

Delta Investment Management is a registered investment advisory firm. Delta welcomes discussions with individuals seeking investment advice and advisors seeking a new turnkey asset management solution.

Delta manages portfolios at TD Ameritrade and Schwab.

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December 30, 2022

20/22 Hindsight

Top surprises in 2022 were skyrocketing inflation and soaring interest rates, hands down. Russia invading Ukraine and China's zero-Covid regime were also on the list. While very few can say they forecasted the Russian and Chinese actions, and yes, they were negative factors, but skyrocketing inflation and the fastest rate rise should not have been such a surprise. When one adds up the actions by the Fed and the government over the past three years, in hindsight, it makes sense.

Fed Actions: Rates, Balance Sheet and Money Supply

At the start of 2022, Fed officials and most market participants were pricing in four 25 basis point (bp) rate hikes. The year-end target on the Fed Funds Rate was 1.00%. We are ending the year with 17 (25bp moves) and a Fed Funds Rate at 4.25-4.50%! Other central banks (the ECB and BoE) mispriced it too. The dashed line in the chart below highlights the move, the miss.

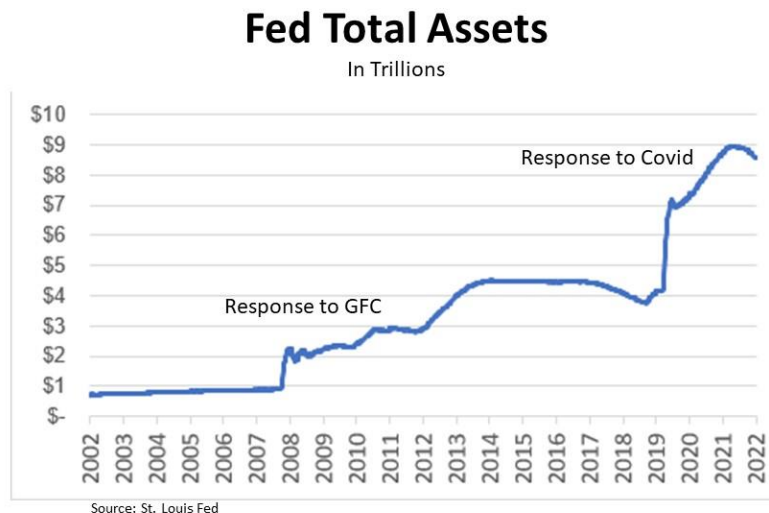
Market Pricing for Central Banks in 2022



The Fed Balance Sheet

In 2008, to calm/rescue financial markets, the Federal Reserve expanded its balance sheets from \$900 billion to \$2.3 trillion. The Quantitative Easing programs (labeled QE1, QE2, QE3 and jokingly QE-Forever) would expand the Fed's balance sheet to \$4.5 trillion by January 2015. When Covid broke out in 2020, the Fed's balance sheet was \$4.2T. By May 2020, the balance sheet was \$7.1T and would top out in April 2022 at \$9.0T. A week ago, it was \$8.6T.

One way to look at the impact of quantitative easing and tightening is each \$1T of balance sheet adjustment may equal 25 basis point or more on the Fed Funds Rate. So, when the Fed Funds Rate was at zero and the Fed doubles its balance sheet by \$4T, the impact is an extra 100 bps of easing. Now with Fed Funds Rate at 4.25-4.50% and the Fed balance sheet contracting, the impact to financial conditions is even tighter. Stock and bond offerings are at lowest level in a decade.

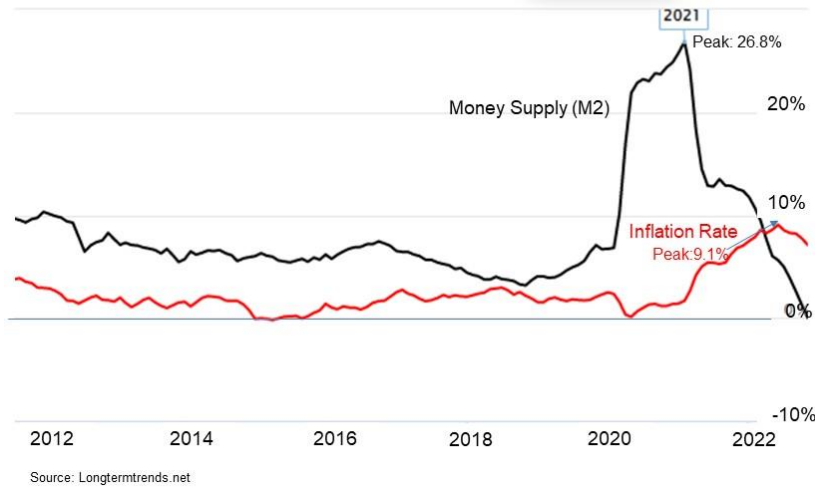


Money Supply Spike and Drop

Prior to the pandemic, for two decades, the money supply (M2) compounded growth rate was 6.1%. The Fed took the reserve requirement to zero in March 2020 and the money supply exploded higher. The CAGR over the next three years was 11.1%. M2 peaked in January 2021 at 26.8%. M2 growth has dropped to essentially zero - the October reading was 0.01%. In the short-run, an increase in the money supply decreases the interest rate which increases investment and output. If the money supply grows faster than the economy, inflation will occur.

Money Supply (M2) and Inflation

Yearly Growth 2012-2022

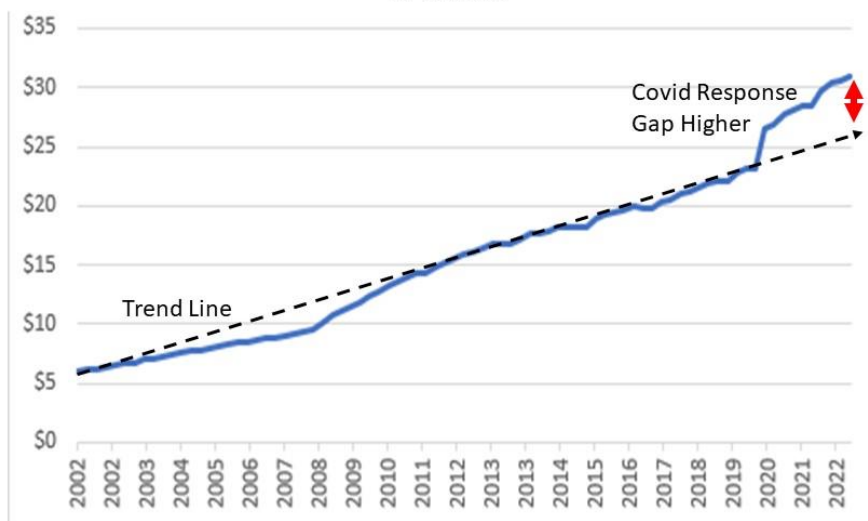


US Government Spending Bump

For the past two decades, federal deficit spending averaged \$650M/year growing at a compounded growth rate of 6%. Over the past three years, the federal deficit spending was \$7.2T or \$2.4T/year or almost four times the previous two-decade average. In 2008, the Federal debt was \$9.3T. By 2020, the Federal debt was \$23T. The US added \$3T in 2020 and now US debt sits at \$30.9T. Lawmakers just passed another \$1.7T spending package last week.

US Debt

In Trillions



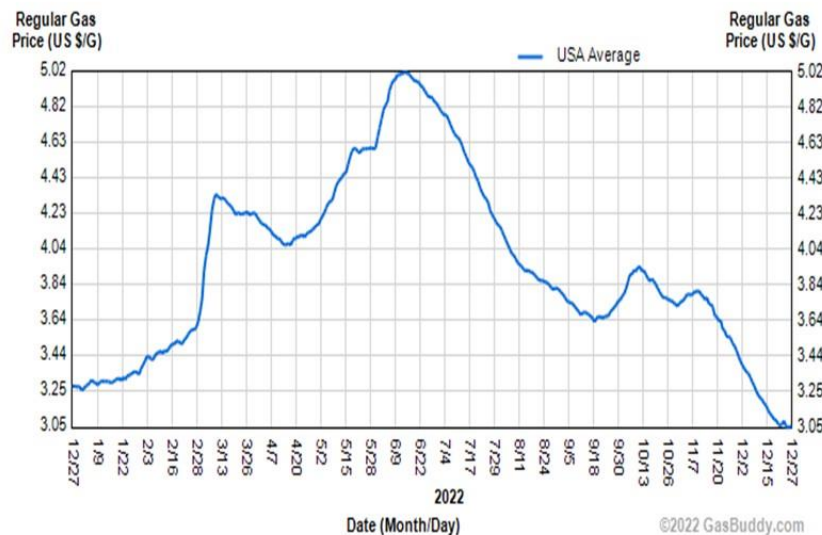
Source: St. Louis Fed

The impact of lowering rates to zero, increasing the Fed balance sheet, increasing the money supply, and gapping up government spending/debt (and Russia invading Ukraine and China lockdowns) led to the highest inflation in 40 years.

Third quarter GDP grew at an annual rate of 3.2% vs. expectations of 1%. The Atlanta Fed GDPNow model is estimating a 3.7% advance in the fourth quarter – consensus is sitting gain around 1% (see chart below in Delta Dashboard). Credit for recent the hook higher is real gross private domestic investment growth increased from -0.2% to 3.8%.

China has done a 180 and dropped many of their Covid restrictions. Supply chain issues and demand will improve. Ukraine has pushed back Russian and is gaining lost ground. Inflation is pulling back from peak levels in June. Gasoline prices are at their lowest levels in 12 months and 40% below the highs of last summer.

12 Month Average Retail Price Chart



Unemployment levels remain low (3.7%). Bonds are attractive and should be less volatile. The miss last year by Fed officials and market participants is not likely to happen again.

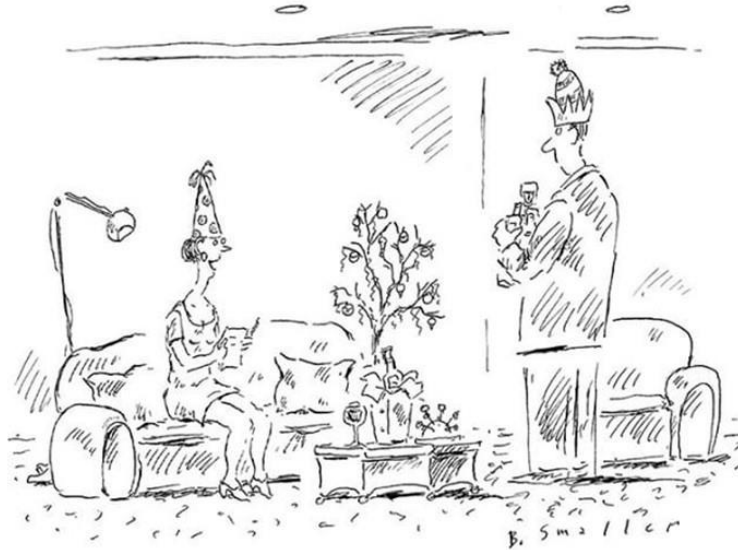
A list of potential 2023 surprises:

- US does not go into a recession as the Fed orchestrates a soft landing.
- Inflation drops back to historical levels faster than anticipated.
- China fully reopens and stimulates economic growth.
- War comes to an end in Ukraine.

Let Us Help You Position Your Portfolio – Give Us a Call Today

We have unique and sophisticated investment methods that seek to capture the stock market's gains while minimizing drawdowns in bear markets. If you would like to learn more about how we manage money, we invite you to give us a call at **(415) 249-6337**, visit www.deltaim.com or email us at info@deltaim.com.

Here's to a healthy, happy and hopeful 2023.



"I've finished my New Year's resolutions, and now I'm going to get a running start on yours."

Delta Stock Market Dashboard

MARKET SENTIMENT IS

BULLISH

THIS WEEK'S NUMBER IS

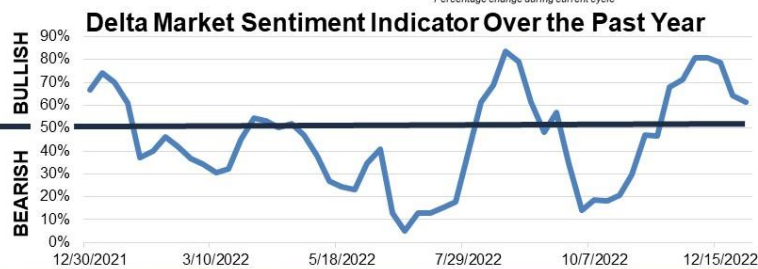
61.6

Our technical indicator declined from 64.2 to 61.6 this week

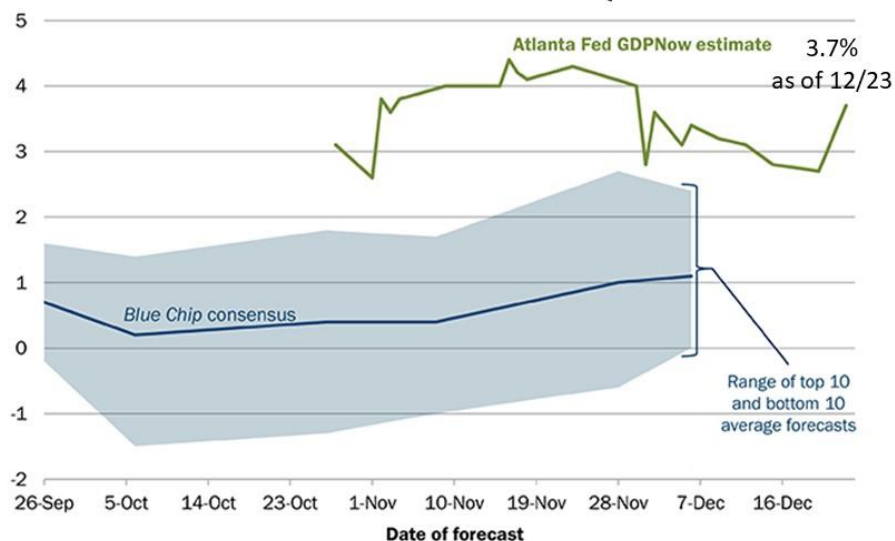
INDICATOR STATISTICS

Consecutive Bullish Weeks:	7
Cycle Inception Date:	11/17/2022
Range:	61.6 – 80.6
Mean:	72.1
Bullish Weeks YTD:	22
Bearish Weeks YTD:	30
*S&P 500	-2.3%
*DJIA	-1.3%
*NASDAQ	-5.6%

* Percentage change during current cycle



Atlanta Fed GDPNow Forecast Real GDP Estimate for Q42022



Leading Economic Index % Change Monthly November 2021 – November 2022



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