MH & ASSOCIATES • SECURITIES MANAGEMENT CORPORATION

# INVESTMENT VIEWS

APRIL 30, 2023

## BEWARE THE CROSSCURRENTS

There are strong crosscurrents at work in the economy and financial markets right now. These crosscurrents, including the ongoing war in Ukraine, inflation, a resilient labor market, a potential recession, aggressive Fed tightening, environmental mandates, a smoldering banking crisis and upcoming debt ceiling political drama create a volatile mix that investors must be aware of.

### Patience

We have stated before that market volatility, both up and down, will remain higher than most investors are used to. Noting the potential for higher volatility, there remain many compelling investment opportunities for the active, patient investor.

As these are crosscurrents, meaning some of the situations are positive, they are pushing against more negative factors and creating confusion and volatility in financial markets. It is unlikely that these crosscurrents will dissipate anytime soon so investors need to mentally prepare for sharp movements up and down ahead.

### Opportunity

In a given month, investors may be faced with economic data showing falling consumer spending, declining GDP and stubbornly high inflation, while news headlines describe an ongoing bank crisis that may imperil Fed rate hike plans. Yet, in the same month, OPEC may cut oil supply and clean energy mandates cause copper and lithium prices to rise.

Buried under all the noise is opportunity. It is beyond our scope to opine too much on various policies and situations except to find a way to benefit or be protected from them.

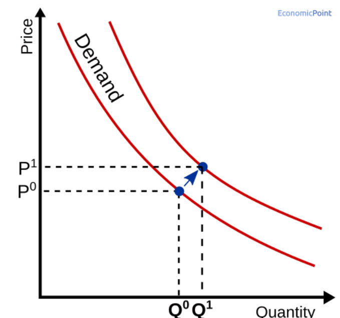
### Staying Active

Our active investment style allows us to build and change portfolios in a dynamic manner. Our process allows the portfolios to change as we research new ideas, incoming data and situations evolve.

Currently, we favor a healthy mix of cash, U.S. Treasuries, precious metals and equities, with a focus on energy, raw materials and select technology. This mix will continue to change over time.

## SUPPLY ISSUES RETURNING?

The Federal Reserve has been on an aggressive campaign of raising interest rates. Surely, with inflation running high, some amount of increase is warranted. However, the heart of inflation is a supply issue. There are not enough of goods, services, even labor to meet demand, causing prices to rise. To be sure, some supply issues caused by the pandemic have subsided, mostly on the technology side, where there is now a glut of inventory.




Interest rate increases were meant to serve one purpose, to curb demand in the economy. These rapid increases though also have an effect on the supply side of the equation as companies are less likely to spend on increasing supply in an uncertain environment. Therefore, when the US central bank begins to ease on rates, the demand will come back much faster than supply, putting the economy further back into another imbalance and potentially stoking the inflation fire once again.

From an investment point of view, we look to areas where supply growth has been neglected for years, even decades, for opportunities. The energy sector in particular has these characteristics, as does commodity mining.

## URANIUM UPDATE

One area of focus has been on the forthcoming nuclear revival or renaissance. We have written before about different aspects of this investment theme and as of now it is our belief that nuclear energy is about to heat up.

Cameco, one of our core nuclear energy holdings, recently assured investors that the upswing in uranium prices is just about to get underway. While uranium once traded less than $20 per pound, it is now headed towards $60 just as global nuclear players begin the long term contracting process.

It is expected that with nuclear power being recognized as the best solution for reliable emissions free energy, uranium prices will likely head multiples higher over the next few years.

## NOT ALL UP MARKETS ARE THE SAME

Since the beginning of the banking crisis, the S&P 500 is up an impressive 4.7%. But how an index is calculated carries a lot of weight in how it performs. This impressive return relates to the fact that the S&P 500 you read about every day is calculated based on the market capitalization of the companies that comprise the index. In other words, the larger the company the more sway it carries in the performance of the index.

If you look at the performance of the S&P 500 over the same period, but calculate it using equal "weights" for all the companies (i.e. each company carries the same influence), then the index is actually down over this period.

What this is telling us is that it is the largest companies that are holding the market above water, what traders like to call a narrow market. This is an unhealthy environment and shows that the average stock is struggling. Are people moving to the safer haven of large companies? Are large cap technology companies (Apple, Meta, Nvidia, etc.) already being repriced due to the prospects of falling rates? Likely a bit of both, but what ever the cause, the average stock needs to start outperforming for the bull market to resume.

## TECHNICALLY *Speaking*

On the right is a chart of the S&P 500 as well as smaller charts showing several ratios which tell the tale of whether the market is in an offensive mode or defensive mode. In general, when investors are buying consumer staples and utilities, this is a "risk-off" environment. The same for when small cap stocks are underperforming large cap stocks.

The bottom three panels on the chart show ratios of Consumer Discretionary to Staples, Transports to Utilities, and small caps to large caps. When these ratio lines are dropping, the market is defensive and vice versa. The market moved up nicely along with these ratios until the end of 2021. Notice as well the peak in small cap leadership occurred much earlier in March 2021 (vertical red line). This was the canary in the coal mine of the market running our of steam. We will need to see these ratios begin to break out upwards if this bear market rally is to turn into another bull market.

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