MH & ASSOCIATES • SECURITIES MANAGEMENT CORPORATION

INVESTMENT VIEWS

AUGUST 31, 2022

THE FED SHOWS ITS TEETH

For 2022, markets have been grappling with inflation and fretting about whether the Federal Reserve will continue to take aggressive action to reduce it. Our stance has been that the Fed will not be as aggressive as they threaten to be as it could cause a recession or other forms of negative economic fallout. However, a recent speech by Fed Chairman Powell, caught many investors off guard. He showed his teeth and intends to proceed down a more aggressive path even if it means some pain for the economy.

While this path is cause for some concern, it continues to be our view that ultimately the Fed will not create a serious economic problem. Indeed, it must follow the dual mandate set by Congress of managing inflation along with ensuring a healthy job market. So, while the Fed may pursue further interest rate hikes in the months ahead, along with quantitative tightening (QT), it must consider the prospect of a deep recession in its decisions. At this point, we are looking out into early 2023 as a point where the Fed may pivot and look to either lower rates or keep them stable.

WHY IS THE FED SO IMPORTANT?

It may be asked why investors are so focused on the actions of the Federal Reserve? Our answer is that it is due to the extraordinary activities of the Fed over the past 15 years. It has set and guided powerful policies that have driven the economy and the financial markets since the 2008 financial crisis and now it is clearly beginning to “unwind” these policies. It is critical on how this unwind is handled and observing how financial markets respond. This process, if continued, will take years, perhaps a decade to complete.

INFLATION REMINDER

Much of the inflation the world is dealing with today is centered around the after effects of the global COVID-19 lockdown and the ongoing war in Ukraine. Dysfunctional supply chains and high energy prices are at the core of the problem. Given time, both these issues should resolve themselves without the need for intervention from the Federal Reserve.

RECESSION AHEAD?

With an aggressive Fed, one that does not mind causing some pain, the odds of a recession increase by some significant degree. Investors should keep in mind that the Fed's goal is to bring inflation down, which can also harm everyone’s standard of living and purchasing power over time.

Incoming data suggests a weakening economy and it is important to watch for a deterioration in employment numbers in the weeks and months ahead. While Chairman Powell noted that he wants to avoid the mistake of easing too early once inflation cools, there will undoubtedly be pressure to ease if and when unemployment becomes an issue and a recession become evident.

Our focus will be to observe incoming data, make any appropriate changes to the portfolio and take advantage of opportunities if and when they present themselves.

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NUCLEAR ENERGY UPDATE

We have been writing about our investments oriented towards a nuclear energy revival for a few years now. We were early to this theme however it always seemed clear to us that nuclear energy would have to be a major part of the drive for a cleaner, yet energy intensive future. There simply is no other source that can reliably deliver the quantity of energy needed to move away from the use of hydrocarbons.

Investors need to understand that coal, oil and natural gas produce 63% of global electricity and over 85% of total global energy. It will be very difficult to completely wean off these fuels even over 30 years with nuclear power and impossible without it being a major part of the solution.

Additionally, the war in Ukraine has highlighted to many western nations their high vulnerability to foreign energy supplies. This has served as a catalyst for those nations to consider keeping nuclear power plants open for longer than planned and move forward with advanced next generation reactors.

Some of the recently announced initiatives include France planning to double its nuclear fleet (already the largest in Europe), Germany, at least, delaying the closure of its remaining reactors, and Poland, Romania, Italy, United Kingdom all making plans to place orders for small modular reactors (SMR). Currently, the United States is also making a major pivot towards SMR reactors as well as other innovative next generation designs. In a future article, we will delve into innovations the nuclear industry is developing and how they might fit into the bigger picture.

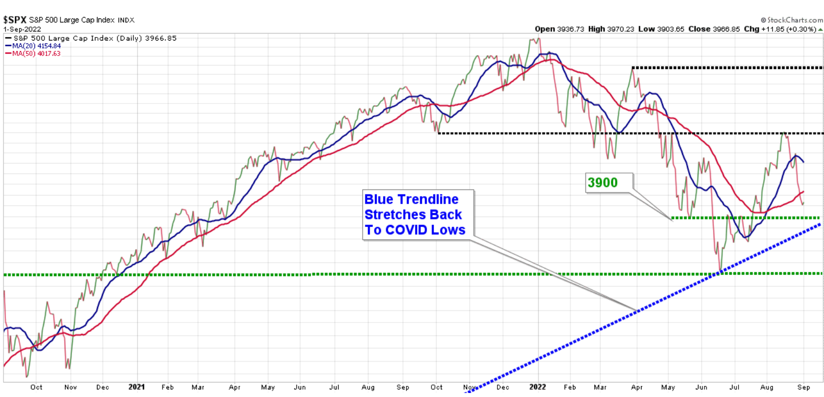
TARNISHED GOLD

Gold is a unique metal in that it does not tarnish. However, it has become quite tarnished in the minds of investors recently. As the Fed pursued an aggressive monetary tightening path, gold has been weak as investors were drawn to short term interest rates that are the highest in over a decade. Additionally, gold miners have taken a double hit as gold prices are down while input costs are up. While this sector looks unfavorable at the moment, we believe that gold will resume it's upward trajectory within the next few months and regain it's shine in the eyes of investors.

TREASURIES ARE COOL AGAIN

We have written numerous times explaining that bonds, in particular Treasuries, did not represent a good risk/reward and we were correct. Our accounts held a high percentage of cash in lieu of bonds for over 2 years now and this year bond prices collapsed, falling WITH stocks in the first part of 2022. However, shorter term Treasuries, with maturities less than 2 years are all paying about 3%, which represents a "no brainer" in our minds. The broader spectrum of bonds remains unattractive in our opinion, however we will be content for now investing and "rolling" various shorter Treasury maturities for the time being.

TECHNICALLY *Speaking*



We wanted to give a quick update to our article last month stating that the 3900 level is very important for the S&P 500 here. After a nice rally which took us to new swing highs (a higher high than the last high that preceded a new low), we are tempting those levels again. The importance of holding these levels hasn't changed and a break would likely result in a retest of the June lows. On the positive side the shorter moving average (blue line) is above the longer average (red line) and that is bullish. Beyond that there are not a lot of bullish things to say if the market doesn't turn again soon.

& 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