MH & ASSOCIATES • SECURITIES MANAGEMENT CORPORATION

INVESTMENT VIEWS

MAY 31, 2022

ECONOMIC TRENDS IN FOCUS

Investors have become very focused on the day to day headlines and movements of the financial markets, as the economic environment shifts and we continue to experience record volatility. However, it is useful to take a step back and review the longer term economic and financial trends we think are important to keep in mind.

Fiscal & Monetary Backdrop

With government debt at record levels and interest on the debt nearly exceeding tax receipts, Treasury and Fed officials are likely to ultimately continue with easy monetary policy. While there will certainly be continued efforts to fight inflation and reduce spending, eventually they should give way to further easing and spending. Obviously, an unexpectedly aggressive Fed or fiscal prudence in the Federal government could change this outlook, however we view this as unlikely.

Inflation & Employment

Investors should expect inflation to wax and wane over the next few years. While it is the common opinion that inflation is due to “too much money printing,” in reality there are many contributing factors at work, mostly on the supply side. Authorities will try to contain it by raising interest rates to reduce aggregate demand, however their actions are unlikely to solve the root issues. Instead, time is needed for the various “kinks” to be worked out and for the supply side to return to normal. Besides, inflation could help the size of government debt to shrink over time.

Employment should remain fairly stable given that Baby Boomers are finally retiring, causing the natural rate of employment to be higher than expected. In turn, this situation should support steady wage growth over time, supporting consumer spending, but hurting profit margins. Technology is the wild card in this area, with software, artificial intelligence and robots making a bigger than expected impact on jobs.

Technology

While technology has recently taken a backseat in the stocks markets, it will continue to push forward in our economy and society. The benefits of technology, including cost savings, efficiency, and personal and corporate empowerment will certainly drive further progress and change going forward. Whole sectors of jobs could be at risk as technology moves further into vehicles, stores, factories and previously untouched fields of law, medicine and banking.

Energy

As discussed in several previous newsletters, we are in the midst of an energy crisis and transition. Supplies of oil and natural gas are low due to nearly a decade of underinvestment and it will take some time and pain to fix. As an example, inventories of natural gas are currently 1.9 trillion cubic feet below our five year average. Spiking natural gas prices should come as no surprise. On the positive side though, gas rigs and oil rigs in use are on the rise. Currently there are 54% more gas rigs and 60% more oil rigs than at the same point last year. To be fair, we will need more to make up for the low supplies, but it is heading in the right direction.

Meanwhile, the world continues to move towards cleaner sources such as solar and wind, with next gen nuclear power recently being added as well. Both the crisis and the clean energy transition mean big opportunity for investors in the raw materials and technology that is needed to keep the world moving.

LOOKING AHEAD AT GEOPOLITICS

The war in Ukraine continues to take a terrible toll on civilians and disrupt critical supply chains that hundreds of millions of people depend on for food, energy and other basic items. The longer the war drags on, the higher the risk of serious escalations, therefore we hope for the situation to end soon for everyone's sake. Even if this war ends, there is very little chance that things go back to normal in the region; it is forever changed.

At the same time, we are seeing signs of tension building up between the US and China over Taiwan. Many experts observe that China is watching our response to Ukraine as a kind of "test" to help formulate a strategy for invading the capitalist island.

Geopolitics is sure to be an issue of increasing significance in the coming years. Whether we are dealing with tensions, trade disputes, diplomatic incidents or wars, changing relationships across the globe will affect markets decade ahead.

WAGES ARE HOT

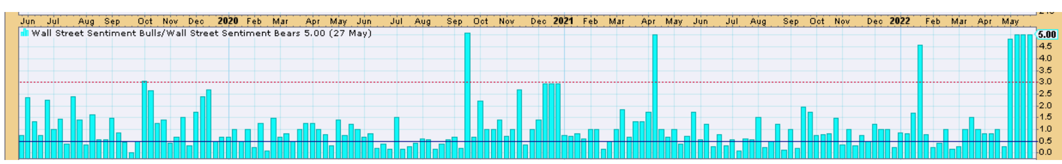
While inflation has captured financial headlines for several months, the story of wage growth has received little attention. Across the board, but especially at the lower end of payrolls, wages are up and in some cases double digits. For sure, this is part of inflation, but it leaves the consumer in a better position that most might think. They may not buy more items, however they should be in a decent position to weather the inflation storm.

VOLATILITY

Investors should be prepared for high volatility in the coming months as markets deal with inflation, interest rate changes, economic uncertainty and policy responses. Equity markets should regain footing as the various factors in play settle down, and the economy moves forward.

TECHNICALLY *Speaking*

We talked last month about potentially seeing the first light at the end of the bear market tunnel. While we are still not certain we have seen the lowest lows of the market just yet, evidence is mounting that we could be starting the bottoming process needed to resume an upward trend. The last full week of trading in May was the strongest three day stretch in terms of volume breadth that has been seen in a while. In those three days, volume was over 80% upside volume and since 1968 (as far back as the data goes), there have only been 13 back-to-back-to-back days like this. The average return three months after this occurs is +6.4%, with only two instances showing negative returns three months onward and no negative returns in the last six occurrences.



Market sentiment readings are also showing some signs of bullishness. The chart shows weekly Wall Street sentiment (i.e. "smart money") and how bullish or bearish they are. The last three weeks readings all show readings at or near 5.0 (five times as many bulls as bears). The chart only goes back to 2020, but reviewing data back twenty years, this has only happened a handful of times and generally precedes a bottom in the market or a continued move forward.

For many reasons, we never expected a recovery like we saw from the 2020 COVID lows. This recovery will likely resemble the credit crisis as there are serious economic and geopolictical issues to overcome. That said, the history of the market shows that eventually new highs will be achieved, but some pain always occurs.

& Associates

MH & Associates Securities Management Corporation
2888 Loker Avenue East, Suite 318 • Carlsbad, CA 92010
23901 Calabasas Road, Suite 2005 • Calabasas, CA 91302
(626) 440-9694 • www.mhinvestments.net