Inside Views From an Investment Management Leader

# UPDATE

July 2018

## 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 MACM's new website and blog!

If you have't already, be sure to visit the new website of Mitchell Anthony Capital Management at **www.MitchellAnthonyCapital.com**. In addition, Mitch and the team publish frequent market and economic updates on MACM's blog, which you can find at **www.MACMblog.com**.

## Economic Review & Outlook

### Strong Economic Data Drives Equity Performance Higher

Mitchell Anthony
President
Chief Investment Officer

US Stocks have regained their footing as predicted in our first quarter newsletter. We believed equities would get back on track after first-quarter earnings reports and economic data that we expected to be quite positive. This is exactly what happened in the second quarter. (Pg. 4, Fig. 4). The leadership centered on domestic equities with NASDAQ and small cap stocks at the top of the list. Foreign markets tumbled as expectations for growth in the globe receded given the current environment for trade and impending tariffs. Emerging markets and China suffered the most with Europe closely behind in the freefall. This downturn came and pushed money into the US markets as the US economy stands strong in the trade war. In anticipation of this MACM exited all of its investments in emerging markets in Europe toward the end of Q1 and repositioned the portfolio in domestic equities leveraged to consumption themes present in America.

Gold and most soft commodities tumbled as inflation expectations declined with economic weakness in Europe and Asia. (Pg. 4, Fig. 5).

Fixed income markets had a lackluster quarter. The selloff that began in the last quarter paused but no reversal is on the horizon with US economic growth now accelerating.

The rebound in REITs that began in the first quarter continued in the second quarter with some REITs pushing toward new all-time highs.

**<u>Economic Data Strong and Accelerating</u>**

It certainly hasn't paid to be a Trump hater. The US economy is doing quite well and much of it can be tied to the changes that have been made by the Trump administration and the increased consumer confidence that has been born as a result. The tax cut is at the top of the list and has brought US corporations to the consumption table. Corporate America is spending on productivity and people seemingly believing that America's confidence that is at an all-time high will translate into better consumption. Thus far that has been a good bet as there has been notable improvements in consumption across-the-board from the consumer. That data is seconded by improving consumption by corporate America and foreign consumption of US products. US total exports have accelerated this year to 145 billion per month from the 126 billion per month level recorded in in January 2018. While the media quips about a dismal outlook for global trade for America the data is telling an entirely different story and so are the markets.

**<u>The Trade War</u>**

The trade war will be painful for the non-American globe. America is the economic superpower of the world and the US is the gorilla in the room when it comes to global consumption. Our financial system is sound and our political room is being cleaned. The second largest economy is China which is still politically unstable and communistic at its roots. China is not trusted in the globe and it will be decades before the world thinks about changing the dollar and letting the yuan become the reserve currency for global consumption. Europe is still asleep and not aware of the war that is being waged against socialism. Capitalism has been revived in America and as a result America has strong growth ahead and renewed leadership and dominance in the world.

*(continued on pg. 2)*

# Economic Review & Outlook (continued)

*(continued from pg. 1)*

**The Tariffs**

Thus far tariffs have caused some higher prices for foreign imports of American companies and consumers. Relief has already been seen however as US-based businesses have quickly brought on new capacity to absorb demand that was being met by foreign manufacturers previously. This is most clearly illustrated in industries like aluminum. Prices for foreign aluminum increased 20% or more in early Q2 due to the tariffs, however domestic producers have now increased capacity to produce raw aluminum and prices have fallen back close to pre-tariff levels. (Pg. 4, Fig. 6).

**Terrorism**

Prior to the Trump election acts of terror in the globe were almost a weekly event with hundreds if not thousands of lives lost in each of the last several years. The news was painful to read. However ISIS has been destroyed by the Trump administration and global terrorism has been on a steady decline. The top news in the media has been about the conflict in Congress which is much more palatable then seeing catastrophic terrorist acts. As a result travel and leisure are abounding and companies like Royal Caribbean and Princess Cruises are making record profits.

**Interest Rates and Inflation**

The Inflationary environment has remained benign despite an acceleration in the US economy. It is likely due to further gains in productivity and softness globally. Gold fell 5.6% in the quarter and is now down 4% for the year, further evidence that inflation continues to remain calm in the globe. As a result, long-term treasuries had a modest rally in the second quarter from oversold conditions that occurred in the first quarter. The path for interest rates and inflation is undoubtedly higher but the path has only a modest tilt upward.

**The Outlook for the Economy and Markets**

The acceleration in the US economy is exciting and America is now taking a strong step into a period of sustainable growth that could last for a few years as the growth and optimism feeds upon itself. It would appear that this cycle will now end in a traditional bust rather than the more uncommon deceleration in consumption, that leads the globe back into recession. This has been feared for several years.

Trump is positioning the US economy to compete better in the globe creating a bright outlook for US growth.

We remain optimistic and believe equities are the asset class of choice for the near term.

## *Table 1: Stock & Bond Market Returns* *6/30/18*

| | Quarterly Change | Trailing 12 Mos | | Quarterly Change | Trailing 12 Mos |
|---|---|---|---|---|---|
| Large Cap Growth (IWF) | 5.7% | 22.3% | Small Cap Value (IWN) | 8.2% | 13.0% |
| Large Cap Value (IWD) | 1.2% | 6.6% | Small Cap Growth (IWO) | 7.2% | 22.0% |
| Europe Asia Far East (EFA) | -2.0% | 5.9% | Emerging Markets (EEM) | -9.7% | 7.0% |
| Invest Grade Bonds (LQD) | -1.5% | -1.8% | High Yield Bonds (HYG) | -0.6% | 1.2% |
| Interm Treasurys (IEF) | -0.1% | -2.0% | Mortgage Bonds (MBB) | 0.3% | 0.0% |

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

## *Table 2: Real Estate & Commodity Returns* *6/30/18*

| | Quarterly Change | Trailing 12 Mos | | Quarterly Change | Trailing 12 Mos |
|---|---|---|---|---|---|
| DJ US Real Estate (IYR) | 7.8% | 4.8% | DJ Commodity Index (DJP) | 0.0% | 7.4% |
| Int'l Real Estate (IFGL) | -0.5% | 8.1% | Goldman Commodity (GSG) | 7.6% | 27.7% |
| NAREIT Residential (REZ) | 10.4% | 0.5% | Gold (GLD) | -5.7% | 0.5% |

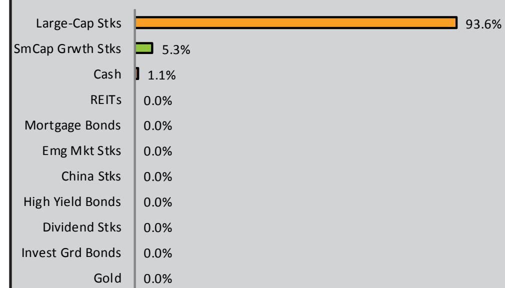
Source: Bloomberg, Barclay's Global Investors ETFs. Actual performance including dividends.

# MACM Managed Accounts

## Growth Portfolios

### Dynamic Growth

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

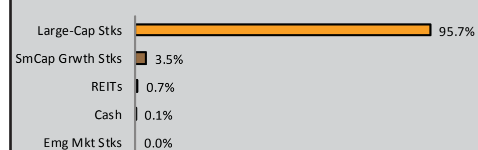



### Growth

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.



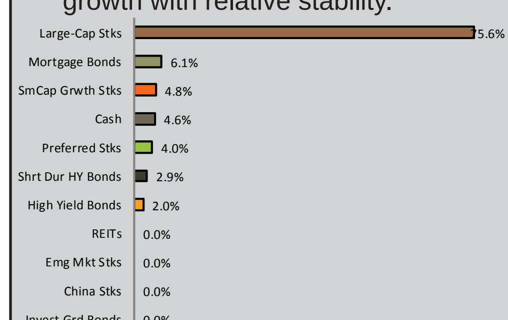

### Focused REIT

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

## Balanced Portfolios

### Asset Allocation for Income

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



## *Equity Markets: Consumption Drives Growth*

*Earnings growth drives leadership in the stock market, while consumption generally drives earnings. Every market cycle has consumption themes which are either secular or cyclical in nature. Here's what is active in this market cycle.*

**Secular Consumption Themes:**

- **Theme:** Global demand for wireless devices, digital media and cloud computing power. Demand growth is a product of industry's ability to innovate. Sector: Technology
- **Theme:** Global demand from wealthier and growing emerging market populations for meat and poultry to support more "western-like" eating habits, as well as growing demand for technologies that provide greater agricultural yields.

  Sector: Materials
- **Theme:** Global demand for energy as population grows as well as increasing demand for the technologies that make it viable to extract natural resources from the farthest reaches of the earth. Sector: Energy
- **Theme:** Increasing demand for healthcare as population ages, as well as growing demand for new and better products provided by innovation in the development of life-saving drugs, devices, and services. Sector: Healthcare

**Cyclical Consumption Themes:**

- **Theme:** The return of mild consumer discretionary spending balanced against purchasing decisions based on need instead of want. Sector: Consumer Discretionary/Staples
- **Theme:** Pent-up demand within the enterprise upgrade cycle. Sector: Technology
- **Theme:** The re-surfacing of emerging market infrastructure spending. Sector: Industrials
- **Theme:** Credit market stabilization and a return of demand for investment banking products and services. Sector: Financials
- **Theme:** The return of demand for manufactured products.

  Sector: Industrials, Energy

**Commentary: Earnings Drive Leadership**

Equities were strong performers in Q2, as investors were encouraged by strong corporate and economic data. As expected, the sectors with stronger earnings growth tended to lead the pack. The energy sector returned over 13.0% for the quarter, as energy company earnings continue to rebound alongside increasing oil prices. The consumer discretion and technology sectors were not far behind (XLY, +8.2%; XLK, +6.6%). On the other end of the spectrum, more conservative and often yield-oriented names in the consumer staples sector left it far behind, down 1.3% for the quarter. Overall, the S&P 500 index rallied 5.8% in Q2.

## *Sector Performance Review* *6/30/18*

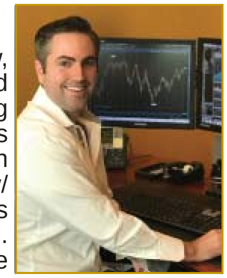
| | Quarterly Change | Trailing 12-Months |
|---|---|---|
| Energy | 14.2% | 22.3% |
| Consumer Discretionary | 7.9% | 22.0% |
| Technology | 6.8% | 31.3% |
| Utilities | 4.2% | 4.5% |
| Healthcare | 3.8% | 7.2% |
| Materials | 2.4% | 9.6% |
| Telecom | -1.0% | 1.0% |
| Consumer Staples | -1.9% | -3.2% |
| Industrials | -2.7% | 6.8% |
| Financials | -3.1% | 9.8% |

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

## Fixed Income Review

By Kyle Aron

### *Equities Regain Focus*



**Kyle Aron**
Senior Analyst

At the close of our last Fixed Income Review, we advised that "equity markets should stabilize once investors refocus on strong underlying factors that exist: solid earnings growth in corporate America, all-time highs in consumer sentiment, wage growth, and low/steady inflation." Fast forward a few months and we are right where MACM predicted. Equity markets clearly refocused on positive incoming data and had strong gains in Q2.

Indeed, US consumers and corporations are looking stronger than ever. Corporate earnings growth turned in a robust 24.3% gain in the first quarter, and is tracking to show more than 30.0% on the year as a whole. Unemployment even ticked marginally up as more and more previously discouraged workers are coming off the sidelines and actively seeking jobs in this robust employment environment. In light of strong economic and corporate data, the Fed raised rates for a second time this year at its June meeting. Notably, the Fed also raised its growth projection for real GDP in 2018 to 2.8%. The Fed observed that "recent data suggest that growth of household spending has picked up, while business fixed investment has continued to grow strongly." The Fed consensus also concurred with MACM's outlook that inflation remains low and relatively stable.

Based on the foregoing, equity markets were broadly positive in Q2. The S&P 500 returned nearly 6.0%, while the growthier NASDAQ returned an impressive 7.4% (QQQ). Notably, performance has continued to diverge between top-tier and low-tier growth stories in the equity space. The NASDAQ is now up over 11.0% year-to-date, while the broad market is up a more modest 2.7%. MACM has held some of the top performing equities over the past year, each with strong underlying growth stories. Some of MACM's best performers include names like NFLX (+179.0% Trailing Twelve Months) and AMZN (+78.0% TTM). Fixed income held steady during the second quarter, with media-fueled fears over trade wars helping buoy the asset class in general. Returns were virtually flat across all segments, however, as accelerating US growth is keeping investor money elsewhere. Gold and most commodities were flat or negative for the quarter, as inflation remains anchored at low levels. (GLD -5.7%; DJP +0.0%). REITs saw a positive divergence from fixed income for the first time in several years. (IYR +7.8%). This sharp upward trend is likely not sustainable, however, given the higher interest-rate headwinds.

The fixed income space offered investors essentially no return in the second quarter, with nearly all segments in the +/- 1.0% range. This asset class is clearly disfavored by investors given the strong corporate and economic climate that currently exists in the US. Near-term support from investor concern over the impact of trade war escalation, which has clearly been misreported by mass-media, may well be short lived. High-yield corporate bonds led performance alongside stronger corporate and economic sentiment, up a meager 0.6% in Q2 (HYG). Investment-grade corporate bonds were conversely the laggard, down just over 1.0% (LQD). The performance of most other segments fell somewhere within this range. As expected, the yield curve continued to flatten in Q2 alongside the Fed's rate hike, with the spread between 2 and 10-year Treasurys now at its lowest level in more than a decade.

The US economy is looking at a steady stride of growth, bolstered by the strength and perseverance of the Trump administration. Impressively, the S&P companies in aggregate are forecasted to earn nearly double in 2018 what they did in the boom 2006/7 period prior to the Great Recession. One would think that the strong economy and bustling business environment would get more media attention, rather than the constant griping over nonsense; nevertheless, MACM is happy to pay close attention and reap the rewards for its clients from the reality of the current environment. Moving forward, equities will remain highly favored unless a shift in the winds warrants a change in the investment sails.

# Economic & Financial Market Charts

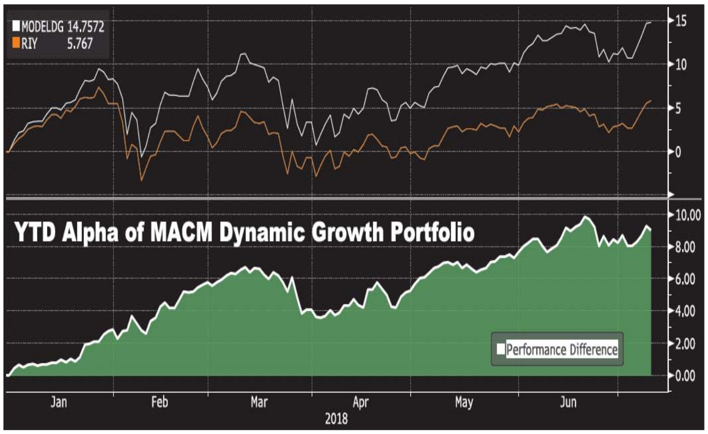



Figure 1 - Source: MACM / Bloomberg Financial

Graph of MACM's Dynamic Growth performance YTD vs benchmark, showing 9% outperformance (Alpha)

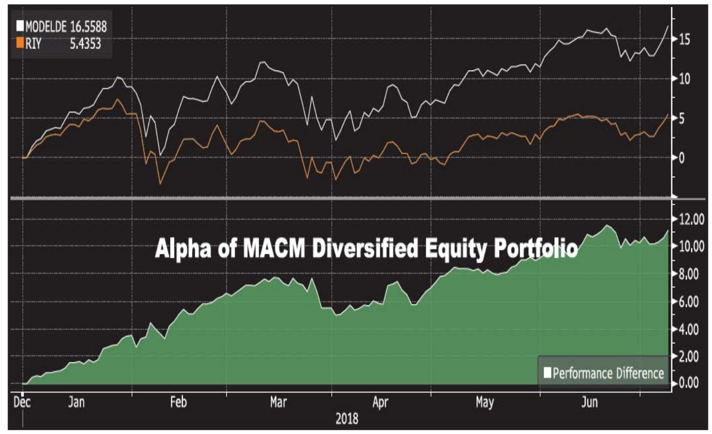



Figure 2 - Source: MACM / Bloomberg Financial

Graph of MACM's Diversified Equity performance YTD vs benchmark, showing 11% outperformance (Alpha)

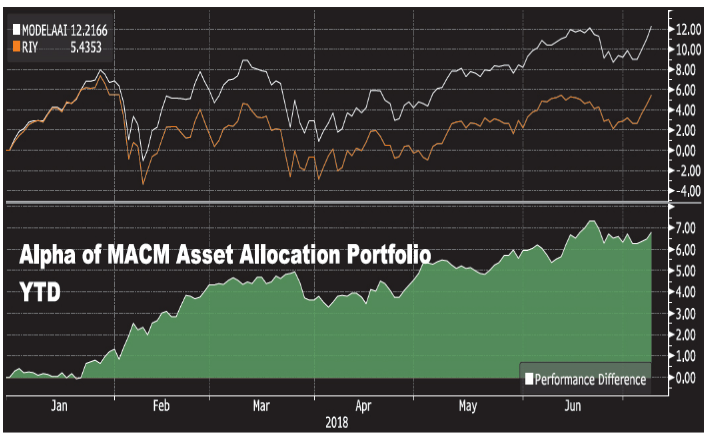



Figure 3 - Source: MACM / Bloomberg Financial

Graph of MACM's Asset Allocation Income performance YTD vs benchmark, showing 7% outperformance (Alpha)


Figure 4 - Source: Bloomberg Financial

Graph of U.S. Corporate Purchasing Manager's Index, showing stength in the second quarter

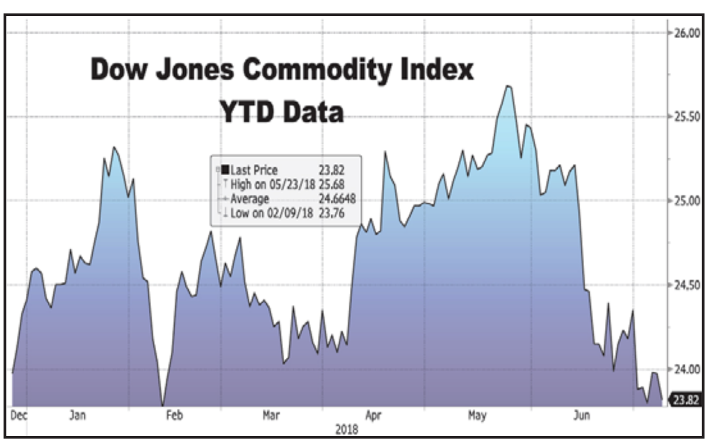



Figure 5 - Source: Bloomberg Financial

Graph of the Dow Jones Commidity Index, exhibiting weakness as inflationary pressure remains subdued


Figure 6 - Source: Bloomberg Financial

Graph of aluminum contract, showing an initial spike on trade wars but easing alongside increased US output