MH & ASSOCIATES • SECURITIES MANAGEMENT CORPORATION

# INVESTMENT VIEWS

MARCH 31, 2022

## CLIENTS AND FRIENDS: BEWARE OF SCAMMERS

A recent article in the publication Barron's recently indicated that some clients at Morgan Stanley Wealth Management were affected by low-tech scam by malicious individuals. These individuals obtained contact information for Morgan Stanley clients and got them to divulge information that enabled them to gain access to the account(s) and make electronic payments. While there was no "data breach" in the modern sense, the clients were involved in an old confidence scam, a person calls on the telephone claiming to be an official employee reaching out to help, claiming they need information in order to resolve a problem.

What can you do? First, if you receive calls from your brokerage, please do not divulge any sensitive information to them. This includes account numbers, social security numbers, login, or passwords. If they actually work for the brokerage, then they have access to that information already and wouldn't need to call. Second, call our office immediately and let us know you were contacted. If there is an issue we either already know about it or can call our contacts at the brokerage to vet the problem.

## SHELTER FROM THE INFLATION STORM

During the first quarter of 2022 investors focused on surging inflation and then the Ukraine War. Financial markets were rocked by volatility, as these events shocked both interest rates and the prices of commodities. In turn, the stock market sold off as investors contemplated the possibilities that inflation could even accelerate, and the Fed would need to get very aggressive in responding to it.

While the volatility certainly negatively affected the growth side of the equity market, several sectors moved sharply higher in response to the shocks. Energy, mining, precious metals and materials all provided shelter from the inflationary storm that is upon us. For example, the energy sector gained nearly 40% during the quarter, while gold miners and other metal miners recorded gains well over 20% during this time.

We were fortunate in having significant exposure to these sectors, which helped us avoid a lot the pain of the overall market during the quarter, insulating portfolios from some of the volatility.

## INFLATION IS A SUPPLY ISSUE

The Federal Reserve is set to raise rates as many as seven times this year to combat inflation. While raising rates certainly could cool off some of the more speculative and “hot” areas of the economy, a great deal of inflation is centered around food, and other basic materials. These items are simply in short supply due to the lingering effects of global COVID lockdowns, with the war in Ukraine set to make the situation worse down the road. It is unlikely that interest rate hikes will change the upward pressure on these basic items. There is no doubt that the Fed must take action where it can to cool inflation, however, hopefully it realizes the limits of it’s policy and that it must tread carefully as to not damage the already slowing economy. A sharp rise in unemployment (see article on next page) could make the Fed throttle back on these plans, but they tend to react slowly.

## WEALTH EFFECT: CAN'T COUNT ON IT

Research has shown that households spend 4-5% of the wealth that is gained from the financial markets over the previous 1 to 2 years. Similarly, they spend 7% of wealth gains in housing. Over the last several years we have seen considerable wealth that has been achieved from both of those markets. This in-turn implies that going forward this new wealth will translate into plenty of dry spending powder for the consumer. However, we are not so sure that this financial tailwind will develop and investors should not count on it.

That seeming tailwind is being met with headwinds of rising inflation, rising borrowing costs and soaring geopolitical unrest. All major stock indices are already down for the year and with mortgage rates going up, real estate is expected to peak sometime in 2022. With many households now on improved or solid financial footing we question whether they are willing to jeopardize their position with additional spending in this uncertain environment.

## END OF GLOBALIZATION

We are optimistic that the conflict in Ukraine will be resolved soon and in a manner that spares more human suffering. However, this war, launched by Russian aggression, has likely split the world and signifies the end of globalization as we know it. We expect that every nation is examining their relationships to see who they really depend on and whether their dependecy should or can be changed. Nations may reconsider freely trading their resources such as oil, gas, minerals and even food, instead only trading with “friendly” nations. Unfortunately, this dynamic is very similar those often seen in history and often precede major wars later on. The genie appears to be out of the bottle and once out, he is difficult to put back in.

## WEAKER DOLLAR AHEAD

With the world now dramatically moving away from globalization, it is likely that investors will see a lower dollar in the long run. We already are seeing a weak dollar in the form of higher prices for nearly everything. Higher commodity prices ahead are likely due to the increased friction in global trade as supply issues hit leaving buyers scrambling and potentially hording necessary items. This is not a dynamic to celebrate, but investors need to be aware of it to position and protect their portfolios from the corrosive effects of inflation.

## COMING UNEMPLOYMENT & RECESSION?

After the COVID induced rapid ascent of unemployment in the U.S., the rate of those unemployed fell just as fast and is currently near its pre-COVID lows. This looks to be coming to an end. Tightening by the Fed and rising interest rates will take the blame publicly but the recipe for this to happen began many months ago.

Economists know that consumer sentiment can play an early role in showing where unemployment will be months ahead of time. Consumer sentiment tends to lead by around ten to twelve months and it peaked in April 2021. This likely coincides with the end of stimulus checks and enhanced government aid. What ever the cause we can expect the unemployment rate to begin to climb going forward.

Will it be enough to send us into a recession? In "real" terms (after accounting for inflation) we are probably already there as GDP growth will not be keeping up. In official, "nominal" terms though, no we have not entered a recession yet. A gauge many look at to indicate a probable recession is the spread between the 2 year treasury yield and the 10 year yield. This spread recently inverted (2 year yield is greater than the 10) which may indicate a recession will occur within 18 months. The last time this happened was in 2019 and it pretty much worked to perfection, albeit thanks to COVID.

Another yield spread to look at that provides even closer timing to a coming recession is the 10 year and the 3 month treasury yields. As of right now they are nowhere near inverting, but something to keep an eye on.

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