Inside Views From an Investment Management Leader

UPDATE

April 2022

About our Company

Company Profile:

Mitchell Anthony Capital Management is a private, boutique investment firm who has helped our clients grow and protect their wealth since 1991.

Key Offerings:

- *Personal wealth management*
- *Proactive investment strategies*
- *Proprietary research*
- *A professional team*
- *Fee-only services*

Distinguishing Values:

- *Passion for excellence*
- *Strategic focus*
- *A disciplined process*
- *Prudent risk management*
- *Comprehensive client care*
- *Superior long-term performance*
- *Sound judgment*
- *Objective Analysis*

MITCHELL ANTHONY
CAPITAL MANAGEMENT

9259 Research Drive
Irvine, CA 92618
Phone: 949-852-4100 or 800-497-9400
Fax: 949-852-4106
www.MitchellAnthonyCapital.com

In the News

Check out the MACM Team's New Blogs

If you have't already, check out the MACM team's new blogs. You'll find them full of up-to-date commentary on everything from finance and economics to politics and current events.

The Intuitive View	Long Story Short	The Starving Market
by Mitchell Pletcher	by Kyle Aron	by Dane May
macmblog.com	thelongstoryshortblog.com	thestarvingmarket.com

Economic Review & Outlook

Fed Handcuffed after 30 Years of Freewheeling Use of Printing Press

Mitchell Anthony
President
Chief Investment Officer

The Most Significant Economic Event of the Quarter was not the War

While most of us thought the most significant economic event thus far in 2022 was the impact of the war in Ukraine on consumer confidence. However inflation really remains the most significant economic problem in the world today and its impact that it has on central bank's ability to monetize our way out of economic problems. The war has only aggravated this problem with food and energy prices still rising.

The Federal Reserve has had freewheeling use of its printing press for over 30 years enabled by inflationary expectations that were anchored at 2 to 2 ½%. Every single recession encountered since 1990 was easily resolved with the Fed's ability to pour new credit into the markets and monetize our way out of virtually every economic problem we encountered over the last 30 years. With the dollar being the reserve currency of the world combined with ultra-low inflationary expectations the Fed acted without hesitation to print money and run its press as often as needed. Unfortunately America has encountered what appears to be a very difficult inflationary environment that may take several years to resolve with tight monetary policy. This is contrary to the belief that was embraced by central bankers around the world in 2021 as the economy emerged from the pandemic lows. Capacity was largely the driver of inflation in the beginning as producers shut down during the pandemic and were very slow to return their factories and facilities to full-scale. At the same time demand ramped up considerably for durable goods and housing as consumer spent a tremendous amount of time at home instead of traveling.

We have never in history had an inflationary cycle end without a recession and a bust in asset prices. Most have thought this cycle would be the exception and many are still optimistic that this will occur but markets are now heavily discounting a recession and a bust in asset prices. The first market to bust was the treasury market where yields have skyrocketed upward to almost 3% over the last 30 days. (pg. 4, fig. 1). Investors do not believe the Fed will be able to come to the rescue with cheap money when this economy falls into recession or stays in a period of slow growth for an extended period of time. This is because of the entrenched inflation that may not resolve itself even with a big slowdown in growth.

As investors embrace this reality stocks and bonds have been sold and the first quarter's performance for both was the worst in several years. The S&P 500 fell almost 5%, NASDAQ (QQQ) over 8% and Treasurys (TLT) declined by over 10% as well. MACM's dynamic growth portfolio fell by over 8% as modest bets on China and reopening names spoiled good relative performance in secular names like Amazon and United healthcare. The big winner in the quarter was energy as oil prices soared to over $120 a barrel briefly during the invasion of Ukraine. Energy stocks (XLE) rose by over 30% in the quarter as oil prices have mostly stayed over $100 per barrel. This has been due to tight capacity combined with steady increases in demand. OPEC conceivably has had more discipline for maintaining production quotas for the last few years than any other period in history. Raw materials in general accelerated in price during the second half of 2021 and the first quarter of 2022.

(continued on pg. 2)

Economic Review & Outlook (continued)

(continued from pg. 1)

It is reasonable to conclude that energy prices will remain elevated for several years and even into an economic slowdown or recession.

While consumer confidence has fallen significantly because of the war, retail sales have stayed hot and continue to climb to all-time highs. Historically there's never been a strong correlation between consumer spending and consumer confidence until confidence gets really bad. Growth in the US economy is expected to show a tremendous slowdown when GDP for Q1 is reported for the first quarter next month. Most analysts are projecting GDP growth of 1 to 1.5% for the quarter, down from over 6% growth the previous few quarters. Given the strength in Housing and retail sales it is hard to understand the forecasted slowdown in GDP?

Home Prices and Housing Sales Still Heading Higher?
The housing cycle would appear to be still on course however most home price indices are delayed by over two months and so recent data on trends in home prices are a bit unknown. The Case Shiller 20 city home price index rose to an all-time high in January. (pg. 4, fig. 2) New home sales have been strong based upon February data with limited supply being added. The Current level of sales is however unknown and we are suspect that a decline is on the horizon or already here – given that rates are now up to 5% or more for most mortgages.

Treasury Rates Heading Higher!
Rates on treasuries have risen significantly over the last few weeks as investors embraced the idea of a handcuffed Fed for an extended period of time. The 10 year rose from 1 ½% to 2.7%, the two-year rose from 2.4% to 2.6% , and mortgage rates as measured by Bank rate rose from 3.26% to approximately 5%. Consumers are just now starting to embrace these higher rates that affect affordability of cars, housing, and credit card purchases. Fed posture changed to fear of inflation and being behind the curve from previous posture of inflation being transitory and driven mostly by capacity problems that would quickly resolve. Markets are currently pricing in a fed funds rate of 2.5% by year end. Up from just 0.5% currently.

Consumption Themes Wavering?
It would seem reasonable that we are just in front of a decline in consumption as stimulus effects fade and overconsumption of durable goods plays out. This is countered by pent up demand for travel and experiences. Consumption of Autos, Housing , and Appliances seem set to fall.

Market Outlook
We continue to hope for a soft landing for the US economy. However the probability continues to decline as inflation forces play out stubbornly. The Bond and Treasury Markets will likely continue lower until an inflection point for inflation becomes visible. This is not likely for another 6-12 months. Commodity prices will remain elevated and stocks will likely move sideways. The dismal outlook for fixed income will keep investors in Equities that are defensive and/or benefiting from secular consumption themes still intact. When a peak in rates is visible a move to Treasuries is likely for our portfolios. Defensive stocks and secular Growth names will be emphasized as we adjust allocation to this slow growth high inflationary environment.

Table 1: Stock & Bond Market Returns 3/31/2022

	Quarterly Change	Trailing 12 Mos		Quarterly Change	Trailing 12 Mos
Large Cap Growth (IWF)	-9.0%	14.9%	Small Cap Value (IWN)	-2.5%	2.8%
Large Cap Value (IWD)	-0.7%	11.4%	Small Cap Growth (IWO)	-12.7%	-14.7%
Europe Asia Far East (EFA)	-6.5%	0.3%	Emerging Markets (EEM)	-7.6%	-13.7%
Invest Grade Bonds (LQD)	-8.4%	-4.9%	High Yield Bonds (HYG)	-4.7%	-1.7%
Interm Treasurys (IEF)	-6.4%	-4.0%	Mortgage Bonds (MBB)	-4.9%	-5.1%

Source: Bloomberg, Barclay's Global Investors ETFs. Actual performance including dividends.

Table 2: Real Estate & Commodity Returns 3/31/2022

	Quarterly Change	Trailing 12 Mos		Quarterly Change	Trailing 12 Mos
DJ US Real Estate (IYR)	-6.4%	20.3%	DJ Commodity Index (DJP)	28.6%	56.0%
Int'l Real Estate (IFGL)	-4.0%	1.7%	Goldman Commodity (GSG)	32.4%	62.1%
NAREIT Residential (REZ)	-2.0%	31.9%	Gold (GLD)	5.7%	12.9%

Source: Bloomberg, Barclay's Global Investors ETFs. Actual performance including dividends.

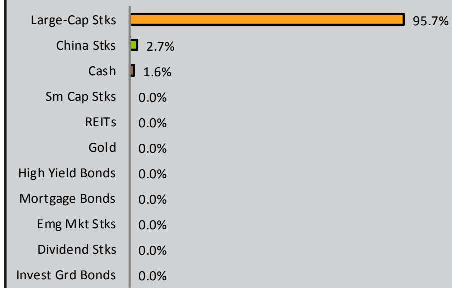
MACM Managed Accounts

Growth Portfolios

Dynamic Growth

(Qualified Accounts)

A dynamic blend of stocks, bonds, commodities, REITs, and cash for growth investors with a bias toward timely asset classes.



Growth

A portfolio of large- and mid-cap US stocks that are industry leaders with strong brands and timely products.

Diversified Equity

A global, all-cap equity portfolio following economic trends across capitalization and geographic ranges.

Focused REIT

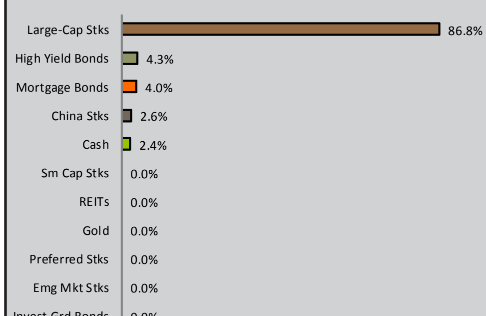
A portfolio of companies whose primary business is owning and leasing real properties.

Balanced Portfolios

Dynamic Growth & Income

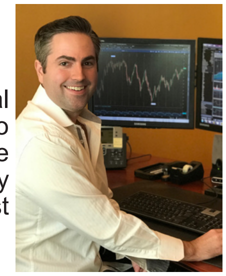
(Qualified Accounts)

A portfolio of stocks, bonds, and cash for moderately-conservative investors seeking income and growth with relative stability.



MACM Research Spotlight

Housing & Rental Markets - Where do we go from here?



Kyle Aron
Senior Analyst

The housing market has been the talk of the town over the past year, with home prices rising faster than they did even during the 2000s era bubble. The rental market has now been following a similar path, seeing rental prices rise at the fastest pace in at least 20 years. As the Federal Reserve has embarked on a path to tighten financial conditions to combat inflation, mortgage rates have risen dramatically and are now above 5%. Just one year ago rates were at only 3%. Given these dynamics, what's in store for housing, in terms of both homes prices and rental markets? While the outlook for home prices is a bit uncertain, the rental market seems poised for continued strength.

Market Dynamics – Home Prices

No doubt home prices have been on fire for the past year. Fueled by record low interest rates, the ability to work from home, young adults forming households and making first time home purchases, and a continuously dwindling supply, home prices have seen double digit year-over-year gains.

On the plus side for home prices, some of the tailwinds that have fueled the record run are still in place. Supply is still at historic lows. A decade of builder caution following the 2008 bust has left the single family home market woefully undersupplied. While builders have been ramping up home starts over the past year, labor and materials problems have hampered their ability to bring new supply online fast enough. Mortgage rates, while having ramped up significantly, are still relatively low from a historical perspective. Working from home seems to be a secular trend that may continue to play out, or at least isn't about to fade away. And demographics still bode well for new household formation and the desire for families to buy their first homes.

Interestingly, over 90% of current homeowners would see a higher mortgage rate if they were to make a new purchase or refinance at current mortgage levels. This is a historically high level of owners effectively locked into their existing homes. This could further keep supply constrained as people opt to remain in their current properties.

However, these tailwinds come up against some significant headwinds. Despite being historically low, mortgage rates moving from 3% to 5% increase the payment on a same-priced house (if purchased at 5% instead of 3%) by nearly 30%. With home prices up double digits over the past year, the overall mortgage payment for purchasing the median-priced home in the US is up more than 40% vs one year ago. This is a big hurdle for new home buyers and will likely put a significant damper on demand as buyers are priced out. Further, the additional supply builders have been trying to bring to market should ultimately come online over the next year or so. And finally, home prices will likely struggle if the Fed causes a recession in its quest to cure inflation.

Market Dynamics – Rentals

The rental market has also been red hot. This began with eviction moratoriums during covid, which pushed occupancy rates up significantly. As home prices rose swiftly over the past year, would-be buyers turned to renting instead, further stretching already historically high occupancy rates.

The tailwinds in place for rentals seem unlikely to abate in the near term. Occupancy rates at all-time highs will continue to put pressure on rental prices. With the ramp-up in mortgage rates and home prices, even more potential homebuyers may instead look to renting. Moreover, as rental prices continue to increase, bigger rental payments will eat into potential homebuyers' cash and savings, putting the downpayment for a purchase potentially further out of reach and perpetuating the need to rent. And should a recession come, homeowners may be forced to sell and cash in on home equity, opting instead to rent to weather the storm. This will further bolster rental demand.

Of course, these tailwinds are not without headwinds. The eviction moratorium has rolled off, and a ramp-up in evictions could open up much needed occupancy. High rental prices measured against still relatively low mortgage rates could also mean buying still makes for many new would-be homebuyers.

Investment Implications

Home prices, and hence the homebuilding space, may be more susceptible to weakness going forward if demand surprises to the downside and/or supply comes online more rapidly. This could be exacerbated if we enter a recession. However, there is reason to believe there could be continued strength in this space, at least enough to suggest the recent selloff in homebuilding names (down 30% YTD) may be overdone.

The rental market, meanwhile, could well be a point of strength given the conditions in place. This may be particularly true for single family rental homes, which tend to historically have more stable tenants and can command premium rental prices.

Equity Market Spotlight: Sector Performance

	Quarterly Change	Trailing 12-Months
Energy	38.7%	65.25%
Utilities	4.4%	19.4%
Materials	0.2%	14.6%
Cons Staples	-0.9%	14.9%
Financials	-1.6%	14.8%
Heatlhcare	-3.5%	16.7%
Industrials	-3.9%	3.5%
Real Estate	-6.2%	21.8%
Technology	-9.0%	17.2%
Cons Discretionary	-9.8%	5.9%
Comm Services	-12..2%	-3.0%

2022 Q1: Tough Start for the Year

Equity markets struggled in the first quarter of 2022, with the S&P down nearly 5%. Already facing a Fed unwinding its support and tightening financial conditions in an attempt to rein in inflation, the markets further faced the eruption of war between Russia and Ukraine. Worse yet, inflation prints that were expected to peak around the first quarter of this year may well be hotter for longer, exacerbated by the onset of war. These conditions collectively overhung the markets, and investors seem to be getting less and less convinced about the possibility of a soft-landing as the Fed battles inflation. Given this environment, defensive and inflation-linked sectors performed well. Energy was the clear leader, up nearly 40% for the quarter as the price of oil spiked sharply higher. Utilities (+4%) and Consumer Staples (-1%) also led the way. Going forward, investors may well continue to favor defensive segments until these myriad concerns appear to be resolving favorably.

Data based upon Russell 1000 Index and GICS sectors. Source: Bloomberg Financial

A Word from our Client Team

Dane May
Client Relations Manager
& Research Analyst

Globalization Under Attack?

First off – what is globalization? It is defined as the process that moves businesses, organizations, workers, technology, products, ideas and inflation beyond national borders. We have all benefited from globalization through access to cheaper goods and services, cultural awareness and the transfer of information and technology. Many would argue on net it makes the world a better place, but critics argue it increases wealth inequality and makes economies more vulnerable. After decades of increasing globalization, due to recent events, we are finally starting to see a real pivot back towards protectionism and nationalism. With the invasion of Ukraine and new lockdowns in China just in the first quarter this year, both governments and businesses alike are making it a priority to rely less on others and become more self-sufficient. Throughout our time ramping up globalization, we have traded the resiliency and redundancy of our global supply chain for efficiency and margin improvement. Fortune 500 companies have increased profits at the expense of increasing their vulnerabilities. These recent “shocks” to the system have us facing the reality that globalization may not be as reliable as we once thought. What may we see as we go down the path of a more de-globalized world?

Governments

While deglobalization will not mean complete independence, we will likely begin to see additional budget carved out to incentivize domestic production. Prioritizing energy, food, technology, and medicinal security. We may see a bifurcation in trade relationships. Creating even stronger relationships with other democratic countries while continuing to pull away from reliance on autocracies like China and Russia.

Businesses

Similar to governments, we will likely see increased investments to begin re-shoring supply chains to withstand more impacts and adapt to market shifts/shocks. We should see a shift towards a preference for inventory overstocking and diversifying suppliers. At the end of the day, each company will have to find the right balance between efficiency and resilience.

De-Globalization Impact on our Economy

Shifting to economic independence has its advantages but it does not come without a cost. The biggest challenge which may be a result of this is the elephant that is already sitting in the room: inflation. The most enticing aspect of globalization was cheap labor in order to manufacture goods. By moving production back to the US our input costs rise significantly likely leading to pricier goods. With inflation already being the biggest problem our country is currently facing we are watching closely how both governments and businesses are reacting and their ultimate inflationary impact.

Economic & Financial Market Charts

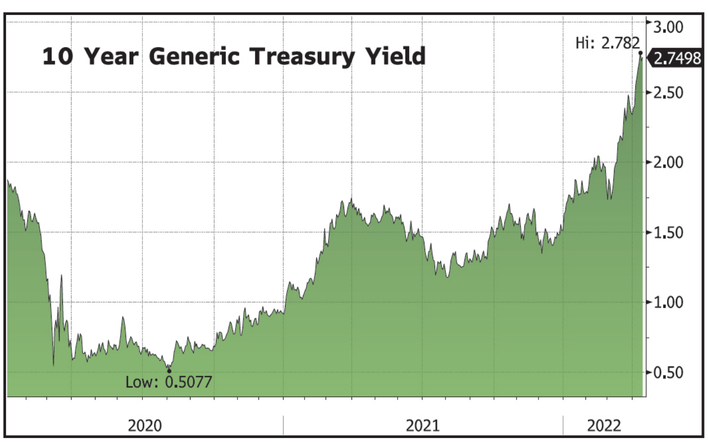


Figure 1 - Source: MACM / Bloomberg Financial
Graph of the 10 Year US Treasury Yield, showing
a rapid run up in 2022.

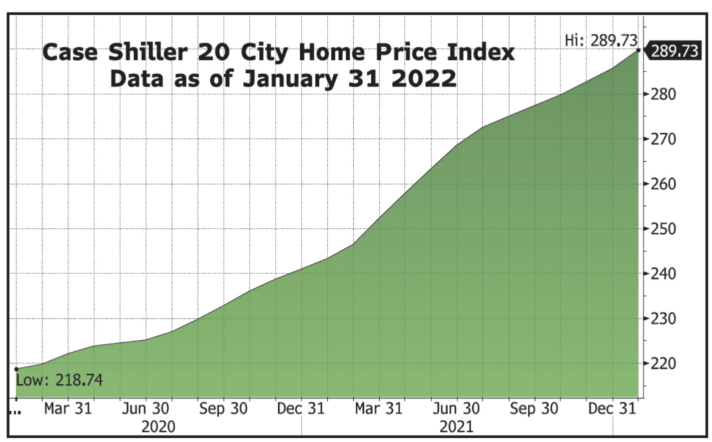


Figure 2 - Source: MACM / Bloomberg Financial
Graph of Case Shiller Home Price Index,
reaching historically high levels.