, and insurance. More than ever, you should have significant savings in gold.

The fact that gold has popped up over \$100 an ounce in the last week or so makes me think it could be the start of a real panic. Let's hope not. I prefer good times, even if they're artificial like these, to bad times.

If you haven't already, start buying gold and putting it aside. The same is true of silver. At \$20, it's excellent value. Tomorrow morning is a good time to start.

In addition, it's important to learn to speculate. The markets will be going up and down like an elevator with a lunatic at the controls. That will make it very hard to invest—meaning allocate money to grow real wealth. But it should be a good time to speculate—meaning allocate money to take advantage of distortions caused by government actions.

Unfortunately, since most people don't understand either economics or the markets, they will confuse speculating with gambling. It won't end well for them. On the bright side, most of the real wealth in the world will still be here. It will just change ownership.

Recession Thoughts

By John Mauldin

With the severe inverted yield curve and other signals flashing recession, I earlier planned to use this letter to delve into the data. Then the latest CPI data convinced markets to blow the all-clear whistle.

Lack of any “green shoots” would have been out of historical character and frankly quite alarming. We got at least some. This is how the transition back to a disinflationary trend starts. But we’re not there yet.

This CPI report was *not* an all-clear signal to the Fed. The headline rate year over year was still +7.7%. The core rate was still +6.3%. Those numbers are still way too high. Whatever the market thinks, the Fed is still on inflation watch.



CPI Cheer

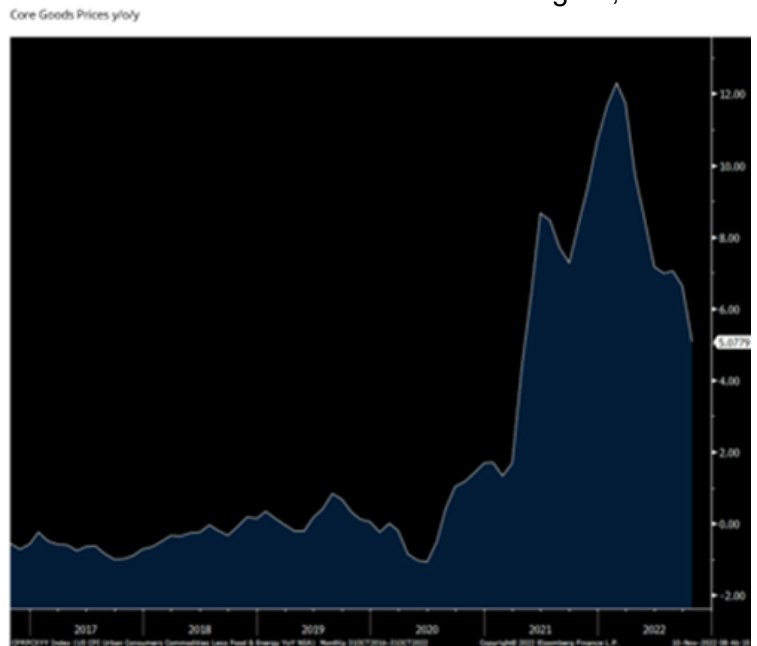
There are indeed a lot of good things to like in that CPI data. Let’s review a good summary from my friend David Bahnsen:

“The CPI news caused the largest single-day bond rally I have ever seen in my career, as the 10-year bond yield fell a stunning 33 basis points (down to 3.81%).

What was that CPI news?

- “The headline rate year over year was +7.7% whereas in September it was +8.2%.
- “The core rate was +6.3%, down from 6.6% the month before. This, despite energy (+1.8%) and food (+0.6%) going higher. Paradoxically, food and energy going higher was deemed a positive because the overall rate came down despite them going higher, not because of them going lower. Also, that food increase on the month was the smallest increase of the year.
- “The ‘owner’s equivalent rent’ absurd contribution to inflation still caused it to move higher, not lower (by +0.6% on the month, though less than the +0.8% of last month). I say ‘absurd’ because rents are not going higher but this is taking into account leases signed a year ago (current lease levels), and is 30% of the CPI reading, so the lag effect as leases roll off month by month is severe.
- “Health insurance prices were down on the month but still up 21% on the year.

“But core prices on GOODS dropped 0.4% on the month and the yearly price dropped to 5.1% from 6% last month. Goods inflation has come down each month since I initially called a peak in goods inflation five months ago.”



Source: David Bahnsen

David Rosenberg had a different way to see inflation, one which struck a chord with me. Under the headline “Deflation Thumbprints All Over the CPI Data,” he wrote:

“If not for big increases in shelter (+0.8%), energy (+1.8%), and food (+0.6%), the CPI would have declined outright by 0.1%, the first dip back to deflation on this measure since May 2020.”

That’s monthly, not year over year, but certainly a good sign. We need many more such signs, though.

Turning the Corner

Monetary policy has a lag. Just because we get an inflation report that indicates we have turned the corner does not mean the journey is close to an end. I have said that I believe Powell has that “old-time inflation religion.” But there are several paths to his goal.

- One is the band aid approach of 75 basis points every meeting, which seems like what he is doing. But the market has lowered the terminal (where we end up) fed funds rate by 25 basis points. Then again, what do they know? They are guessing just like everyone else.
- They raise 50 basis points (bps) in December, the data continues to show moving in the right direction, and then they get to a series of 25 “bips” rate hikes until they get to where they think positive rates are *at a minim* in sight, if not already there.
- He can blink. Remember, Volcker backed off in 1980 (recession) and inflation came back hard. Volcker later said among other things you have to change expectations. He did that in 1982. Powell is aware of Volcker’s biography. I don’t think he will want to stop too early and he has said that would be dangerous but it is a possible path.

The end point is likely the same (give or take 25 bips).

But the market got positively giddy that Thursday. The positive move in bonds was eye-opening. Not sure I have seen that size of move before. The 10-year fell 0.33% in one session! The Dow up over 1,000 points. No recession in our future! This is going to be better than a soft landing!

A point I have made over the years. The market knows very little when it comes to predicting recessions. We get an inverted yield curve sufficient to signal a recession and the market shrugs it off and goes higher (2001 and 2007, etc.). Not unlike today. Let’s see what my good friend Sam Rines has to say:

“There are a couple takeaways from the rip in risk assets. **First**, a **soft landing** was not priced in. **Second**, the market is beginning to **test the ‘higher for longer’** mantra the FOMC has been pounding at for months.”

[Note from John on this chart: This is the statistical probability of rates reaching a specific point in a specific month. Go to the 3/22/2023 line. The market thinks there is a 23.3% chance for rates to be at 4.5–4.75%. 0% chance it will be only 4.5%. **An almost 50% (47.9%) probability of rates being 4.75%–5%.** This also assume rate hikes of 50, 25 and 25 bips. The majority of the market is also seeing cuts in the third quarter of 2023, although a sizeable majority see more rate hikes in May/June.]

MEETING PROBABILITIES									
MEETING DATE	350-375	375-400	400-425	425-450	450-475	475-500	500-525	525-550	550-575
12/14/2022	0.0%	0.0%	0.0%	85.4%	14.6%	0.0%	0.0%		
2/1/2023	0.0%	0.0%	0.0%	0.0%	53.0%	41.4%	5.5%	0.0%	0.0%
3/22/2023	0.0%	0.0%	0.0%	0.0%	23.3%	47.9%	25.7%	3.1%	0.0%
5/3/2023	0.0%	0.0%	0.0%	0.0%	20.5%	45.0%	28.3%	5.8%	0.4%
6/14/2023	0.0%	0.0%	0.0%	0.7%	21.3%	44.4%	27.6%	5.6%	0.4%
7/26/2023	0.0%	0.0%	0.2%	7.6%	29.1%	38.8%	20.2%	3.9%	0.2%
9/20/2023	0.0%	0.1%	3.2%	16.2%	32.9%	31.3%	13.7%	2.4%	0.1%
11/1/2023	0.1%	1.8%	10.4%	25.5%	32.0%	21.5%	7.4%	1.1%	0.1%
12/13/2023	1.0%	6.5%	18.6%	29.1%	26.3%	13.8%	4.0%	0.6%	0.0%

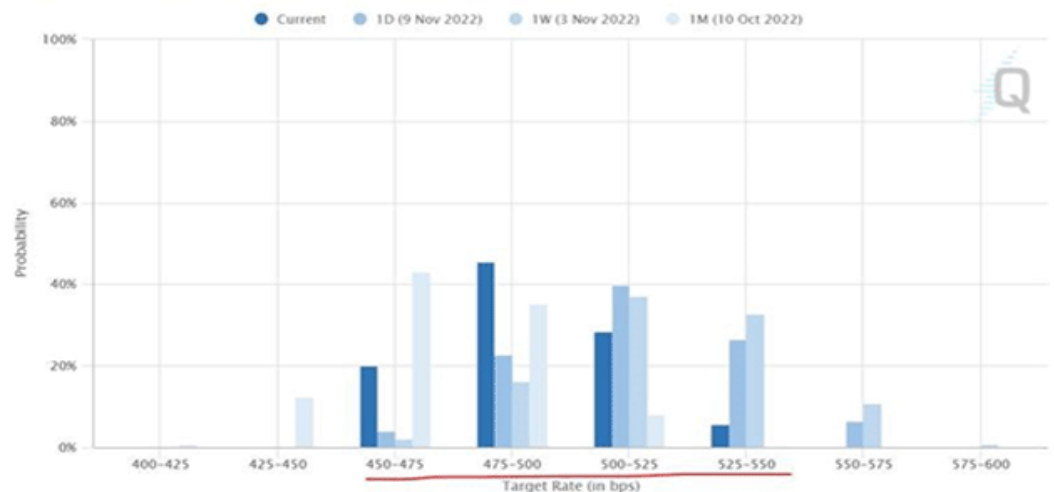
Source: Samuel Rines

More from Sam:

“Previous *PolyMacro* (Sam’s very private letter which he graciously lets me quote from time to time) notes have stated that the risk is not ‘75 or 50’ at the next meeting. The risk is **more 25s than priced**, and the FOMC not being in a mood to cut late next year. The reaction to today’s print was ‘case in point’ with a 25 bps point hike taken out and cut(s) being priced in late 2023.

“For the moment, the June FOMC probabilities are the ones to monitor. Why? That is where the terminal / pause is being priced. If the next jobs report is a bust, does another 25 bps come out? If it is a blowout, does the market reprice the terminal?”

TARGET RATE PROBABILITIES FOR 14 JUN 2023 FED MEETING

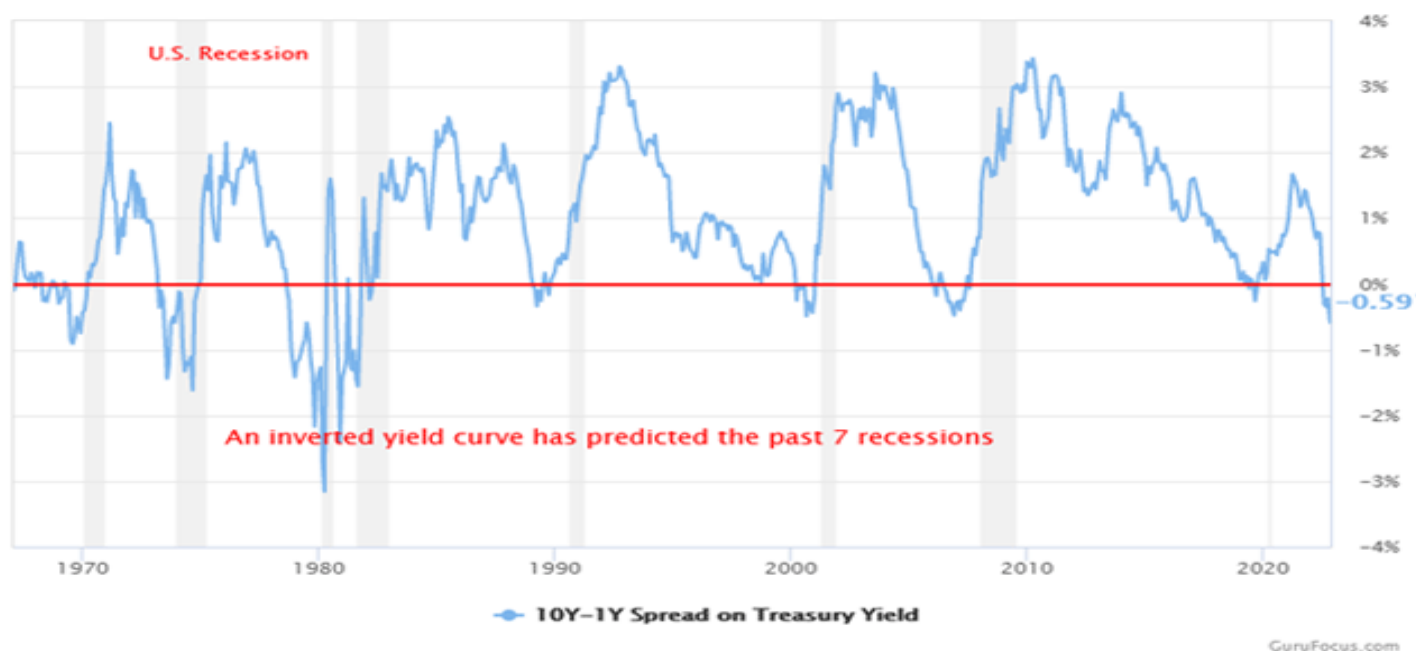


Thinking out loud with no real answer: First, recessions are *by definition* deflationary events. What if we get a real recession in early 2023? Will that reduce inflation faster? (Short answer: yes!) Does the Fed pause or even cut if inflation really falls? That seems not an unrealistic possibility. Something to watch.

As readers know, I expect a 5% fed funds rate and 5% unemployment, but perhaps not with a serious recession in the first quarter because inflation will take a tumble and the Fed has to start looking at future housing prices which will roll over in a recession but not show up for 6–9 months at a minimum.

Confused? That’s understandable. I am happy to get the direction right when talking about the future, let alone the specifics. That being said, I still think we are headed for a recession. Let’s examine that thought.

Recession Thoughts



The word “recession” implies generalized economic pain. Business activity slows, people lose jobs and income, asset values fall—something for everyone. Not all feel the same degree of pain, but everybody feels something. Or at least sees it around them.

I’m not sure that’s the case anymore. Over the last 25–30 years, technology has made life an increasingly *individualized* experience. We all live in slightly different worlds based not only on our physical locations, but also the ways we communicate and the information we choose to consider.

The simple question, “Is the economy in recession?” doesn’t compute when there is no “the” economy. Your economy is yours, mine is mine, and we can have radically different impressions of its health.

Yet even as we perceive different realities, an *actual* reality still exists. Back in July I predicted [A Weird Recession](#) with falling GDP but perhaps not the usual mass unemployment. That’s still my expectation, though maybe we need a new word to describe it.

While this probably won’t be good no matter what you call it, letting inflation get further out of control would be even worse. Avoiding that fate will have a price.

Curving Higher

We have a pretty reliable recession indicator: the inverted yield curve. It’s often early but rarely misses. Right now, the yield curve says recession is coming and I see no reason to think it wrong.

[Quick review: The yield curve is simply a graph of interest rates by maturity. Normally, rates go higher as the borrowing period gets longer. A 5-year auto loan will have a higher rate than a 2-year loan because the longer term means more risk for the lender. Same with government bonds, though in that case you’re not worried about credit risk. Inflation is the bigger factor.

It is highly unusual for short-term rates to be higher than long-term rates. When it happens, we say the yield curve is *inverted* and it usually points to recession. I wrote a longer explanation earlier this year (see [Curve Ball](#)) which you should read if this is unfamiliar to you.]

Now, there are different ways to define inversion. Most involve comparing a shorter-term Treasury yield with a longer one. Inversion occurs when the short-term rate goes higher. You can graph these comparisons as a

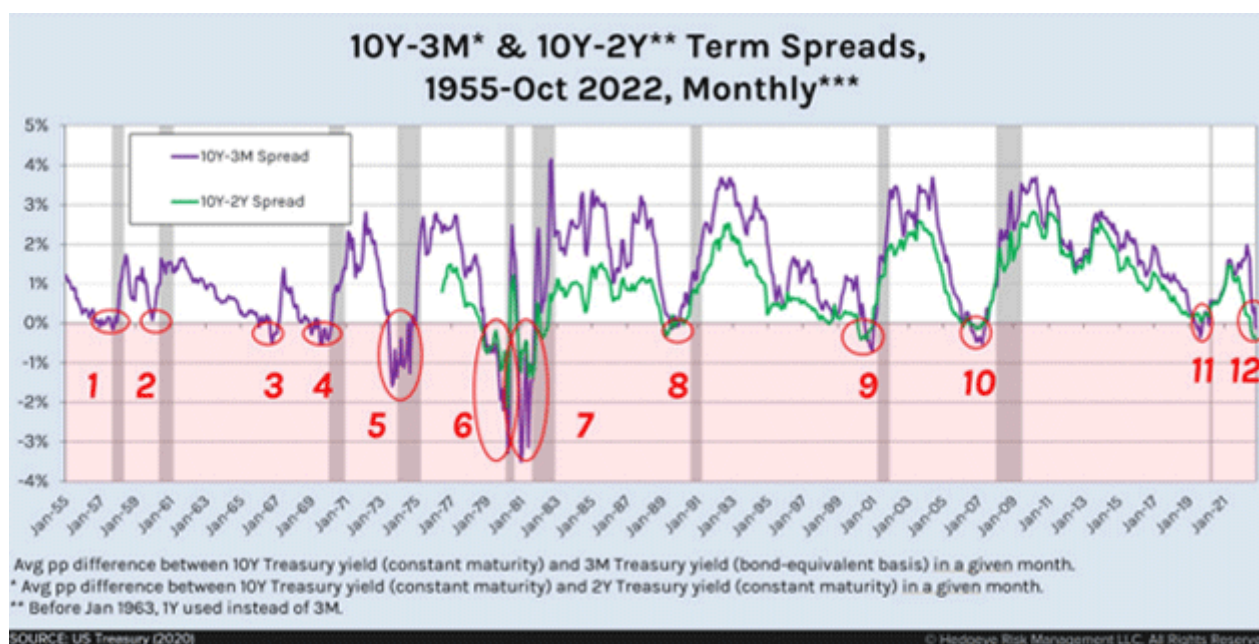
“spread.” Here’s a chart of the 10-year yield minus the 1-year yield. When the spread goes below zero (the red line), it’s an inversion. You can see from the recession bars these occurred ahead of the last seven US recessions.

Source: [GuruFocus](#)

The pattern isn’t unique to this pair of rates. Here’s a chart (courtesy of Neil Howe) illustrating the 10-year/3-month and 10-year/2-year spreads. It goes back to 1955 and shows the same results. Inversions indicate recession is coming.

Source: *Neil Howe*

Curiously, the yield curve even predicted the 2020 recession long before any of us heard about COVID. How it did that, I don’t know. Maybe recession was coming anyway for other reasons the pandemic pushed aside. Obviously, it’s an indicator we shouldn’t lightly dismiss.



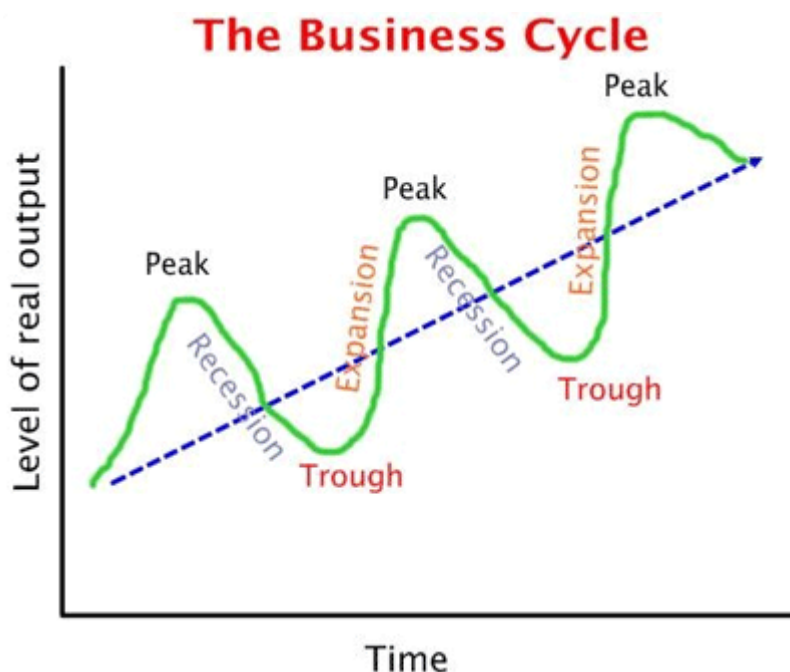
The current inversion was already forming when the Fed began raising rates last spring. It has only grown clearer since then. This long delay doesn’t mean it’s wrong. Look at those charts and you’ll see inversions can precede recession by months, sometimes over a year.

I know all the reasons to think the economy looks better. I don’t *want* recession. But I’m also not going to argue with the yield curve, and it is very confident recession is coming.

“Hardly a Boom”

In business cycle theory, “recession” is the opposite of “expansion.” The economy alternates between expansion and contraction phases, netting out to gradual growth over time. The process looks something like this, though not quite so steady in real life.

“Richard Cluver Predicts”
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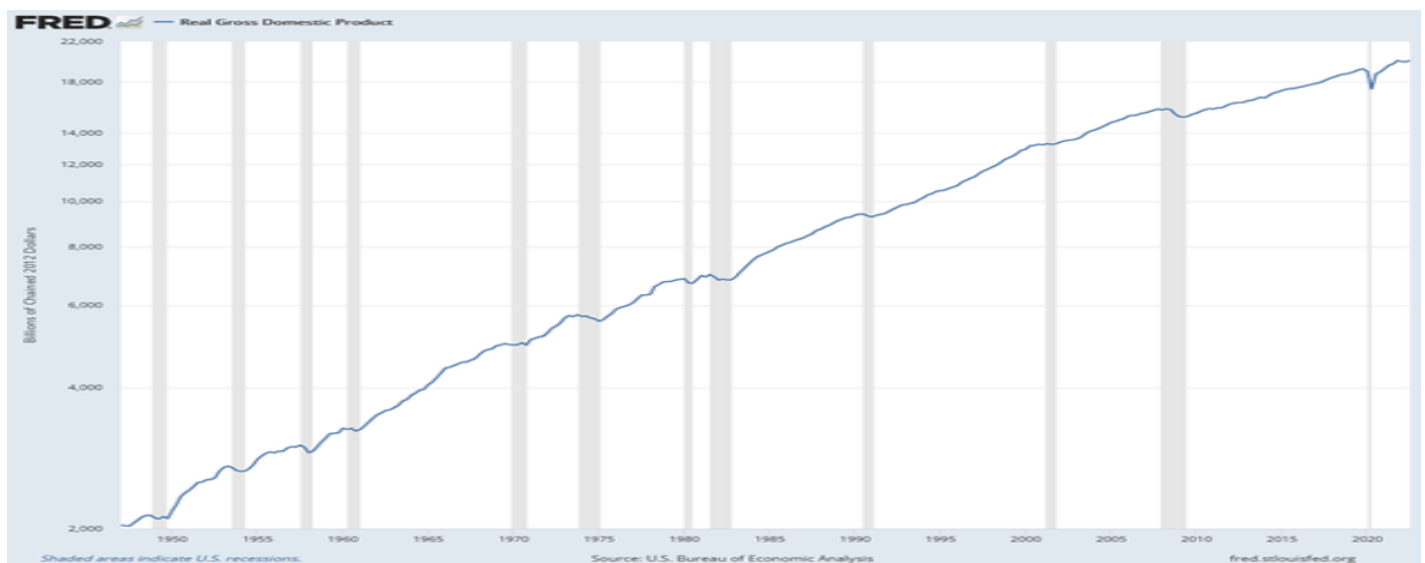
Source: *Economics in Plain English*

This cycle isn't a law of nature. Our collective economic choices affect it in ways we don't always understand. **My friend Peter Boockvar went further a few years ago, saying we no longer have business cycles but credit cycles instead.** By that, he meant central bank policies have overwhelmed the other factors that once caused expansion or contraction.

But exactly what is expanding or contracting? That's a whole different question. We use GDP, Gross Domestic Product, as a proxy for economic growth. It has many flaws but is the best single indicator we have.

I'm going to review some GDP history in a way you may not have seen. Analysts usually talk about GDP as a percentage change. Raw GDP is actually expressed in dollars, though, and looking at it that way can be more enlightening.

Here's a chart showing real GDP since 1947—not real GDP *growth* but the actual output, adjusted to 2012 dollars. This is a log scale to keep the percentage change constant.

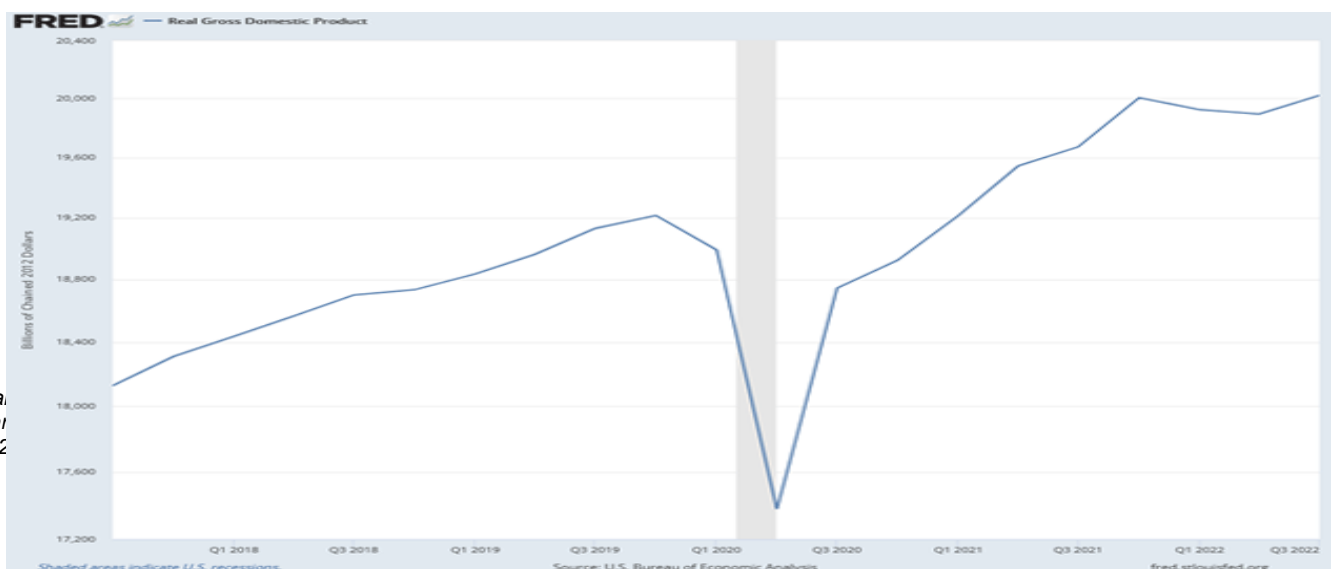


Source: [FRED](#)

You can see from the generally constant angle how long-term growth has been quite steady, though the angle flattened noticeably after 2008.

You can also see how the recession bars correspond with periods when GDP declined. That's not coincidence. Declining GDP *is* recession, or at least a necessary element of it. Recessions don't occur when economic output is rising.

Now let's zoom in on the last five years.



Source: [FRED](#)

This shows how COVID produced a sharp downturn in the first half of 2020, then a recovery by mid-2021, followed by a drop in this year's first half and a third-quarter bounce. (Note the Q3 number is still an initial estimate at this point and could change.)

Here are the real GDP raw numbers for the last five quarters:

- Q3 2021: \$19.673T
- Q4 2021: \$20.006T
- Q1 2022: \$19.924T
- Q2 2022: \$19.895T
- Q3 2022: \$20.022T (est.)

On October 27 when the Commerce Department released the [Q3 advance estimate](#), the headlines said GDP was growing at a 2.6% annualized rate. But using the numbers above, growth in the last year was 1.8% (from \$19.673T to \$20.022T est.). What happened?

The answer is that headline GDP is reported as the current quarter's growth, annualized (and seasonally adjusted, but we'll ignore that for now). The change from the preceding quarter was 0.64%. Compound that to four quarters and you get 2.6%. But that is not what actually happened.

On the surface, you might look at the 2.6% and think 2022 could still be pretty good. It won't be.

This year's first three quarters saw real GDP grow from \$20.006T to \$20.022T, a difference of 0.08%. If the Q3 estimate holds up and Q4 is about the same, we are looking at something like a 0.7% year. Maybe 1% if we're lucky. That's not recession territory, but it's hardly a boom.

Remember, though, we're looking at *real* GDP here. The inflation adjustment matters; lower inflation means higher real GDP. Indeed, inflation had a lot to do with this year's two quarterly declines. It seems to be moderating somewhat as the Fed tightens.

That might help real GDP growth. But the *reason* inflation is moderating could push it right back down.

Core Problem

In his news conference following the September FOMC meeting, Jerome Powell gave a surprisingly clear picture of where he thinks interest rates should go: *"You want to be at a place where real rates are positive across the entire yield curve."*

"Positive real rates" means the interest rate for a given maturity is higher than the inflation rate. He wants to see this "across the entire yield curve" before the Fed stops tightening.

So, Powell wants to see every interest rate from overnight out to 30 years higher than the inflation rate. Which inflation? For Powell, that means the Core PCE index, which is part of the GDP dataset. The [last report](#) put year-over-year core PCE at 5.1%.

The "core" part means it excludes food and energy. **Falling food and energy prices have no immediate effect on core PCE.** Its main drivers are housing prices and rent, which are weakening in real time but not in the way it is calculated using the absurd Owner's Equivalent Rent and lagged rent as input sources.

If we take Powell at his word (and I do), he's told us quite plainly the federal funds rate is headed for 5%, unless inflation should mysteriously and unexpectedly go way down. It could need to go even higher if the rest of the yield curve doesn't respond as desired.

If Powell stays the course, he will get us to the point where inflation is not the main driver and employment once again is. For the record, I think the employment mandate is misplaced. That should be a fiscal policy role, not monetary policy. But for now the Fed has to consider it.

All that points to recession in our future, at least to this humble analyst. Again, it could be a weird recession, milder than past ones because the labor market is so tight. I'm hopeful we won't see the kind of mass layoffs that happened in 2008 and 2020. But we will see some and they'll have an effect.

Meanwhile, those higher US rates will keep strengthening the dollar (despite the last few days) which is having a negative and sometimes dire effect overseas. This could change if other central banks start to raise rates to catch up. I don't believe they actually think that way. That raises the odds we will see some kind of debt crisis or financial institution failure. The UK fiasco and this week's bankruptcy of crypto exchange FTX could be just the beginning.

Adding all this up, I'm not optimistic 2023 will be a good year, at least the first half. I'd like to be wrong. I don't think I am.
