

UPDATE

July 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

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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
by Mitchell Pletcher
macmblog.com

Long Story Short
by Kyle Aron
thelongstoryshortblog.com

The Starving Market
by Dane May
thestarvingmarket.com

Economic Review & Outlook

Rising Inflation Expectations Drive Investors out of Risk Assets

While inflation has been running hot for over 1 ½ years, investors and the central bank have not believed that the inflation was entrenched and hence inflation expectations stayed relatively low until recently. Over the last 3 to 4 months that position has changed significantly and as a result investors hit the sell button in a dramatic manner last quarter. Risk assets of all types had double digit losses in Q2. Stocks, REITs, Treasuries, Corporate Bonds, Junk Bonds, and Commodities all swooned with the worst losses occurring in high PE stocks and real estate investment trusts. Both of these were down 25 to 30% in Q2. MACM's dynamic growth portfolio lost over 16% despite a double digit cash position. Clearly we have a new hawkish position from the Fed that combined with investors armed with knowledge of how stocks and risk assets perform during periods of high inflation, combined to drive investors out of risk assets and into cash. Even ultrashort term bond funds lost money in Q2!

The Fed's new resolve to kill inflation all but ensure that a recession will take place this year and maybe into 2023. The uncertainty of what a recession might do to the current themes of consumption in the globe has caused extreme volatility in risk assets. The US economy has been driven by four strong consumption themes for the last several years. These themes include: housing and related durable goods, the buildout of cloud computing infrastructure, consumers desire to convert to electric vehicles, and consumers pent up demand for experiences. The sustainability of these mostly secular growth themes has now been questioned by investors and will continue to be questioned until more visibility is available causing further volatility in risk markets.

Almost all risk assets have had a severe decline! Cash alternatives also got hit

In the second quarter US stocks were down 15 to 25% depending upon the index, emerging markets declined by over 11% (EEM). REITs

fell 15 to 30% depending upon the type of property with malls and office buildings being hit the hardest and single-family homes performing the best of the worst.

US treasuries fell 5 to 15% depending upon the maturity. Corporate bonds as measured by (LQD) fell over 9% along with their junk bond counterpart declining near 11% (hyg). Ultrashort term bonds which hardly ever lose ground, declined a bit as short-term rates rose dramatically. (MINT-1%, JPST -.4%).

Believe it or not the worst returns in Q2 were in the commodity marketplace as traders now believe the Fed will ultimately be successful at killing inflation. As a result lumber fell 28%, copper fell 22%, and steel fell over 40%. Most food commodities were flat with some a bit higher and some a bit lower. Wheat and corn declined the most. Oil remains steady gaining over 5% in the quarter as producers were nimble at matching production with demand.

Global Economic Trends Mostly Similar To US Trends

The global economy is mostly in an economic downturn and has similar trends to America. The economic impact from the pandemic seems mostly minimal now. Trends in China are still very hard to understand or explain. China's response to Covid was mostly negative as they shut down their economy and did very little from the fiscal perspective to prop up consumers or stimulate their economy as the pandemic storm subsided. As a result markets crashed but now seem to be stabilizing but at the lowest valuations in decades.

US Trends Are Almost All Negative In Some Manner!



Mitchell Anthony
President
Chief Investment Officer

Economic Review & Outlook (continued)

- Continued high Inflation CPI 8.6% all quarter, PPI - 16.7%, PCE 5.2% – 4.6%
- Core Inflation is rolling over in both CPI and PCE but Food and energy are keeping it hot;
- Rising inflation expectations are notable - Breakevens (TIPS – Treasury) however show a decline in inflation expectations of over 100 bips over a longer period (pg. 4, fig. 1)
- Food and energy are sticky – related to war.
- Prices of Durable goods are mostly rolling over? Finished goods are not! (pg. 4, fig. 2).
- Rising interest rates - treasuries, mortgage, CC's all saw significantly higher rates in Q2.
- Strong trends in Employment Remain although the size of our employment pool has declined.

The US economy continues to have strong consumption despite falling confidence. Consumer Confidence is now near its pandemic low. There's clearly been trouble in the world of retail. E-commerce giant Amazon over-expanded their warehouses and employees during the pandemic which created expensive excess capacity that more than killed almost all of 2021's earnings. Big box stores like Target made substantial mistakes by extrapolating out pandemic consumption into the future and over ordering inventory. As a result they are awash with televisions and other durable goods that they are having to sell at discounts or losses. The previously strong world of experiences is now a bit uncertain. It would seem that dining out is less attractive given the higher prices and the decreased wealth of consumers. This seems to go hand-in-hand with other forms of entertainment. The substantially higher interest rate environment has or is in the process of hitting housing and related durable goods. Sales are down although prices have tried to hold past levels but seemed destined to crumble as deceleration or declining demand hits. The industrial sector is still running strong based upon its inability to meet the demand we had through most of 2021. The production of Autos and other durable goods are playing catch-up even while current demand is in decline. We are seeing weakness in factory equipment and automation stocks like Rockwell and Ingersoll-Rand leading us to believe that orders there have weakened considerably.

The Economic and Market Outlook

Inflation will undoubtedly set the tone for both growth in the Global economy and the performance of Risk assets. Inflation has been difficult to forecast as we haven't had a real inflation cycle since the 70s to live through and experience. Given that it seems reasonable to err on the side of forecasting that inflation will last longer than is reasonable to expect. The risk is that markets will undoubtedly take off to the upside as we get hints that inflation is subsiding. Right now the reality is that food and energy prices are still high and are being led higher by fertilizer and other related products for crop production. The good news is that durable goods seem positioned for disinflation or deflation as there is evidence in a notable decline in durable spending on household equipment.

We believe risk assets are unlikely to bounce significantly until inflation has begun to confidently trend back toward 2 to 3%. The timeframe for this is unknown but likely to be more than six months and may be as long as two years. The best-performing asset classes for the next six months will likely be ultrashort term bonds as risk assets ebb and flow as we work through the unknowns of inflation. MACM DG portfolios have 20% or more in ultra-short term bond ETF's. Beyond that we see investors returning to equities that are positioned well for the consumption themes that will likely remain intact through this recession. Speculation will clearly ebb and flow and bring about rallies in risk assets as we await the death of hyper-inflation.

We are optimistic that risk assets will return front and center and we will be positioned to leverage the great returns in those areas as they occur.

Mark Platzer

Table 1: Stock & Bond Market Returns

6/30/2022

	Quarterly Change	Trailing 12 Mos		Quarterly Change	Trailing 12 Mos
Large Cap Growth (IWF)	-21.1%	-19.0%	Small Cap Value (IWN)	-15.3%	-16.4%
Large Cap Value (IWD)	-12.3%	-7.0%	Small Cap Growth (IWO)	-19.2%	-33.5%
Europe Asia Far East (EFA)	-13.2%	-17.4%	Emerging Markets (EEM)	-10.4%	-25.6%
Invest Grade Bonds (LQD)	-8.4%	-16.1%	High Yield Bonds (HYG)	-9.5%	-12.8%
Interm Treasuries (IEF)	-4.7%	-10.5%	Mortgage Bonds (MBB)	-3.9%	-9.0%

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

Table 2: Real Estate & Commodity Returns

6/30/2022

	Quarterly Change	Trailing 12 Mos		Quarterly Change	Trailing 12 Mos
DJ US Real Estate (IYR)	-14.7%	-7.9%	DJ Commodity Index (DJP)	-5.7%	27.9%
Int'l Real Estate (IFGL)	-16.7%	-20.9%	Goldman Commodity (GSG)	2.0%	43.6%
NAREIT Residential (REZ)	-16.2%	-2.3%	Gold (GLD)	-6.7%	1.7%

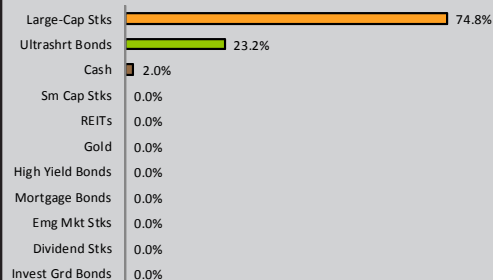
Source: Bloomberg, Barclay's Global Investors ETFs. Actual performance including dividends.

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.



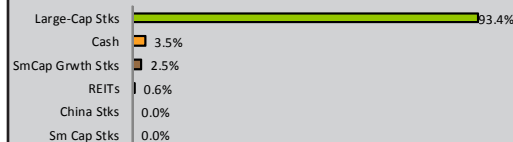
Growth

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.



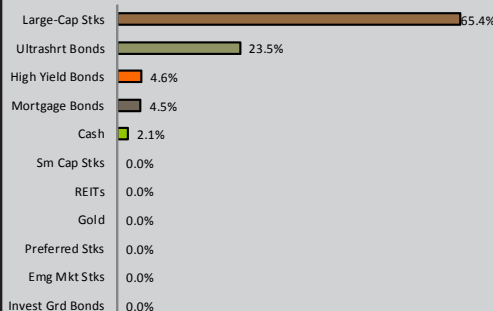
Focused REIT

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.



Housing Market Update - Signs of Softness

Much like the housing market heated up at lighting speed over the last year, it seems to have cooled just as quickly. As the Fed moves swiftly to combat inflation by raising interest rates, housing market dynamics have shifted significantly. Buyer demand has dried up, and prices have stalled their torrent of increases. In my last article, I discussed a potential softening in the home purchase market. Let's now check in and see just how much changed for housing during last quarter, and consider what might be ahead.

Mortgage Rates & Affordability

Following along with interest rates generally, mortgage rates continued to rise in the second quarter, shooting above 6% - levels not seen since the mid-2000's boom era. When combined with the huge run up in home prices over the last year, this pushed housing affordability down to levels not seen since 2006.

Buyers using mortgages seem to have dried up markedly as they are priced out or simply aren't interested in taking mortgages at these levels. While cash buyers remain, it seems likely that many of them – at least the institutional cash buyers – will be taking steps back as well while the market cools to avoid paying peak prices for homes in their portfolios.

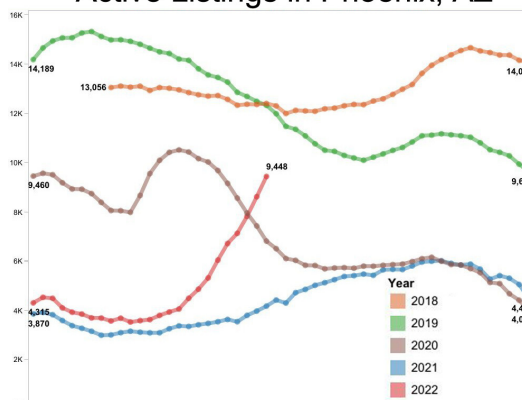
Without question, the continued ramp up in mortgage rates and associated drop-off in affordability has put a dent in buyer demand and caused the housing market to soften.

Supply of Homes

Indeed, there are a few ways to examine the weakness the housing market experienced in the second quarter. The number of homes available for sale tells some of the story. In Orange County, for example, the number of houses actively listed for sale has doubled since the same time last year. As buyer demand dwindles, houses are sitting on the market longer (allowing active listings to accumulate). In addition, owners are quickly bringing their houses to market in hopes of getting them sold before prices decline. Similar metrics are playing out across the nation.

In markets that experienced the hottest run-ups over the last year – places like Boise, ID, that were pandemic work-from-home darlings, active listings have nearly tripled versus this time last year. The Phoenix, AZ, market is similar, and demonstrates the rapid run-up in supply seen just recently in many markets.

Active Listings in Phoenix, AZ



Granted, the supply of available homes for sale remains absolutely low – for example, still half of what was available for sale in 2019 nationally – but this is changing rapidly and certainly has put pressure on home prices on a relative basis.

Price Reductions

Another great way to examine softness in housing is in price reductions. Again, using Orange County as an example - only about 1 in every 15 houses had a price reduction while actively listed for sale at this time last year. Now, nearly 1/3 of all active listings have had price reductions. Most of these reductions have come only over the past couple months.

And if you look at some of the previously ultra-hot markets like Boise, ID, it's even worse – 50% of all listings have now had price reductions. The number of price reductions nationally is now around levels not seen since late 2018 – the peak of the last Fed rate-hike cycle.

Notably, while price reductions have become more widespread, they are yet to be too great in magnitude. According to Redfin, the average price reduction in Southern California markets is only around 5% so far, for example.

Looking Ahead

All told, it seems the housing market is finally showing signs of cracking under the pressure of high prices and higher rates. While price drops have only just begun, they may accelerate as demand continues to dwindle. Indeed, the downward cycle will likely feed on itself, as would-be buyers choose instead to wait to see if they can buy in at lower prices. Price declines may be buffered by still historically low supply of houses for sale, although this supply has been increasing rapidly. It seems the housing market is in for continued weakness and likely some further price declines in the months ahead.

Equity Market Spotlight: Sector Performance

	Quarterly Change	Trailing 12-Months
Cons Staples	-5.0%	5.3%
Energy	-5.2%	39.8%
Utilities	-5.3%	13.5%
Healthcare	-6.4%	0.4%
Real Estate	-14.8%	-7.3%
Industrials	-15.8%	-16.5%
Financials	-17.4%	-12.2%
Materials	-18.3%	-10.6%
Comm Services	-20.8%	-30.7%
Technology	-21.3%	-17.4%
Cons Discretionary	-26.0%	-26.6%

2022 Q2: Equities Under Pressure

Equity markets (and virtually all other markets) continued to struggle in the second quarter, as the Fed ramped up efforts to fight the hottest inflation in decades. There was nowhere to hide, with all sectors in the red. Even the Energy sector ended the quarter down marginally, as Fed-induced recession fears began to rock commodity prices towards the end of the quarter. Indeed, recession fears crushed sectors like Consumer Discretionary, down nearly 30% in just the quarter and the worst performer overall. Some solace was found in defensive Staples and Healthcare segments. Going forward, high inflation, an unfriendly Fed, and slowing growth are likely to keep investor sentiment sour on equities, with opportunities perhaps in strong secular segments or individual stocks.

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

Stagflation on the Horizon

You've likely been seeing the word Stagflation pop up across your TV, computer screen or phone but what does it really mean in regards to inflation, growth and employment? First let's define it – Stagflation is where an economy is experiencing a simultaneous increase in inflation and a stagnation of economic output. In simple terms, it is high inflation coupled with an increase in unemployment and slowing growth. While we can look back and better understand periods of rising and falling growth and employment we do not have as much empirical data regarding inflation. With inflation being the key ingredient to Stagflation – lets start there.

Inflation: To understand how we got to where we are at today, let's take a quick look at where we've been. The U.S. has not really had to worry about inflation since the late 70's early 80's when the infamous Paul Volcker raised the Federal Funds rate to nearly 20% killing both inflation and the economy. Since then, the Federal Reserve (Fed) has been using Monetary Policy to lower interest rates in order to spur growth by

reducing the cost of capital.

Now they have only been able to do so because inflation has never really flared up long enough to meaningfully change their outlook. This, along with technology advancements, have been a massive tailwind for innovation and has led to both increased productivity and decreased cost of goods/services. As one would imagine, this has been putting downward pressure on inflation resulting in our economy seeing disinflation for quite some time. We can see it firsthand with companies such as Amazon and Tesla, who were able to take advantage of the ability to borrow cheap and run their businesses unprofitably for decades in order to hit critical mass. We as customers are now the beneficiary of this. With the click of a button, we can have a package arrive on our doorstep in 24 hours instead of driving to the local store and picking it up. What would have previously cost us additional time, energy and money now can be consumed at a fraction of the price. That is quite disinflationary!

It appeared this disinflationary theme was well entrenched until Covid came along. Once the government gave us the green light to re-open the economy we were hit with a massive supply / demand imbalance. This instantly led to more dollars chasing fewer goods kickstarting inflation. Continued friction with supply chains along with fiscal stimulus on the demand side only exacerbated the inflationary pressures. Throw in an abhorrent invasion of Ukraine creating a surge in energy and food prices and that has led us to where we are at today, 8.6% YoY inflation. This high inflation number has set the stage for Stagflation.

Growth: Now that inflation has reared it's ugly head for the first time in a long time the Fed has had to react. Unfortunately, they only have one blunt tool to address the situation and that is raising rates to slow growth. They began this process early this year and it appears to be working. Whether it was their actions or the economy naturally cooling off we are on track for our second quarter of negative growth (nearing a technical recession).

Unemployment: We now know we have high inflation and slowing growth but what about the last piece of the puzzle, rising unemployment? Finally some good news! Currently, our economy's employment situation is fantastic. Not only do we have a historically low unemployment rate but we have more job openings available now than we ever had in the past. While we currently have a healthy labor market things can change quickly. We have already begun to see hiring freezes, layoffs and CEO's with less optimistic views into the second half of 2022 so we may be on the brink of this turning the other way.

Conclusion: Without rising unemployment, we narrowly dodge being in a Stagflationary environment. And while it ultimately is just a label for economic stagnation it encompasses three important areas all active investors are watching and reacting to. Ideally in the following months, we begin to see inflation decelerating, growth turning positive and our labor market continuing to stay strong. That being said, it will take some time to see this play out in the data, and in the meantime we will be watching more high-frequency data and listening to our portfolio companies give their outlooks in the upcoming earnings season to help guide our positioning.

Economic & Financial Market Charts



Figure 1 - Source: MACM / Bloomberg Financial
Graph of 10-year inflation expectations, declining significantly in the second quarter

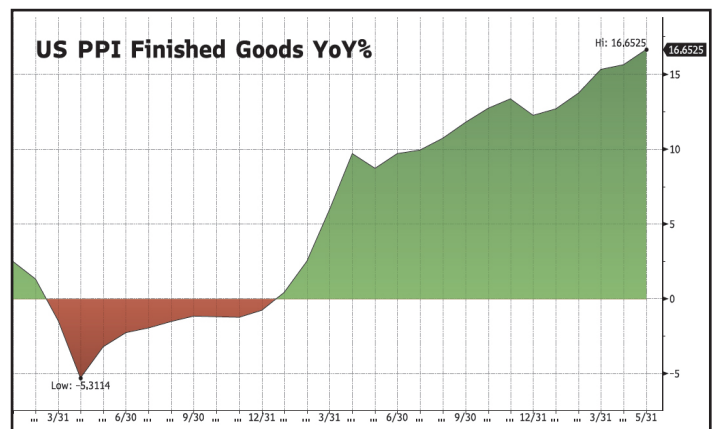


Figure 2 - Source: MACM / Bloomberg Financial
Graph of US PPI for finished goods, continuing its march higher during the second quarter