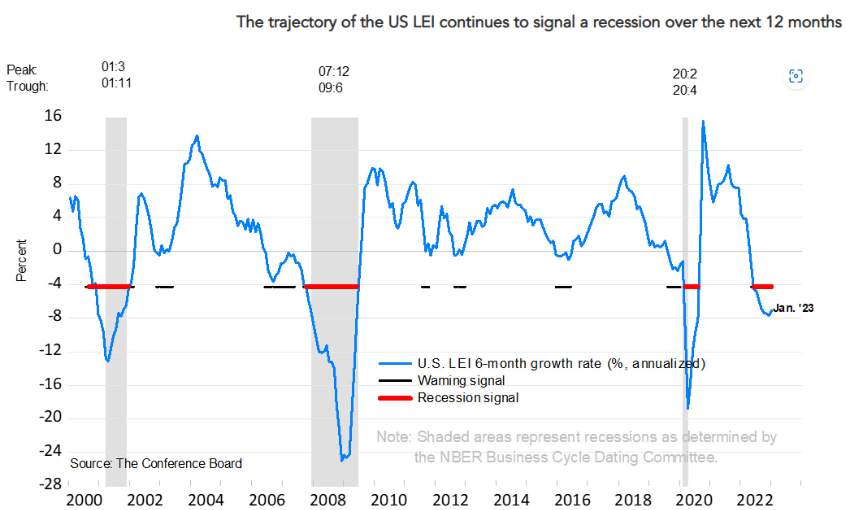
MH & ASSOCIATES • SECURITIES MANAGEMENT CORPORATION

INVESTMENT VIEWS

FEBRUARY 28, 2023

LEADING ECONOMIC NUMBERS POINT TO TROUBLE AHEAD

The "risk off" trade definitely reemerged in February after a jobs report came in hotter than expectations and, later in the month, the Fed's preferred inflation gauge was also more elevated than analysts predicted. These events put investors back into a hawkish Fed frame of mind just at a time when economists had expected them to continue slowing their rate of increases. It's no wonder the market started to roll over after a very positive January. The problem is, the Fed continues to look at very few data points, and those generally represent lagging information. The Fed also seems to be ignoring the big picture on employment and that is the continued announcements of large layoffs, particularly in the technology sector. We expect a good portion of these layoffs will make their way into the unemployment claims report at some point, perhaps then the Fed will finally pay attention.



If one were to look at more leading economic information, such as orders for durable goods, consumer sentiment, housing starts, among others...then you will see a different picture. These indicators are either falling fast or already at extremely low levels (like consumer sentiment). The Conference Board's Leading Economic Index (last updated February 17th) declined again in January and was down 3.6% for the six month period of July 2022-January 2023. This decline was much steeper than the 2.4% decline for the January 2022-July 2022 period. On the positive side, the January reading ticked up slightly from December.

When looking at the "three baskets" of economic reports (lagging, coincident, leading), the lagging show that the economy is in fair shape. Coincident indicators show an environment that is flat lining and leading show danger ahead. This is not the data you would see at the beginning of a period of growth. There is a key market fact that almost all economic recessions contain a market bottom and markets do not bottom ahead of an imminent recession (one exception, December 1917). Both stock and bond markets could continue lower as the Fed continues hiking rates. However, we also believe we are closer to the end of this process and other dynamics could provide the soft landing the Fed is looking for. One of these is that China appears to be opening (for real this time) and, while relations have cooled, will provide a boost as well as an inflation lowering level of supply of goods. China opening also helps emerging markets which have been hampered.

At some point, the obsession over every word the Fed says will die down and we believe it would be wise to pay attention to fiscal policy and federal spending to see where the money is being spent. There are already big spending bills that have been approved that are hitting the market place, namely the CHIPS act. We expect there to be more and should provide some ammunition for sectors of the market.

THE END OF GLOBALIZATION

We have written previously about the end of globalization, and what it means for the investor. At the time it was something distant and hard to see, however in the past year it has come into focus. Initial actions such as tariffs and duties on imports have given way to sweeping legislation mandating certain goods be made in the U.S. or prohibiting citizens employed in the tech sector from working in foreign countries. Exports are now also being closely scrutinized as every nation is concerned about giving an advantage to a potential rival. Indeed, globalization seems to be quickly receding.

With the world now looking quite fractured and divided, it is no surprise that nations and corporations are looking to closely guard their most valuable resources and at the same time securing the ones they need for themselves. From basic items such as oil, natural gas, metals, and grain to advanced technology goods such as semiconductor chips, computer hardware and software, nothing is "off the table." Energy is being used as a weapon in Europe, while the U.S. is doing a similar action with advanced computer chips, aiming to keep such technology out of global rivals hands.

This dynamic will yield mixed fortunes for investors. Certainly some items such as commodities should do well as friction in global trade will put upward pressure on prices (i.e. inflationary). While at the same time, technology goods may see weakness as restrictions will likely lead to less total demand. While we hope that this dynamic will turn around, it is likely that it will get worse, before it gets better.

ENERGY SECURITY AT THE FOREFRONT

From oil and natural gas, to more advance clean technologies such as solar and next generation nuclear power, nations are looking to secure their energy supplies. Since the Russian invasion of Ukraine, many nations have taken a second look at their energy security. The chaos that Europe has experienced is at forefront in the thoughts of many government officials around the world. Energy has been used as a weapon by Russia and those officials are keen to make sure that they are not in a position where that could happen to them. It is important to note that at the time of the Ukraine invasion the U.S. was nearly completely dependent on Russia for uranium and uranium fuel.

There are now government incentives to find and stockpile essential "energy" metals and minerals such as copper, lithium, cobalt and nickel domestically. All these materials are needed to make the clean energy/EV transition that this Administration has been championing and many of them are not currently found or produced in the U.S.

Nuclear energy is now recognized by governments as a highly reliable, safe and secure form of electricity. The U.S., China, France, Canada, India and Saudi Arabia are all looking for new uranium deposits needed to fuel next generation reactors that are being built. These nations and the companies that represent them seek to establish reliable, and preferably friendly sources of uranium as a cornerstone to a smarter, more secure energy policy.

FUEL OF THE FUTURE?

Nuclear energy is becoming priority for governments around the world. Here in the U.S., one of the only companies that can manufacture advanced nuclear fuel is Centrus Energy (LEU). The company has been in business for decades, though for most of the time it was a government owned entity. It was sold off and became public a few decades ago and it struggled to survive as various headwinds challenged it.

Over those decades Centrus developed a new, advanced nuclear reactor fuel , known as HALEU (High Assay Low Enriched Uranium) that is safer and more efficient. They (LEU) recently received approval to scale up its new processing plant and will be producing HALEU for use in a variety of new small modular reactors coming to market in the next few years.

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