MH & ASSOCIATES • SECURITIES MANAGEMENT CORPORATION

INVESTMENT VIEWS

APRIL 30, 2022

MARKET CORRECTIONS

The major stock indices have seen significant declines this year. Nobody likes corrections, but they are part of investing, and will continue to happen. Quite frankly, they are good for the long-term health of the market as they tend to squeeze out the speculators. In volatile times like we are in today it is important not to panic. Investors should be focusing on making a list of what undervalued stocks to buy. As in the past, this correction shall pass.

A TIGHT SPACE

We have written before about what can only be described as the Federal Reserve and other policy makers being stuck between a rock and a hard place. Inflation has been persistently high, while evidence is growing that the economy also losing momentum. This week we saw the 1st quarter GDP contracting by nearly 2%. With inflation running near 8%, real GDP is shrinking by 10%! This is stagflation and puts the authorities in a very difficult position.

Many pundits are currently downplaying recent weak economic data as a unique one-time situation that will quickly pass. However, there currently is not much clarity around the direction of economy with many different dynamics at work, including a slowing housing market, a lack of Federal fiscal initiatives, higher interest rates all seemingly working to slow down the economy. Certain caution appears warranted.

The Fed has signaled a very aggressive regime of interest rate increases to combat inflation at the same time we are getting clear signs of a slowing economy. While surely inflation must be tamed in the long run, it seems like a policy error is taking shape that could harm an already weaking economy. With an expected rate increase in the coming week, we will see if the Fed has recognized any of the signs of weakness we are observing.

LIQUIDITY CONCERNS

At the time of this writing, Amazon is the latest mega-cap stock to severely disappoint investors, closing down nearly 15% on the day. This follows other high flying tech stocks such as Netflix, Meta (formerly Facebook), Nvidia and many similar names now being down over 20% from recent highs. There are many other stocks that are also down significantly as well.

Though corrections are necessary and healthy for a longer term bull market, losses in these mega-cap names do damage to general market liquidity. These stocks are often used by large institutional investors or wealthy individuals to borrow money (margin loans) and could force them to sell those shares or other margined positions.

Clearing out margin in the market is also healthy, but it will surely require liquidity in the near term. Investors should prepare to take advantage of it.

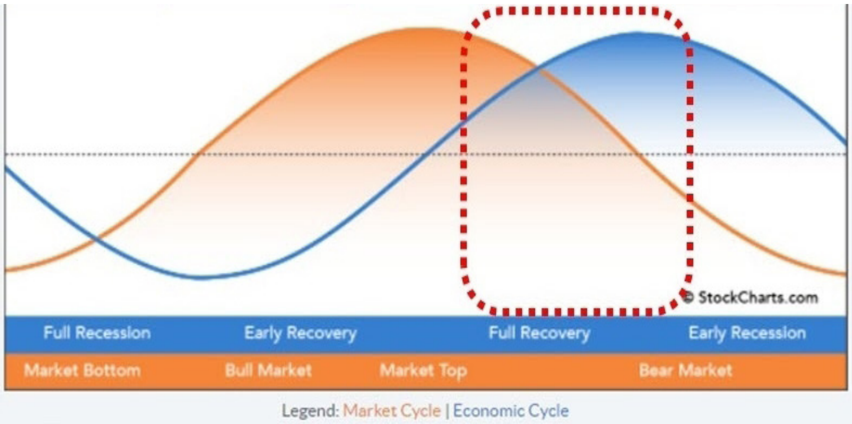
BONDS LOOKING BETTER

With inflation rising to nearly double digits, bond yields have soared, and prices have crashed. Less than year ago, the yield on a 10 year US Treasury bond was barely over 1%, while today in is quickly closing in on 3%. This is a reason why we have avoided most bonds for several years now. An investor in the 10 year would be down nearly 20% from a year ago...not safe at all!

We are beginning to watch more closely how the bond market is behaving as yields are looking relatively more attractive. If inflation is subsiding, or even just cooling off for a while, yields can come back down quickly. We believe that the yield benchmark 10 year Treasury should top around 3.25% to 3.5 % in the near term. Once there, it will deserve much more attention from investors.

HILLS AND VALLEYS

Many things run in cycles, the market and the economy are no different. While nothing is written in stone, cycles generally run at a certain cadence and roll from one to the next. The graphic below depicts the general flow of the stock markets and the economy. The market peaks and bottoms before the economy, thus the idea that the market is a discounting mechanism as it prices in an economic decline before it happens.

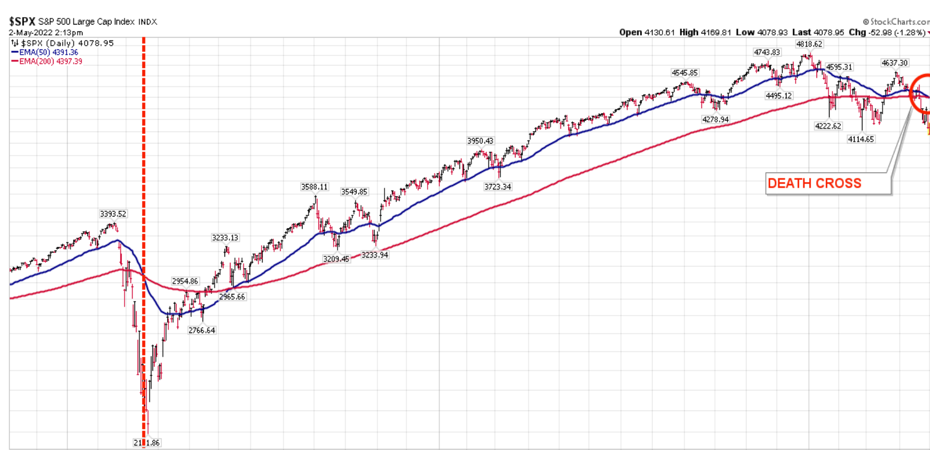


When looking at current economic data, the actions by the Fed and the direction of the stock market, the consensus is that we are somewhere within the red dotted box, full recovery to early recession. Current conditions of rapidly rising rates and industrial production that is flat, place us in the full recovery category. Consumer expectations that are falling sharply and the yield curve is either flat or inverted generally indicate a recession is starting.

To be fair, market forces have been manipulated for years by such things as quantitative easing programs as well as easy monetary policy. These actions were very well intentioned, but eventually when you begin to normalize the forces that drive economies, there will be a catch up phase that can be painful. This certainly appears what we may be experiencing right now. The market indices mostly peaked around the beginning of 2022, while some peaked all the way back in November. This places us in the early innings of a bottoming process which can last several quarters to even longer. To get a gauge on when it will be over, we will look for sectors like financial, technology and consumer discretionary to signal that we are moving out of a full recession and into a recovery. These moves will be evident before it shows in lagging economic data.

TECHNICALLY *Speaking*

Looking at charts in a bear market can be a very frustrating exercise. As a long term investor (as opposed to an investor looking to short the market) you are looking for any kind of positive you can find which might point to momentum shifting back to the upside. Much of the technical talk about the market in the coming days will likely be centered around the recent "death cross", which is when the 50 day moving average of the market crosses below the 200 day moving average. While this is definitely not a positive, the bright side is that when this occurs, it has generally happened towards the end of a correction in the market. The red vertical line indicates the last time this occurred and, as you can see, a majority of the damage had already happened. Past occurrences have shown a similar pattern as well. So perhaps this is the first light we see at the end of the tunnel.



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