

UPDATE

January 2023

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 Blogs

If you have't already, check out the MACM team's 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

Can Markets Move Higher with Inflation Finally Lower?

Financial markets have been extremely volatile throughout most of 2022 as high inflation shocked the economy and central banks around the world reacted with significantly higher interest rates. The inflation battle has taken significant time to even dent inflation and the path out of the crisis is still unclear. As a result stocks, bonds, and commodities have all been volatile as inflation and the cost of money is critical to the success of an economic cycle.

Inflation peaked in October and has begun to tilt lower but the path back to the feds target of 2% inflation is still very uncertain. (pg. 5, fig. 1). Fixed-income securities have declined in value substantially throughout most of the year as the fed pushed rates higher although the decline has paused over the last few months. Equities have followed a similar path but a modest rally has begun several times that is now again struggling. Yields on treasuries have quadrupled this year reaching as high as 4.5% but falling back to 3.7% today.

The equity market has ebbed and flowed since the June bottom and three rebounds have occurred.

While the first two failed, the third has been quite strong narrowing the S&P 500 loss to -18% YTD.

It is clear that investors are anxious to return to stocks still remembering how good the returns were for the last decade. However inflation problems continue to obstruct anxious stock investors. Further, company specific problems have developed for the corporate superstars that have led the economy and the market for the last decade.

There are several tech and Internet titans that are under siege. Amazon perceived to be the world's greatest company has now found that its house is out of order. They have far too much retail capacity and have over-expanded their business as though the pandemic fueled recovery would go on forever. We've also discovered that the new CEO Jassy lacks the vision of his predecessor Bezos.



Mitchell Anthony
President
Chief Investment Officer

(cont on pg. 2)

Economic Review & Outlook (continued)

(cont from pg. 1)

Amazon's web service division which has been the primary driver of their stellar growth for the last five years has now encountered a bit of a slowdown because two of their major customers have found their businesses in decline. Crypto and the mortgage businesses are on the sidelines of this economic cycle today. Additionally, Amazon continues to pour money into questionable product lines such as "Alexa" which takes a toll on their earnings.

They are not the only one to fall victim to this problem but most of us have put them on a pedestal as a company who would never make errors such as this. With the economy in a broad slowdown the entire retail sector is under siege with most having problems with inventory management and supply chain consistency. Amazon is still a great company but they have lost their momentum and it is unclear how much time it will take to regain the growth rate of the past cycle or if it is even achievable again.

Google and Facebook are also still great companies but likewise have developed some problems over the last decade that have dimmed the outlook for these titans. Similar to Amazon, headcount was expanding like the Covid recovery would continue indefinitely. Facebook lost its way by focusing on the meta-verse while their core business was under siege by changes to Apple's iPhone privacy settings.

Netflix is adding a new revenue stream through an advertising model that has shown tremendous promise as they have stumbled with domestic membership growth. This, along with a gloomy outlook for global growth has caused the valuation to get cut in half despite a very strong rate of growth for earnings.

Apple is dealing with regulatory headwinds that are challenging their ability to keep their monopolistic app store intact. Their business model is quite strong and their products are almost perceived to be as stable as milk and cereal in the diet of Americans.

These corporate superstars still have secular tailwinds that will push them for many years to come, however the secular tailwinds might not be enough to allow them to avoid a substantial decline in earnings as we move through this recession.

The problems noted above with the FAANG superstars is also common in many other parts of corporate America. The economic boom of the last decade caused more than a few corporate CEOs to take their eye off the ball and miss the next turn. This recession will give all of these players a chance to reset their business plans and make the best of the next decade.

Inflation is now tilting lower and optimism has risen that this inflation cycle will end quickly

Expectations in the market for inflation over the next year are now near the feds target of 2.5%. This is lower than even what the Fed is projecting! The Fed is expecting a slow and bumpy decline to 2.5% that will take two years or more while the market expects it to be almost linear over the next year. Structural problems with labor will likely keep inflation from returning to 2.5% as currently expected by investors. The structural problems involve a shortage of labor due to a slowdown in immigration, unexpected retirements of baby boomers, and the fact that Covid related stimulus is still keeping workers at home and demotivating them from returning to work. Current expectations in market prices reflect extreme optimism for inflation. Futures and swap prices for CPI inflation levels by late next year show investors believe inflation will be down to 2% within 12 months. (pg. 5, fig. 2).

The Fed has said that it expects to raise rates well above 5% and keep them there for an extended period, whereas the market is betting that rates never get above 5% and that the Fed will change to a policy of cutting rates by the end of 2023. Obviously there is a difference between the fed speak and the market speak. Someone here will be proven wrong. It may well be that the truth lies in the middle as is typical. We believe high interest rates will likely persist for another 12 to 18 months or until inflation is anchored at 2.5%. We look to the horizon for signs that the structural problems with labor are resolving but see nothing significant yet. There are other signs that the economy is feeling the grip of higher interest rates and undoubtedly this will work its way into lower prices in the year ahead.

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Economic Review & Outlook (continued)

(cont from pg. 2)

The housing industry has slowed dramatically but prices have only just begun to decline broadly down and are down about 10% from the peak price achieved nationwide. Overall the service side of our economy has been very resilient and no signs of a slowdown have been visible in the service sector. Employment is now starting to show some weakness as layoffs are rippling through other industries outside of services. Wage gains while elevated are easing back now.

The outlook for the financial markets and the economy

We believe the rally in the stock and bond markets are due to pause if it hasn't started already. The equity market could make new highs with further news on inflation and more importantly improvement in the structural problems with labor and employment. This seems like wishful thinking for the time being.

The leadership in the market has changed from growth stocks to value oriented type names. Consumer Staples, healthcare, financials, and aerospace and defense have taken the lead and will likely continue to lead the market as we move through this period of modest growth over the next few quarters. Bond prices will likely turn lower and yields turn higher as the inflation proves to be more difficult than the optimists currently believe possible.

Both the stock and bond markets will likely be range bound with limited upside and modest downside as there is a strong balance in the marketplace between optimism and pessimism. There actually is more of a bias toward optimism currently.

We sit in a relatively heavy cash position and have increased our positions in consumer staples, financials and healthcare. We have decreased our positions in tech and the FAANG names a bit further. We remain optimistic.

Mark Platke

Table 1: Stock & Bond Market Returns

12/31/2022

	Quarterly Change	Trailing 12 Mos		Quarterly Change	Trailing 12 Mos
Large Cap Growth (IWF)	2.1%	-29.3%	Small Cap Value (IWN)	8.3%	-14.8%
Large Cap Value (IWD)	12.2%	-7.7%	Small Cap Growth (IWO)	4.1%	-26.3%
Europe Asia Far East (EFA)	17.7%	-14.4%	Emerging Markets (EEM)	10.3%	-20.6%
Invest Grade Bonds (LQD)	4.2%	-17.9%	High Yield Bonds (HYG)	5.0%	-11.0%
Interm Treasuries (IEF)	0.6%	-15.2%	Mortgage Bonds (MBB)	2.2%	-11.7%

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

Table 2: Real Estate & Commodity Returns

12/31/2022

	Quarterly Change	Trailing 12 Mos		Quarterly Change	Trailing 12 Mos
DJ US Real Estate (IYR)	4.3%	-25.5%	DJ Commodity Index (DJP)	2.4%	17.5%
Int'l Real Estate (IFGL)	10.6%	-24.1%	Goldman Commodity (GSG)	3.2%	24.1%
NAREIT Residential (REZ)	-3.8%	-28.3%	Gold (GLD)	9.7%	-0.8%

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

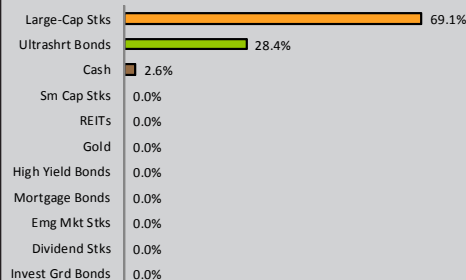
MACM Managed Accounts

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.



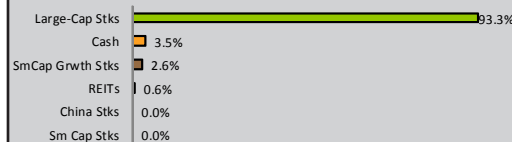
Growth

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

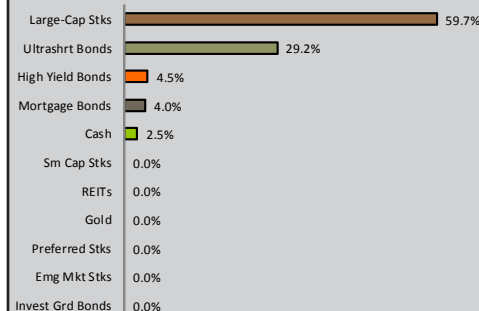
A portfolio of companies whose primary business is owning and leasing real properties.

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.



Will Employment Soften?

One of the significant factors driving inflation has been the strength of the labor market. With unemployment still hovering around all-time lows, wage gains by employees have been nearly two times their longer term average. As the Fed continues its battle to slow the economy and talk of recession looms, where might the employment picture ultimate crack? It appears we may be heading into a white-collar led employment slowdown.

Historical Context

For a frame of reference, let's take a look at the 2008 recession. In the lead-up to this bust, housing had been on fire. So too was the employment growth in that area. When housing ultimately broke, employment in areas like construction declined by 30%. Mortgage workers, realtors, and many others faced similar levels of employment struggles being directly tied to the excesses in the economy. So the question is, then, have we seen anything like this in recent years that is primed to bust to that same degree?

Current Employment Picture

Without question, covid caused some dramatic shifts in our labor markets. Notably, it seemed to cause a bit of a structural shift in unemployment. Many people retired early, immigration slowed, and others simply dropped out of the labor force given the surplus of fiscal support. This resulted in a lack of available workers generally. This has been part of the fuel behind the fire of wage gains and a tight labor market.

One of the places this structural shortage showed up most acutely was in the blue collar leisure and hospitality space. At the onset of covid, this sector cut jobs significantly. The overall workforce in this area was reduced by about 50%. Over the past year and half or so, however, there has been a huge resurgence in demand for these services as people sought out the experiences they missed during covid times. Even with the massive uptick in demand for these services and experiences, however, this area still has employment below pre-covid levels (owing at least in part to the structural shortages mentioned earlier). As a result, leisure and hospitality has been one of the biggest wage-gain beneficiaries over the last year. While it does seem that this wage strength needs to slow, this area probably won't be the first unemployment domino to fall as an obvious glut hasn't really developed here.

We should turn our attention, then, to the technology arena. Companies like Meta, Amazon, Google, Netflix, Zoom, Twitter – all the companies that saw a huge surge in demand for their products and services at the onset of covid. Much like the boom times in housing in the 2008 cycle, these companies hired like

the trends in demand for their products and services during covid times would continue into perpetuity. As their revenues soared, hiring was excessive and little mind was paid to increasing costs and headcount. It seems like payback for this excess may be on the horizon.

Let's take some of the major FAANG players, for example. Meta, Google, Amazon – each of these companies increased their headcount by nearly 100%. Meta went from 44K employees in 2019 to 87K in 2022. Amazon went from 800K employees to nearly 1.6M employees now!



Kyle Aron
Senior Analyst

The hopes for endless covid-era demand have met a harsh reality. Demand in these areas has softened. While still seeing good growth, the levels are not at the outlandish rates seen during the boom times of covid. Technology stocks have been punished as profitability has suffered owing largely to hiring excesses, which have yet to be corrected despite the slowing growth. Further, with the Fed attempting to clamp down on demand, consumers having burned through excess savings, and covid-related spending binges (first on goods, now on services) potentially winding down, the economy appears to be facing a slowdown more generally.

This all points to the need for technology companies to enact sizeable layoffs. Some have already started – Meta has cut a tad more than 10% of its workforce, Netflix 5%, Amazon 3% – but these don't seem to be sufficient. Staffing remains well above pre-covid levels.

Twitter is perhaps a good example. Say what you will about Elon Musk's methods, but Twitter has shed 50% of its workforce and appears to be intact operationally. There might be some hiccups, but it doesn't seem like staffing needs to return to twice its current size for the company to work. Will something similar soon be the fate of other technology companies? At the very least, Twitter and the housing-related areas of 2008 could serve as a guide.

Outlook

Thus, we may be facing a white-collar led employment slowdown. Cuts of 20-30% in this sector alone could boost unemployment nearly 1%. This could ultimately soften demand, taking pressure off of other sectors like leisure and hospitality, eventually leading the way in bringing wage growth and employment back to manageable levels. Whether or not this is enough to overcome the structural employment problems that developed during covid, however, remains to be seen.

Equity Market Spotlight: Sector Performance

	Quarterly Change	Trailing 12-Months
Energy	21.1%	64.3%
Industrials	17.2%	-8.3%
Materials	15.8%	-12.0%
Financials	12.7%	-11.2%
Consumer Staples	12.7%	-0.9%
Healthcare	12.6%	-3.8%
Utilities	8.7%	1.3%
Real Estate	3.9%	-25.9%
Technology	3.8%	-30.0%
Comm Services	-1.9%	-40.2%
Consumer Disc	-8.4%	-36.6%

2022 Q4: Markets Rally to End Year

Equity markets broadly moved higher to close the year. Inflation eased, while optimism seemed to develop for economic growth in the coming year. Indeed, 2022 Q4 GDP growth is looking to be 3-4%, with consumers continuing to exhibit strength. Against this backdrop, cyclical sectors outperformed, with energy, industrials, materials, and financials leading the way. With rates-sensitive sectors like housing under pressure, and with employment in the technology sector beginning to show cracks, markets may continue to be volatile as investors eye the path of inflation, growth, and Fed policy over the coming year.

A Word from our Client Team



Dane May
Client Relations Manager
& Research Analyst

Could Inflation be Sticky?

As we make our way into 2023, likely with peak inflation behind us, it is important to look at where it will ultimately stabilize. Currently, inflation is decelerating and in the process of normalizing but we must ask what is the new normal? Will we make it back to the Federal Reserve's target of 2%? Or are we now in a new era of structurally higher inflation? Demographics, De-carbonization, De-globalization, and Dominance of Fiscal Policy, the four D's, lead me to believe getting back to the 2% target will be a difficult task. Let's explore.

Demographics – The baby boomers, who have been shaping the economy for many decades, are finally hitting their retirement years. These are years in which as they stop working, their contribution to economic output vanishes while their consumption continues. This large aging cohort is leading to worker shortages. A lack of supply of workers leads to a supply/demand imbalance creating higher wages for those who do work thus keeping persistent upwards pressure on inflation.

De-carbonization – Our transition to a net zero carbon emissions world has become increasingly important for both politicians and investors. And while this is a high priority for many, through this transition both oil and gas are still needed to meet current and future energy demands. Fortunately and unfortunately, more focus, subsidies, and investments are being made into low/no carbon alternatives rather than traditional energy. This could result in shortages, driving up prices and potentially disrupting global economic activity.

De-globalization – Prior to Covid and War, companies and governments were both confident and comfortable in their global supply chains. They were efficient, cost-effective and believed to be resilient. These recent events have caused them to re-think their supply chains and action is now being taken to trade efficiency for resiliency and decrease the risk of future global disruptions. Building up bigger inventories, nearshoring / onshoring production, and finding alternative close-by suppliers are all being discussed and/or implemented to better manage new supply chain complexities. All these options likely lead to increased costs for companies which will ultimately be passed on to the end consumer of the good or service.

Dominance of Fiscal Policy Instead of Monetary Policy – Quickly after Covid arrived the Fed responded by bringing down the Fed Funds Rate to 0% in an attempt to keep the economy from falling apart. Not thinking this was enough, our government quickly resorted to Fiscal policy to stimulate the economy, passing nearly \$9T in 2020/2021. While we could argue they did "too much", one thing is clear, it worked to spark growth and it was well received by consumers and businesses. While our government acknowledges this fiscal stimulus may have played a small role in the resulting inflation, the response on both sides of the aisle was to pass additional Fiscal stimulus in 2022 (Inflation Reduction Act). Continued Fiscal policy seems inevitable as we move towards a more socialistic society where wealth inequality is exacerbated by even more inflation. Populism is on the rise with millennials, and politicians understand who will eventually be the largest cohort of voters. It is hard to ignore that both sides of the aisle continue to move towards fiscal expansionary policies ultimately leading to additional inflationary pressures.

Summary: While inflation is decelerating and in the process of normalizing, it is hard to imagine this will be an easy road back to the Fed's 2% target. Most investors would prefer a pre-covid world with an accommodative Fed, stable inflation, and slow steady growth. Equities have proven to perform quite well in that environment but we have to be realistic with the inflation challenge that lies ahead. We will closely be following the impact of the above four D's as this normalization process plays out.

Economic & Financial Market Charts

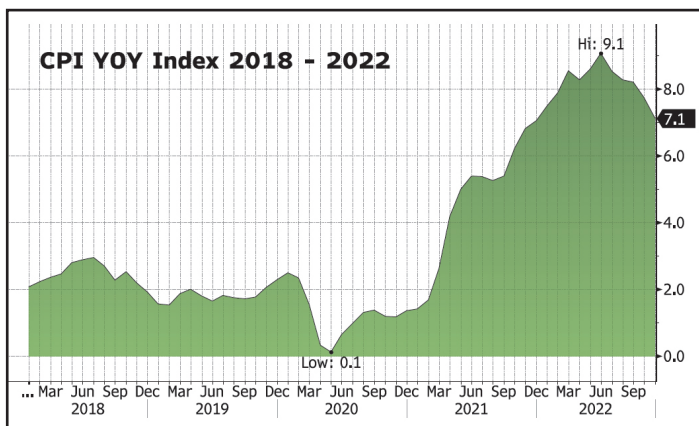


Figure 1 - Source: MACM / Bloomberg Financial
Graph of CPI, finally rolling over but still at elevated levels

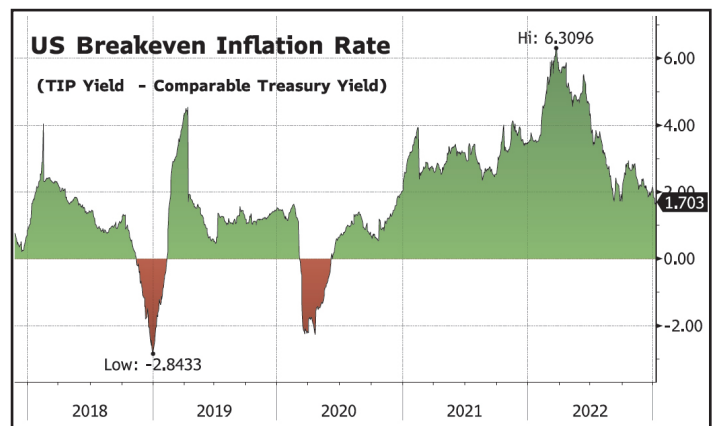


Figure 2 - Source: MACM / Bloomberg Financial
Graph of inflation expectations, showing investors believe inflation will be significantly lower within a year