MH & ASSOCIATES • SECURITIES MANAGEMENT CORPORATION

# INVESTMENT VIEWS

AUGUST 31, 2023

## HAWKISH POWELL FOCUSED ONLY ON INFLATION

We have written several times over the past year regarding Chairman Powell's effort to bring inflation back to the arbitrary 2% target. Last week Powell had the chance to relent on his campaign and offer some conciliatory words to those who are concerned about the building economic and financial tensions created by his aggressive interest rate policy. He offered none – and stubbornly stuck to his plan.

While inflation is a concern, minimizing all other components in an economy certainly is not wise and there are growing signs of recessionary pressures. We wonder if Chairman Powell is walking the US economy into a downturn, noting that the Fed does not have a good track record of recognizing problems until it is too late.

## THE UNWINDING OF GLOBALIZTION

The term "globalization" refers to the interconnectedness of the world's economies, brought about by growing cross-border trade in goods and services. For many decades the integration of more and more economies into international trade has worked well and has been a key driver for much of the world's economic growth. However, about a decade ago small geopolitical changes started to appear in the global economy, shifting towards "deglobalization." More recent events like the Trump tariffs, Covid, and the Ukraine war have accelerated the shift as these events became very disruptive to the flow of trade.

In response to the disruption, we are seeing a new world order develop. Many companies that used to source their inputs from around the world now face tougher times and are being forced to adapt. Businesses are diversifying their production and relocating it nearer to home in a process known as "reshoring."

Whether the era of globalization is permanently over remains to be seen but we believe we are close to a tipping point towards accelerated deglobalization. This development warrants close watching as this will have important implications in terms of challenges and opportunities for investors in the years to come.

## ENERGY CRISIS

### Preparing For The Next Move

Our firm took a significant position in energy-related investments over the past few years. In 2022, these investments provided very strong returns and were a major hedge against general market weakness which was driven by the Fed's aggressive interest rate hikes. This year this energy position has proven to be an anchor so far, underperforming a market led by technology.

While this might be somewhat frustrating for some investors, it is important to keep in mind that the world is still in the midst of an energy crisis that may last several years. With that in mind we see this as an opportunity and have added to positions over the last several months. We are convinced that absent a major crisis, high energy prices lie ahead.

## BOND UPDATE

### Focused on US Treasuries

After being very negative on the bond market for several years, we have become big fans of US Treasuries, especially on the shorter end of the yield curve. With yields around 5% all the way out to 2 year maturities, US Treasuries provide a decent return in an uncertain market. However, other parts of the bond market remain unattractive, including corporate, high yield and municipal bonds which do not offer an attractive "spread" over US government bonds. We do expect those spreads to develop and widen, after which we will reexamine their investment case.

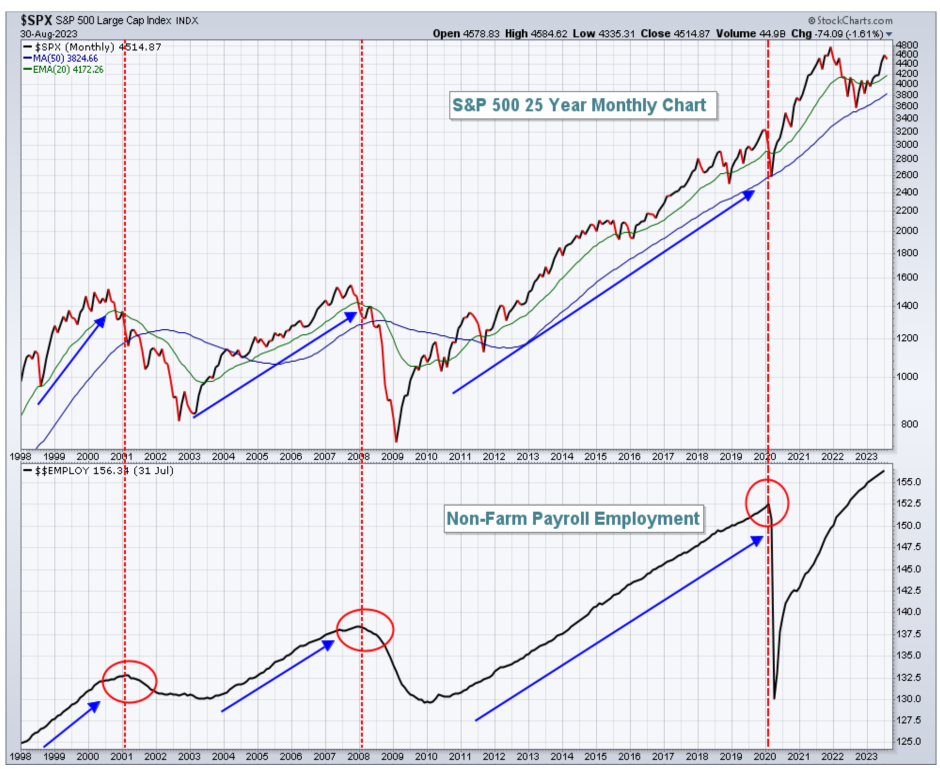
## Bloomenergy

While the debate around climate change rages on there is one thing that is certain, the demand for electricity is outpacing the supply. The electric grid in most cities is unable to keep up and this is resulting in power outages and higher prices for businesses and individuals. We started a position in Bloom Energy in the lows of the pandemic as its valuation was enticing based on its long term potential.

As a leader in the market of clean hydrogen energy production, the market has been waiting for the costs of this technology to come down to a competitive level. While they are getting closer to this breakthrough, the company has not stood idle and offers its energy servers (currently using biogas or natural gas) to customers with the flexibility of switching to green hydrogen when this technology matures. As electricity supply issues have struck businesses in the past couple years, the benefit of such servers as a reliable alternative to the grid is starting to take off. Customers ranging from hospitals with heavy energy demand during the pandemic to data centers needing reliability due to the increasing workloads of artificial intelligence applications, Bloom can expect a wide range of uses for their micro grids. While hydrogen will not provide a meaningful impact to revenues until 2025, signing up customers on their current technology provides a revenue stop gap in the meantime. The company has been successful in meeting their aggressive revenue targets so far and are confident that will continue. With profitability still a year or so off, we are still early in this play. However, increasing demand here and abroad will continue to rise.

## RECESSION OR NOT?

Recession talk seems to be constantly in the air for the last couple years. While we arguably had one already with two consecutive quarters of negative GDP over a year ago, there is still chatter that another one is coming. There are many measures of economic strength we look at, but one of the morereliable is the non-farm payrolls number that comes out every month. In fact, one will be out as we send this newsletter to clients. As you can see in the chart below, when this payroll number begins to level off and rollover (red circles) the market is likely in for an extended downturn. Actually the market, being a discounted mechanism will lead this by a little bit as it begins to price in a recession while employment numbers continue to drop. The pandemic level drop in employment was definitely an outlier in that it was artificial and produced only a relatively small market reaction (although seemed terrible at the time). So we will be watching this number closely going forward for some clues on what the market may do and so far it is still climbing like the market.





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