Inside Views From an Investment Management Leader

# UPDATE

January 2020

## 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 MACM's new "Beat the Bogey" YouTube Series

If you have't already, check out MACM's new "Beat the Bogey" video series, where we publish fresh and insightful investment content on a regular basis. We sift out truth from the flood of the media's twisted commentary on hot issues facing investors today. Search "Beat the Bogey" on YouTube and look for our "Beat the Bogey" series icon to find our YouTube channel homepage, or use the following link: https://www.youtube.com/channel/UCoHAvcpQWpYvLDE0Vk6RMzw

## Economic Review & Outlook

### Markets Advance as US Economy Ebbs

The US equity markets moved counter to the economy and the bond markets in the fourth quarter of 2019. US equity markets had their best quarter in years as the S&P 500 advanced 9% and MACM's dynamic growth portfolio (DG) and diversified equity (DE) advanced 11.9% and 12.9% respectively. The rally was rooted in several beliefs that grew deeper in the minds of investors as the quarter unfolded. The attacks on capitalism by liberal Democrats began to wane as Warren and Sanders retreated from their strong rhetoric of tearing apart corporate American superstars like Amazon, Facebook, Apple, Google, and Netflix. The trade picture also improved during the quarter as a deal was struck with the Chinese that would be incorporated in several phases. While trade has really not impacted the economy in America it has slowed the Asian economies dramatically and hurt global growth. These manufacturing areas of the world purchase significant amounts of American industrial equipment and this part of the US economy has been soft for several quarters. These areas of the economy came to life in the fourth quarter and we also saw Netflix and Amazon return to the top of the leaderboard.

The US economy continues to be led by a strong consumer who is executing on several different consumption themes. Millennials have been renting apartments at record paces and as a result apartment construction has been a theme for many years. Millennials also prefer experiences over things and as a result companies who produce services have been seeing strong consumption for many years as well. This theme of experiences has benefited cruise lines, hotels, airlines, restaurants, and entertainment in general. The millennials also need their digital devices and seldom go anywhere without their phone tethered to their hip. These devices as well as all kinds of other digital devices are being consumed by consumers and corporate America as the world digitizes and relies upon digital devices for almost everything that they do in their lives and workplace. Corporate America continues to build out its infrastructure to allow consumers to do their computing on the cloud as opposed to having PCs and laptops loaded with software. This theme has benefited the web services divisions of Amazon, Dell, and Microsoft. All of these are significant holdings within MACM's portfolios. The millennials are the largest part of the population and as a result we must keep our eyes tuned on what they are doing with their consumption. While they don't earn as much as the baby boomers their mere size cannot be ignored.

**Mitchell Anthony**
President
Chief Investment Officer

Millennials are generally people age 25 to 45 with the largest part of the millennials population being people 35 to 45. A good portion of these individuals are now starting to opt for homeownership over apartment living. As a result housing seems to be a consumption theme that could reemerge after years of below average consumption. New home sales and existing home sales have been respectable but home prices nationwide have slowed from over 6% growth per year to under 2% per year currently. (pg. 4, figs. 1,2).

Another plus for the US economy and the Trump administration was the finalization of the trade deal with Mexico and Canada (USMCA).

*(continued on pg. 2)*

## Economic Review & Outlook (continued)

*(continued from pg. 1)*

This deal seems to bear fruit for all three countries and all should benefit from stronger growth in the years ahead.

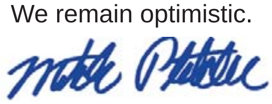
The trade deal that the Trump administration engineered calmed the markets fears substantially in the fourth quarter. Over the last few years tariffs on US goods exported to China have risen from approximately 8% to over 20% currently. At the same time tariffs on Chinese goods being exported to America have risen from under 2% to approximately 20%. The first phase of the trade deal ends further tariffs by both sides and requires the Chinese to purchase substantial amounts of American agriculture. China has also made substantial concessions to new rules and penalties for not respecting American intellectual property. It is hard to say if America is much better off today as a result of the work Trump has done on trade but it would seem there has been some progress. The Chinese are feeling the pain of their unfair trade actions of the past years. Trump has called them out on their past actions and is holding them accountable for these breaches of fair trade and theft of intellectual property. As a result they are at the table negotiating with Trump.

The move in the equity markets in the fourth quarter was pretty amazing. This 12% gain in the fourth quarter came on top of 18% gains achieved in the first three quarters of 2019. MACM's dynamic growth portfolio (DG) and diversified equity portfolio (DE) advanced 31.1% and 32.5% respectively in 2019. It was a great year for absolute return but only a modest year for alpha. The performance of Netflix and Amazon in 2019 was only average as these companies were attacked viciously by socialists and at the same time Amazon had its first quarterly miss in many years. This earnings miss was due to significant investment on next-day delivery which has proved to be of value but caused increased cost in Q3 as they introduced this service.

The outlook for the markets and the US economy remains bright. Economic conditions in the globe also seem positioned for improvement. After several quarters of below average consumption in the globe it would now seem that this ebb and flow global economy is set to flow a bit after several quarters of ebbing.

Pent-up demand has developed in America and the globe and will likely push the economy at a bit faster pace in 2020. As a result earnings growth will likely rebound to single digit levels from current flat levels. With inflation bottled up and real estate and bonds at all-time highs in valuations, stocks remain the best valued asset class. We have a world of highly valued assets that is supported by an economy that never seems to fall into recession and never seems to go fast enough to bust. This slow growth environment is ideal for stocks and remains our asset class of choice.

We remain optimistic.



## *Table 1: Stock & Bond Market Returns* — *12/31/19*

| | Quarterly Change | Trailing 12 Mos | | Quarterly Change | Trailing 12 Mos |
|---|---|---|---|---|---|
| Large Cap Growth (IWF) | 10.5% | 35.9% | Small Cap Value (IWN) | 8.4% | 22.0% |
| Large Cap Value (IWD) | 7.3% | 26.1% | Small Cap Growth (IWO) | 11.4% | 28.5% |
| Europe Asia Far East (EFA) | 7.7% | 22.0% | Emerging Markets (EEM) | 12.1% | 18.2% |
| Invest Grade Bonds (LQD) | 1.5% | 17.4% | High Yield Bonds (HYG) | 2.5% | 14.1% |
| Interm Treasurys (IEF) | -1.4% | 8.0% | Mortgage Bonds (MBB) | 0.5% | 6.2% |

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

## *Table 2: Real Estate & Commodity Returns* — *12/31/19*

| | Quarterly Change | Trailing 12 Mos | | Quarterly Change | Trailing 12 Mos |
|---|---|---|---|---|---|
| DJ US Real Estate (IYR) | 0.5% | 28.2% | DJ Commodity Index (DJP) | 4.8% | 7.6% |
| Int'l Real Estate (IFGL) | 5.7% | 20.6% | Goldman Commodity (GSG) | 7.7% | 15.6% |
| NAREIT Residential (REZ) | -4.4% | 24.5% | Gold (GLD) | 2.9% | 17.9% |

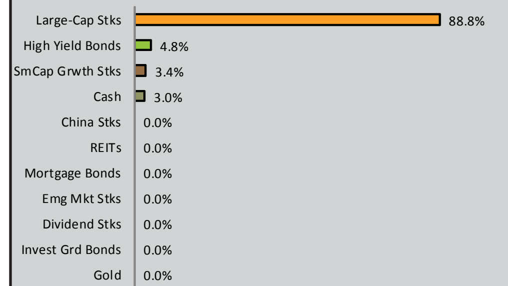
Source: Bloomberg, Barclay's Global Investors ETFs. Actual performance including dividends.

## MACM Managed Accounts

### Growth Portfolios

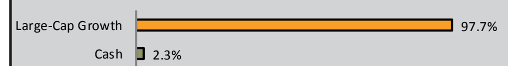
#### Dynamic Growth

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.

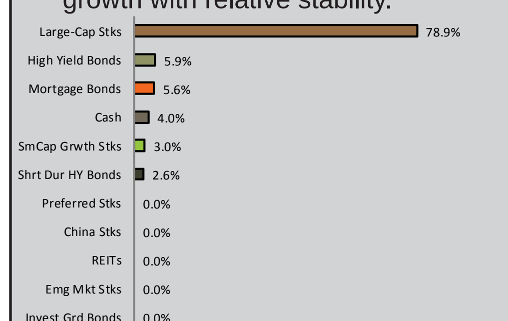

#### Focused REIT

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

### Balanced Portfolios

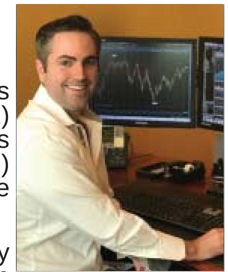
#### Asset Allocation for Income

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



# MACM Research Spotlight

## MACM'S "Beat the Bogey" Series: The Experience Economy



**Kyle Aron**
Senior Analyst

In an economic cycle, consumption themes generally emerge and represent a key part of economic growth and investment opportunity. In the 2000's, for example, home buying saw tremendous demand and was a core consumption theme. As a result, investments in housing saw strong returns (before the eventual bust, of course). Today's economic environment doesn't seem to have any overt consumptions themes quite like housing, but several more nuanced themes do indeed exist. One such theme is something that MACM refers to as The Experience Economy.

**Background: Changing Preferences – Experiences vs Things**

We define The Experience Economy as one in which people prefer to spend on and consume experiences, rather than tangible goods. Indeed, over the past few decades, the share of consumer spending on experiences and events has increased by 70% relative to total US consumer spending. In fact, since 2014, growth in experience-related spending is trending at 6.3% year-over-year, while growth in tangible goods spending is sitting at just 1.6%. While the leaders of this trend are Millennial consumers, the same consumption theme exists across generations.

So, what gives? Why aren't people out there buying more fancy new cars and luxury watches like the days of old? There are likely several reasons for this. Among them are scars from the 2008 financial crisis, a Millennial generation burdened with student loan debt, the growth of social media and sharing of our lives, the rise of rental service businesses, and strong scientific evidence that experiences actually provide more happiness than things.

Many Millennials watched as their parents lost their houses and life savings in the 2008 financial crisis, leaving distrust for accumulating assets and the tendency for assets to appreciate over time. Further, many Millennials are burdened by hefty student loan debt, and are having a more difficult time qualifying for major purchases of things like houses or other big-ticket items. This has led to both Millennials and their older generations to spend on experiences rather than on assets and tangible goods.

The rise of social media has also had an outsize impact on the shift to The Experience Economy. With widespread social media use, consumers have become more and more focused on the sharability of their lives. Indeed, the number of followers one has on a social platform is more of a status symbol than a luxury watch. To this end, unique experiences and mutual moments with friends tend to be the most sharable items on social platforms, driving the most engagement (likes, comments, follows, etc). Consumers are thus opting to spend on unique and interesting experiences for their sharability on social platforms.

Rental service businesses are also at play. With Uber, AirBnB, and the like, it has become increasingly simple to get transportation and housing on-demand, without any formal commitment. With the average Millennial only staying at a job for three years, not being anchored to a mortgage or auto-loan commitment allows a highly desirable amount of flexibility. This leaves money to spend instead on things like experiences.

**Implications for Businesses & Investment**

It's worth dissecting the business implications of The Experience Economy into two cases: (1) Established/traditional experience businesses that are well positioned as incumbents, and (2) Other businesses that are adapting to meet the changing preferences of consumers.

With the incumbents, The Experience Economy likely has and will continue to provide a boon in revenue as consumers focus their spending in this arena. Travel, entertainment/events, and dining are some of the primary industries that are likely beneficiaries of the changing consumer preferences. Unfortunately, much of this is not easily investable, as with things like small restaurant groups and live entertainment ventures. However, there are some largely investable segments, including things like cruise lines, amusement parks, and hotels/casinos. Royal Caribbean, Disney, and Las Vegas Sands are a few of the names that come to mind as incumbent players that may be well positioned to benefit.

Royal Caribbean has notably done a terrific job of expanding the scope of its cruises – including experiences designed for families, Millennials, partiers, singles, etc. Indeed, Royal continues to improve the build-out of its ships, offering more forms of on-board entertainment and experiences to drive overall business. You can see better live theater on a cruise ship now than at many off-Broadway venues! Disney also continues to excel by focusing on its various revenue streams, several of which are experience-based. Disney movies drive visits to theme parks to be immersed in the world of Disney, and further drive purchases of toys related to the movies. This is a great experience-driven feedback loop for revenue.

Other typically non-experience type businesses have opportunities as well. Businesses with a keen eye on this trend have been building out the experiential nature of their businesses to address this change in consumer preferences. Capital One, for example, has introduced Capital One Cafes – traditional bank branches that also offers a coffee bar, yoga workshops, and other experiences. JP Morgan Chase introduced its Sapphire Reserve credit card, with a spending rewards system and special benefits tailored directly to travel, dining, and related experiences. Indeed, American Express has seen outflows of consumers who prefer a card with perks more tailed to their experiential preferences. These businesses and others are making smart strategic moves to capture the consumption theme of The Experience Economy.

While some of the drivers of The Experience Economy may not last forever – financial crisis scars, for example – there are entrenched drivers behind the shift in consumer preferences to experiences over tangible goods. As Millenials rise in the corporate ranks and eventually have more disposable income, experience-based consumption may well continue on its path of growth for years to come.

# Equity Market Spotlight: Sector Performance

| | Quarterly Change | Trailing 12-Months |
|---|---|---|
| Healthcare | 14.3% | 21.4% |
| Technology | 14.1% | 49.6% |
| Financials | 9.9% | 31.7% |
| Comm Services | 9.2% | 32.8% |
| Materials | 6.4% | 24.4% |
| Energy | 5.8% | 10.7% |
| Industrials | 5.7% | 30.0% |
| Consumer Disc | 5.5% | 27.9% |
| Consumer Staples | 3.5% | 26.9% |
| Utilites | 0.5% | 25.5% |
| Real Estate | 0.3% | 29.1% |

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

**2019 Q4: Strong Finish to 2019**

Equities soared to new highs to end 2019, bolstered by favorable trade developments with both North American partners and China. Healthcare stocks led the way up, as democratic candidates backed down their plans around Medicare-for-all. The technology sector was close behind, also benefitting from dialed-back rhetoric from the presidential field. Technology, MACM's biggest sector weighting, put in an impressive 50% return for 2019. Interestingly, despite the strong market performance in 2019, overall S&P earnings were slightly negative for the year. As the economy potentially moves from ebb to flow going forward, equities are well positioned and remain MACM's preferred asset class.

# Economic & Financial Market Charts


Figure 1 - Source: MACM / Bloomberg Financial

Graph of Annual Change in Existing Home Sales, showing recent uptick reversing prior downtrend

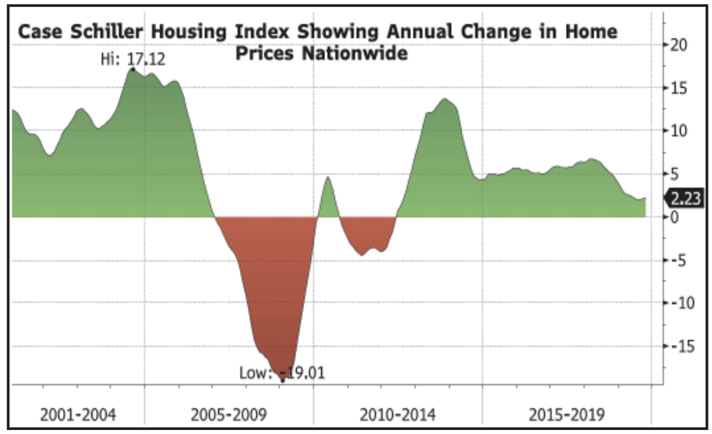



Figure 2 - Source: MACM / Bloomberg Financial

Graph of Case Shiller Housing Price Index Change, showing growth, albeit only modest

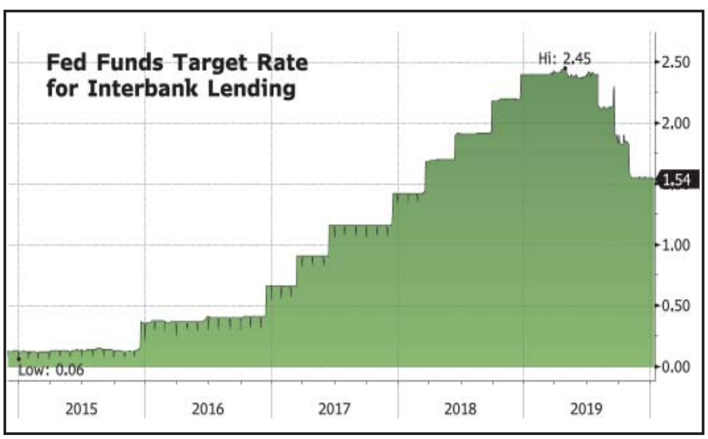



Figure 3 - Source: MACM / Bloomberg Financial

Graph of Fed Funds Target Rate, reflecting the Fed's reversal lowering rates beginning in 2019


Figure 4 - Source: MACM / Bloomberg Financial

Graph of Markit PMI, showing a recovery in manufacturing