MH & ASSOCIATES • SECURITIES MANAGEMENT CORPORATION

INVESTMENT VIEWS

JUNE 30, 2024

DRIFTING...

As investors enter the second half of 2024, they find themselves in an increasingly drifting economy and drifting financial markets. We say this because data on the economy increasingly lacks direction overall, and in the same regard are also continuing to see a lack of broad momentum in the markets.

On the economy, home sales numbers have fallen dramatically, unemployment seems to be beginning to tick upwards, yet inflation is cooling down (for now) and (some) consumers, while more careful, are still spending. Some measures of industrial activity also continue to remain resilient. Overall, the economy is losing momentum, with the increasing risk of an economic slowdown.

The equity markets continue to show a narrowness that we have written about in previous newsletters, with much of the gains concentrated in a few megacap companies. Earnings reports in general have been mixed and often result in big outcomes, up or down. Going forward, markets are likely to only be increasingly defensive as investors demand good earnings with the current market valuation. With the aforementioned drifting economy, it is unreasonable to expect solid earnings across the board.

LOOKING FOR ROTATION

Looking For Where The Puck Is Going

Over the last 6 months or so, the major themes driving the market have been fairly stagnant. The broader market has been pulled back and forth by monetary policy statements and contradicting economic indicators. When it comes to themes that are driving performance it basically boils down to AI and weight loss drugs. As we spoke about in the above article and in past newsletters, a narrow market can indeed go up, but is far from healthy.

When just a handful of stocks are leading the way, it tends to suck the oxygen out of the room and leaves very little volume for the rest of the market to feed on. The leaders will need to see investor interest rotated away from them in order for other names to participate in a more broad move forward. When certain stocks are so widely held by the largest funds in the country, money will tend to look for less obvious places to go. This will generally resemble sideways (at best) or negative action in the overall stock market since these large names from which there is selling comprise a large percentage of the market cap of the index. Once this subsides however, then the market can move forward in a more orderly way. Last week we may have seen the first signs of this as NVIDIA fell nearly six percent in just a few days and this dragged down the semiconductors for the first time in a few months. This was definite rotation since the S&P 500 was up on the week.

We are looking for where this money is moving to and it will generally lead us to beaten down stocks and sectors. One sector in particular that we have started an ETF position in is Biotechnology which has been going sideways for nearly two years after crashing from its 2021 peak. Biotech's are capital intensive and do not do well in a rising interest rate environment. Should rates shift lower, we like the idea that money can rotate there. Also, biotech's absolutely love the month of July. Over the last fifteen years they have been up in July 86% of the time with an average gain of 3.8%.

AWAITING DIRECTION

Investors are waiting for direction not only from the Federal Reserve, but more importantly the Federal government. Indeed, for the time being the economy is now more reliant on fiscal spending than in the past and while it is unlikely that new spending plans are passed this year, investors are likely to hear more about the Presidential candidate plans as the November election draws near.

EYES OF THE WORLD

Further dynamics we continue to watch include global economic growth and geopolitical situations in Eastern Europe, the Middle East, and possibly Taiwan. Changes to, or escalations in any of the areas mentioned could have an impact on commodities and materials.

Global growth has also been mixed, especially in the world's second largest economy, China. Despite repeated attempts to reignite growth, Chinese authorities have not been able to get the economy of a sustained growth track. It is expected that authorities will not give up and will eventually succeed, putting upward pressure on commodities.

WALGREENS - A FALLING KNIFE

Clients may have noticed the recent addition of Walgreens Boots Alliance (WBA) to portfolios in May and the subsequent sale recently. This small position was based on the idea that management had a plan to turn the business around and transform the struggling retailer into a leaner version of itself. Additionally, it paid a great dividend of nearly 6% which appeared to be safe at the time of initial investment.

After the recent earnings release it was clear that in fact management was still moving too slowly in their efforts and is putting the business at risk for further deterioration. Furthermore, management noted general weakness in retail store traffic, which complicates any plans for a turnaround.

While we are disappointed at taking a loss, discipline demands that action be taken when necessary. Walgreens has turned into a falling knife we are not going to catch.

THE SEVEN WEEK WIN STREAK

A phenomenon that occurred back in December 2023 was the fairly rare occurrence of the S&P 500 having a seven week win streak which also being up more than seven percent over that period. It has only happened 21 times since 1953 and tends to be a harbinger of good things for the market going forward and we have been tracking this since it occurred. We just past the twenty-sixth week since this win streak and the performance metrics continue to be impressive. Since it occurred, the S&P 500 is up over 15%, making it one of the better performance over that time span looking back at historical statistics. Since 1953, the six month performance is positive 71% of the time with a median gain of 5.9%. Better yet, after twelve months since the win streak, the index is up 85% of the time with a median gain of 13%. While this indicates a bullish bias for the market for the second half of the year, understand that the market could drift lower from here and still close that twelve month period with a gain since the move up this year has been so heady.

THE DOLLAR'S IMPRESSIVE YEAR

One thing that has hampered international corporate earnings so far this year is the strengthening of the U.S. Dollar. Just recently the Japanese Yen hit its lowest level against the dollar since 1986. While Japan has attempted to stop the decline in the Yen, it has so far been unsuccessful. A relationship we watch for direction of the dollar is the spread between the US 10-year treasury yield and the 10-year German yield. When this ratio falls, it generally corresponds with a decline in the dollar. By and large this ratio has been on the rise since mid-2023 and corresponds with a general uptrend in the dollar. Lately however, after spiking in the first quarter, this ratio has fallen while the dollar has risen. The Japanese will certainly welcome a respite in the dollar's rise which may reduce their need to sell U.S. Treasuries to stabilize their currency.

Recommendation List: A list of all previous specific investment discussions published over the past 12 months will be provided upon request. Please email lara@mhandassociates.com or call our office for this list.

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