MH & ASSOCIATES • SECURITIES MANAGEMENT CORPORATION

INVESTMENT VIEWS

JULY 31, 2022

TURNING POINTS

After a volatile and relentlessly negative first half, investors have been left feeling very pessimistic. Who can blame them with all the negative headlines they are facing. From high inflation to non-stop media talk about a recession, domestic political drama and serious geopolitical situations, there is plenty of risks for investors to worry about. The important aspect to remember is that the stock market is a discounting mechanism. It looks forward into time and values companies according to what is likely to occur several months to a year ahead. So the question arises, what exactly has been discounted in the decline that the market has already experienced?

PRICED IN ALREADY?

Has a recession been priced in? Or has it accounted for inflation already and the aggressive actions the Fed might take to cool it off?

Overall, it is our observation that a good deal of problems have been priced into the market. While we are not calling for THE bottom, we do think that for now the market should at least continue to tread water as the market assesses incoming economic and financial data. Of note, recent quarterly earnings demonstrated a certain resiliency among many of the market leaders who reported weak numbers and outlooks, demonstrating that certain negativity has been priced in already. It is generally viewed as a sign of a bottom when stocks rise on bad news and we saw this in various stocks in the last weeks of July as earnings season began.

Furthermore, incoming economic numbers, while not great, are also better than expected. Employment has been holding up fairly well so far, durable goods orders have been growing and retail sales also holding in better than expected. Offsetting these positives are a sharp drop in housing numbers, slowing auto sales and cautiousness in the banking sector. To be fair though, rises in the previous mentioned categories were a part of the inflation issue and we are seeing more forward looking inflation measures indicating a slowdown in inflation. A rise in unemployment (large companies have already been announcing layoffs) will further dampen inflationary pressures, but certainly not be an aid to the economy.

FED HOLDS THE KEY

Chairman Powell has been unambiguous in his commitment to bring down the rate of inflation to the stated target of 2%. He is likely to further raise rates at the next two meetings, however it is also likely that he will at least pause afterwards to wait and see if inflation is cooling off. Higher rates are definitely pushing the economy down and could put the US in a more obvious recession since many economists are dismissing the current negative GDP readings. The economy has been somewhat resilient so far, however the Fed cannot count on such resiliency lasting too long. If corporate sales slow further and margins continue to be pinched, it will not be too long before deep job cuts begin as we are already seeing some from companies like Oracle and Amazon.

The Fed holds the key to the direction of the market over the next few months, as it tries to balance fighting inflation with keeping the economy into a more serious recession. For the time being, investors are stuck in a holding position until the market finds its next turning point.

OPPORTUNITY WITHIN

As always, every negative situation brings certain opportunity. While cautious, we are definitely looking to take advantage of investments that present excellent longer-term risk/rewards. We feel very comfortable with our active, individual stock picking strategy as each company can be evaluated on its own, irrespective of factors that may influence the general market in the near term.

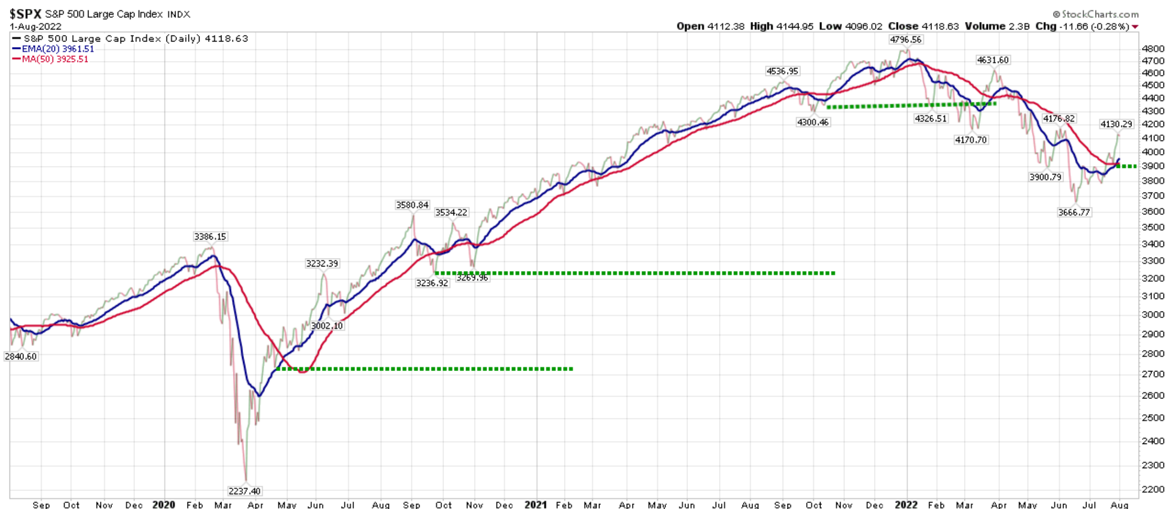
Currently, we are considering companies in the technology, energy, healthcare, transportation, materials and industrial sectors. We will add and/or replace holdings in the portfolio as opportunities present themselves.

TECHNICALLY *Speaking*

Bullish Pulses Rising

We still consider ourselves to be in the midst of a cyclical (intermediate term) bear market that is occurring within a secular (long term) bull market. Since 1950 we have had eleven cyclical bear markets and on average they last about two hundred days. The current downturn hasn't quite reached that duration yet, but it is getting near that length and as far as bear markets go, has been particularly harsh, losing about 25% of value. So how do we know when a bottom is a bottom? The answer is you never really do, but you look for trends to change and breakouts to occur, which then provide more support for the market. While we track a large amount of market breadth measures to tell us the "health" of the market, just looking at simple moving averages can tell you a lot about where the market is going. Sure they are numbers that do not give the most timely signals, but they are generally very meaningful ones.

The chart below shows the S&P 500 since the COVID lows with two key moving averages plotted in red (50 day moving average) and blue (20 day moving average). When the 20 day crosses above the 50 day moving average (a silver cross), this tends to be quite bullish. When we see this, we then look for new areas of support for the market. The first level we look at the is the most recent low right before the moving averages crossed. In this case it is the 3900 level and we believe this is the level the S&P needs to hold to confirm that the June lows were the actual bottom of this bear market. We plotted similar green lines for support after the 20 day average crossed the 50 since COVID. This level did not hold in early 2022 and gave an early indicator that the crossover that occurred in March might not be the bottom. At this point though we did not consider it to be a bear market as the S&P was not down 10% yet. Analysis of previous bear markets (i.e. more than 10% down) shows this support level has only been broken once in all of the eleven cyclical bears, so this previous low holds importance. We should pay attention to the market holding above 3900.



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