MH & ASSOCIATES • SECURITIES MANAGEMENT CORPORATION

INVESTMENT VIEWS

JANUARY 31, 2022

VOLATILITY REIGNS

As expected, 2022 started off in a volatile fashion. It is not difficult to find a reason for this, whether it is investors seeking to lock in profit from the past two years of record gains, concerns over Fed tightening, higher trending inflation, slowing growth or perhaps tough earnings comparisons.

From the recent stock market highs in the fourth quarter of last year to the lows in January of this year, we have seen the following corrections:

S&P -12.4%	**DJIA -10.3%**	**NASDAQ -18.1%**	**RUSSELL 2000 -22.8%**

What caught many off guard was not the magnitude but the speed of the decline. While the indices have recovered somewhat, there is still much to prove as we make our way into 2022. It is likely that volatility will reign for the balance of the quarter, with a chance for the market to regain it's footing towards the mid-point of the year. Investors should prepare, both taking profits and adding to holdings where warranted.

STRONG INFLATION, WEAK ECONOMY

We note that 4th quarter nominal GDP came in at 6.9%, mostly lead by business inventory restocking, while inflation is currently running at 7% annual pace. This means that real GDP growth was negative for the quarter.

With two different stimulus programs running off in December, *real* and nominal GDP for the 1st quarter of 2022 is likely to be lower than at year end. Inflation may decelerate as consumers adjust to higher prices, however we believe that it will be around for the next few years, regardless of changes in Fed policy. As of this writing, economists are beginning to recognize this and downgrade GDP forecasts for the coming quarters.

This paints a complicated picture for investors as the unusual crosscurrents of inflation and slowing growth make for an uncertain policy response by government authorities.

At this time, we believe it is likely that the Federal government will deliver another stimulus package later in the year to support the economy, while at the same time the Fed may make some gesture interest rate hikes.

WARNING: POLICY MISTAKE AHEAD!

With mid-term elections coming up, it is certainly possible the Fed will feel pressure to "do something" to tame inflation. They have already stated that the markets are not of real concern to them (as opposed to the past). Unfortunately, there are not many easy options available "to do," and whatever path authorities go down will have consequences. Whether it is raising rates too high, rushing through a fiscal stimulus plan or further political gridlock in passing an infrastructure plan, we believe the probability of an error is elevated. This also underscores the degree to which the economy and financial markets are dependent on authorities for direction.

ENERGY UPDATE: IMBALANCE CONTINUES

For several years now we have maintained a descent size position in energy investments. These energy positions performed well in the past year, as the world is dealing with surging demand and shortage of supply causing a rise in energy prices. We continue to have a very favorable long term view for this sector and expect energy prices to stay at an elevated level for the following reasons:

• Demand is roaring back. Even though we had recent surge in Covid cases, demand remained resilient. Expect global demand to be back to pre-pandemic levels sometimes this year. Most of the significant growth will be coming from emerging markets and, as Covid cases taper, western economies will contribute a fair share to growth in demand as cruises, road travel, and jet travel booms back.

• Supply continues to be restrained due to lack of investment. Capital expenditures by producers peaked in 2014 and have been declining ever since. As an example, in 2014 the US independent producers spent $140 billion (exceeding operating cash flow) on capital expenditures. The last two years investment has averaged $35 billion. This is important because new supply can take years to come on line and requires extensive planning and permitting so it is unlikely that additional supply can come on-line quickly.

• OPEC+ remains restrained on how much additional capacity they bring back on-line. After all, two years ago oil prices collapsed almost 50% below $40/barrel—now they just want to make that money back. We will see increased spending here in the U.S., but production will continue to disappoint as producers remain disciplined on new investment and focusing on returning profits to owners rather than rapidly increasing production.

• Foreign outages and geopolitical factors are adding to the oil price risk premium. We have outages in Libya, Ecuador, and Nigeria and geopolitical situations in Ukraine, Kazakhstan, Saudi Arabia & UAE.

Demand for energy is growing faster than production as the world transitions away from the worst of the pandemic while supply will remain constrained. We expect this situation to continue well into the next year.

DRILLED UN-COMPLETED WELLS (DUCs)

We recently made our first investment in the oil service industry and expect companies in this industry to benefit as the world deals with the supply/demand imbalance noted above. Crude oil inventories in the U.S. have been declining for much of last year and is now below the 5-year average. Another very important statistic for energy sector is level of Drilled Un-Completed wells (DUCs*). This number is at recent lows as energy producers have spent much of the past two years depleting this pre-drilled inventory. Oil producers are in a great position to benefit from these tight and represent an area of value in an expensive market..

*These are oil and gas wells where drilling has been done but the producer has not gone through the process of finishing the well to bring it online.

COLA

Social Security recipients received a nice surprise at the beginning of this year with an almost 6% increase in cost-of-living adjustment (COLA). Also important, inflation adjustments were made to estate tax inclusion for decedents which was increased to $12.06 million per person, and the annual gift tax exclusion amount was increased to $16,000—from $15,000 person in 2021. Important to note, the present estate tax exemption will expire on 12/31/2025 and the new exemption in 2026 will be $5 million per person and indexed for inflation.

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