MH & ASSOCIATES • SECURITIES MANAGEMENT CORPORATION

INVESTMENT VIEWS

MARCH 31, 2024

NARROW RALLY CONTINUES

The rally in the equity markets continues to be fairly narrow, with only a few sectors and only a few stocks in those sector participating so far. Of course, a big part of the 2024 rally is centered around Nvidia and beneficiaries of artificial intelligence (AI). While AI is surely a theme that investors should embrace, we are looking for broader participation among the sectors. We are finally seeing some stocks without ties to AI catching some tailwind, but still very early stages and more small and mid cap names need to follow. Continued narrow participation would be a red flag that this rally is not sustainable.

INFLATION IS NOT DEAD, IT'S SLEEPING

Investors are becoming convinced that the Fed has killed off inflation and that rates cuts are right around the corner. Inflation has cooled and is approaching the Fed's target rate of 2% according to the latest readings. However, we believe that inflation is not dead, but instead asleep and ready to wake up again.

When inflation started rising 2022, many economists and the Fed believed that it was "transitory" and due only to pandemic related disruptions. However, as we all know now, inflation became much hotter than anticipated, prompting the Fed to become aggressive in attempting to bring it down.

While pandemic related issues have faded and, in part, prompted the decrease in inflation we have seen over the past 18 months, there are several reasons why we believe it will reemerge. First, Federal government spending has dramatically increased, leading to record deficits, which basically offsets the Feds interest rate rises. Second, inflation expectations are now hardening, meaning that citizens and companies are expecting more inflation. This mentality itself reinforces inflationary pressures and is difficult to undue once set. Higher wages being demanded by workers begets higher prices and can be a vicious circle. This is not to say that such pay increases are not justified, however businesses will always try to maintain profit margins for as long as possible. Last, in order for inflation to go lower, later readings this year need to be lower than those at during the same period in the prior year. This would seem unlikely at this point as prices are not even stable yet. Of course, there are other factors in play that should keep inflation higher for the next several years, including mass retirement of baby boomers and continuing global trade disruptions.

Our portfolios are prepared for higher inflation. Stocks, gold and other commodity exposure all play their role in keeping us ahead of inflation.

RED METAL FUTURE

Copper, the red metal, is destined for a big future as the world shifts away from petroleum-based energy supplies to electrification. We are skeptical that such a transition will occur in the timeline that many authorities want, it is nevertheless happening. This electrification of society will require enormous amounts of copper, much more than we have in production today. Electric vehicles alone require about 5 times more copper than internal combustion engine vehicles. Electric grids across the globe will require upgrades and expansions that will also use multiple times more copper than current grids.

Freeport MacMoran (FCX) is one of the largest copper miners in the world. The company understands the bright future copper has and it has been preparing for it by developing new resources and mines right here in the US. We added this to our portfolios over a year ago and have been patiently waiting for the shares to appreciate with a rise in copper prices.

WHAT DO BONDS SAY THE FED WILL DO?

Recent comments from Fed governors indicate a mixed view of what they should do with rates for the remainder of the year. Some expect cuts, while others are saying to stay put. The one thing we have not heard is anything about rate increases, which should at least buoy the market even if we don't get rate cuts. After the most recent Fed meeting, former chief Larry Summers argued that there is no reason for the Fed to be considering cutting rates and quoted unemployment being below full capacity and inflation targets for the next two years being above target. Summers also points out that monetary conditions are very loose at the moment.

So the question is why lower rates if economic indicators are OK? The answer lies in the fact that most of the economic data that are looked at are lagging indicators. One indicator we can look at that is the bond market itself, which is more forward looking and often considered the "smart money". In particular, the yield on the 2-year Treasury Note has been an accurate indicator of the path that the Feds rates should take and usually moves a few months before the central bank acts.

Currently the yield on a two year treasury note stands at about 4.60%. With the Fed Funds Rate standing at 5.375%, the bond market is saying the Fed Runds Rate is about 75 basis points too high. So, while Larry Summers is looking at data and questioning a cut, the bond market is saying the Fed is too restrictive and cuts should be on the way.

S&P SIX THOUSAND

It might sound outlandish at the moment, and certainly did at the beginning of last year, but the S&P 500 reaching the six thousand level is not as crazy as you might expect. The end of February marked a run in the market that has not occurred very often. Since 1950, there have only been 13 other times that the market has closed at the end of February with a four month winning streak. In all of those occurrences, the market has never been below the level it started off March at twelve months later. In fact, the average return during these periods is nearly +17%. If the S&P 500 can return the average between March and the end of next February, then we would be right on the cusp of six thousand as you read our newsletter this time next year. Rest assured though, this will not be a straight line up move as some of the drawdowns the market has experienced have been upwards of -12%. So even though we are feeling bullish when statistics like this are favorable, there is always something to watch out for.

AI NEEDS A MEMORY

Lost in the shuffle of the need for NVIDIA's processors for AI data centers, is the essential requirement for a lot of memory chips to be loaded along side them. Artificial intelligence programs are extremely data intensive and memory needs to evolve in order to keep up with the speed at which the programs demand the data to be processed. As these processors get faster, the memory can't keep up and is now holding things back. For years, several firms have been working on a new design called "high-bandwidth memory" which essentially is as many as sixteen DRAM chips stacked on to one another. This could solve the issue, for now at least, and will revive the fortunes of the companies making this memory.

A long term holding of ours is Micron Technology and we have written about them several times in the past. After overcoming an overbuild up of memory purchases by data centers over the past several years, the company believes they are in the very early stages of a multi-year growth phase driven by generative AI. The stock has had a great run since the beginning of 2023, but we feel there is more to come as the AI story plays out.

Recommendation List: A list of all previous specific investment discussions made over the past 12 months will be provided upon request. Please email lara@mhandassociates.com or call our office for this list.