PETERSON FINANCIAL SERVICES

Limited Liability Company ♦ Registered Investment Advisory Firm

Second Quarter 2022

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INFLATION IS FORCING AN ECONOMIC SLOWDOWN, AND ENERGY COSTS ARE AT THE HEART OF IT.

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- Markets are now pricing in correcting inflation and rising interest rates, and the possibility that will lead to a recession.

QUARTERLY MARKET RECAP

The second quarter saw brutal sell-offs in all asset classes, driving major indexes into bear market territory and ending in the worst first half for a year in five decades. Along the way, several new technical uptrends fell apart, adding to the difficulty of determining if a bottom had been found. As of this writing, we're in our seventh attempted rally since December. We'll see if this one sticks.

Last quarter, the DJIA lost 11.26%, the S&P 500 declined 16.45%, the NASDAQ imploded by 21.18%, and the small-cap Russell 2000 dove 17.49%. Foreign equities shed 16.60%. Some individual sectors have been slaughtered and many leading tech companies are trading at half their peak or worse. The Fed is well into its interest rate tightening cycle, so the Barclay's Aggregate Bond Index dropped by 4.92%. Rate increases will continue into next year, so some months ago we sold out of all bond positions.

The markets are pricing in the inflation expectations and the continued interest rate increases that go with them. And, it appears a recession is being priced in as well. Pessimism is high, and from a contrarian standpoint, that is actually positive, as historically market bottoms are seen at these fear levels. The war in Ukraine is slogging on but is no longer a major market concern at this point for now.

STATED ADMINISTRATION ENERGY POLICY IS DELIVERING WHAT IT ORIGINALLY ADVERTIZED

President Biden ran his campaign in part on his declaration of war against the fossil fuel industry. He stated he wanted to raise the price of various fuels to the point that consumers would consume less, and more expensive green alternatives wouldn't look so bad by comparison. Well, he got it.

The administration claims today's high gas prices are caused by Putin's war against Ukraine. To be sure, that has further constricted supplies and added to fuel inflation, but well more than half of the increase at the pump in the last year occurred before the war even started. There are other factors at play, and they are part of a well-stated policy direction.

After telling energy companies he wanted to run them out of business, Biden now complains that they aren't doing enough to increase production! And after alienating and excoriating the Saudi Crown Prince as a "pariah" he is now going there to beg him to increase global supplies. Federal policies are the main culprit, but don't forget that states have their own mandates and laws in place as well. If you live in California, you're paying about $1.50 more per gallon than the rest of the country – and that's down to their specific green energy agenda and their own state taxes at the pump (over 50 cents). But the main damage is done at the federal level.

On his very first day in office, President Biden reversed the previous administration's policies and halted all new leases in the Arctic National Wildlife Refuge, and also put a stake in the heart of the Keystone XL pipeline. Just a week following that, he banned all new oil and gas leases on federal land and offshore. By June of last year, all exploration on *existing* ANWR leases had been closed off. In October, he then increased regulations and costs on building oil and gas infrastructure and pipelines. Further restricting American domestic oil and gas production came in February of this year when the administration limited leasing in Alaska's National Petroleum Reserve. Additionally, the administration raised the federal royalty by 50%, making the base cost of oil and gas extracted from federal lands more costly to consumers. Further, Biden issued climate disclosure rules that have made lenders fearful about providing capital, nominated regulatory officials who are openly hostile to the entire industry, and has coerced banks into shunning fossil fuel companies as clients. You can't raise the cost of production and limit supply without hefty price increases, so here we are.

This environment has caused daily US oil production to decline from 12.29 million barrels before the pandemic to 11.85 million barrels, estimated through this year. And this has come with an expanding economy, which is now larger than then, so we're allocating less fuel across a larger economy. More demand, but less supply equals higher prices.

On top of all this, Biden is now threatening oil and gas companies with a "windfall-profits" tax. All this will do is further dis-incentivize energy companies from bringing more supply to the market. We've never understood what a "windfall" profit is anyway. The purpose of a corporation is to make money for its shareholders – that's why it exists. When they do so, that's not wrong. The reason profits that are in excess of average levels occur is because of the supply-and-demand imbalance, and it is this self-correcting mechanism that brings that equation back into balance! Besides, in 2021 oil and gas industry production only had a 4.7% profit margin. Apple's profit margin was 27%, Microsoft's was 39%, Facebook's was 33% and Google's was 30%. He makes no mention of confiscating their profits, or identifying them as excessive. Is an excess profit one that is well below average?

The federal government gasoline sales tax levy is 18.4 cents per gallon. The government is making more money from a gallon of gas than the oil companies are! And they don't risk anything. Who's collecting "excess" profits?

All of these impediments are on the exploration and production side of the ledger. Just as troublesome is the refining piece of the puzzle. EPA regulations result in an assault on small domestic refiners, which produce nearly a third of the nation's gasoline and diesel. Regulations require the blending of renewable fuel into the petroleum-based product, and if they can't do so, the refineries must purchase credits in a special marketplace. But due to the corrosive nature of ethanol, most of these refineries can't blend it in because it can't be moved through pipelines. The EPA has traditionally solved this problem by granting exemptions when these credits aren't available, but just this month, the EPA announced it is ending these exemptions and going one step further to punish refiners by retroactively denying exemptions going back to 2016. We, the consumer, will have to cover these billions of dollars in additional costs, which even the EPA admits will be passed on to us. Many industry representatives are concerned that refineries will not be able to operate under these restrictions, and will shut down, further decreasing supply.

Fuel inflation creates inflation in all goods and services, since everything comes into being with the use of fuel. These destructive policies are creating this mess, along with too-loose money for too long, and the government flooding the economy with more money than it could absorb. Just the announcement of a rollback of some of these conditions would immediately reduce prices.

"He that lieth down with dogs, shall rise up with fleas!"

- Dr. Benjamin Franklin

Pursuant to SEC Rule 204-3 (C) of the Investment Advisors Act of 1940, we hereby offer, without cost, a copy of our "Disclosure Statement", Form ADV Part II, which is the document attached to your copy of our Service Agreement. Please e-mail us, or mail us, a written request if you'd like another copy and we'll send it in February after we update our annual filing. Also, in conformance with Regulation S-P of the Gramm-Leach-Bliley Act, we are required to provide annual notice of our Privacy Policy. Our policy is posted to our website, and is mailed to each client.

ABOUT PETERSON FINANCIAL SERVICES, LLC

As an aside, we wish to remind our clients of our various services. While we specialize in portfolio management, we continue to provide financial planning and insurance services. Longtime clients may have forgotten this, and newer clients may not be aware of this. Additionally, we build our business through referrals, and much appreciate them. Please keep us in mind as you come across friends, family and colleagues who might benefit from our financial services. We appreciate your business.

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