Inside Views From an Investment Management Leader

UPDATE

October 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 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

Markets Climb as Virus Containment Continues

The US equity markets had a terrific quarter despite the fact that little progress was achieved in containing the coronavirus. US Equities led all asset classes in the 3rd quarter of 2020 with the S&P 500 advancing 9%, MACM's Dynamic Growth Portfolio Advancing 12%, and MACM's Diversified Equity portfolio advancing 13.7%. Foreign Equities lagged badly in the quarter likely due to the fact that the European economy has very little share of the globe's big cap tech industry. Gold advanced 5.8% as the Fed adopted a posture of more accommodation and more patience with inflation. Real estate failed to follow through with further gains in the third quarter after significant gains in the second quarter. Generally most REITs were flat or up 1-2% in Q3. High quality fixed income investments were mostly flat for the quarter as prices began the quarter at historical highs with only a few rational reasons why investors might expect yields to decline further. Distressed debt performed a bit better as credit quality improved during the quarter given the feds intervention and Congress's willingness to support distressed areas of the economy.

The US economy's recovery that began in the second quarter continued in the third quarter but at a relatively slow pace as the defense of the Covid 19 virus remained a top priority for America and the globe. While the infection rate in the US has declined it is still at a relatively high level averaging 30,000 to 40,000 infections per day.

The US population seems to be respecting the virus and adapting their lifestyle to steer clear of the virus. Social distancing measures are in full force across America. Masks are in use in public areas and required by retail businesses in most states across America. Public gatherings likewise are highly restricted by states and counties. There has been a 2nd wave of the virus that hit in Europe as summer vacations tested individual's patience for social distancing. It is hard to estimate what expectations there are for individual's willingness to take the vaccine but it is notable that Global Vaccine production is ahead of plan as testing went quite well.

Mitchell Anthony
President
Chief Investment Officer

US Economy Recovering in Volatile Manner

The US economy has been hit hard by the coronavirus but yet the resilience of the American consumer is notable and the economy has made progress but there has been volatility amongst sectors with some having headwinds and some having tailwinds. Consumer Confidence has had a modest rebound of about 4% during the quarter but is still off 30% from pre-Covid levels. (pg. 4, fig. 1). It is interesting to note that consumer confidence is not highly correlated to retail spending or personal consumption. The American consumer typically talks pessimistically all the time while spending optimistically. Personal Income remains high at 19.5 Trillion falling back to trend. Personal income had a significant rise due to all of the helicopter money given to consumers during the second quarter. While the second dose of helicopter money was expected it has not surfaced yet and as a result personal income has fallen back a bit. Unemployment remains high at 7.9% but has rebounded significantly from the second quarter levels during the peak of Covid fears and reactions to the virus. We have seen a sharp bounce of 7% in the quarter in retail sales levels which is far above historical levels. Personal Consumption rebounded over 9% but is still well below pre-Covid levels as the services component of personal consumption reduced the overall level of personal consumption. Consumer services obviously remain distressed as one on one contact is still discouraged and being avoided by most consumers. The Industrial sector is rebounding with mixed results. (pg. 4, fig. 2). Commercial aircraft production is not rebounding nor is it expected to for the next year or two. Housing has been the best part of the industrial sector with New Home sales up over 49% in the third quarter. Further Existing home sales gained by 53% in the third quarter.

(cont on pg. 2)

Economic Review & Outlook (continued)

The virus pushed people out of apartment living and into single-family homes and people are now buying more home than they had previously as they spend more time doing everything from home. Industries that are tied to homebuilding are recovering and the outlook seems bright. However the outlook for durable goods is very uncertain due to consumption trends that continue to be affected dramatically by the virus.

US Exports rebounded to 113 billion but are still off the 130 billion trend of the past year. While the US has clearly been a hotspot for the virus compared to the rest of the world consumption trends in the US are similar to that of other foreign countries who have less of a virus problem but are still hunkered down similar to America. Corporate America is clearly suffering because of the virus. The service sector is not operating or if it is it is limping along at a fraction of its capacity. The problem is notable in the fact that Corporate Profits are lagging and still off trend by over 10%.

US Economy Still Struggling To Reopen
The work from home theme prevalent in the US economy has had mixed results for the underlying businesses. Clearly the Financial Sector is struggling to work productively from home. Wall Street cannot maintain its culture or keep its employees motivated while they are at home. The Manufacturing sector has had mixed results and obviously cannot have most of their employees at home and hence has had to embrace social distancing at work at extreme cost. The Tech sector has found that working from home to have reasonably good success but continues to move toward bringing people back to the office so cultures can be maintained. Obviously social distancing is still highly impacting retail services.

The first round of fiscal stimulus saved the US economy during the worst economic downturn in history. The outlook for the economy is now a bit uncertain as the Second round of planned fiscal stimulus has not been approved by Congress. It is clear that help will come however it is uncertain how much will come and how much damage might be done while Congress wrangles over the issues.

Financial Markets Made New Highs With Stay At Home Leadership
The leadership in the equity markets attempted to shift away from stay-at-home names to cyclical names several times during the third quarter. However it became clear that the tailwinds for our tech titans were much stronger than anticipated and the headwinds for the cyclicals failed to calm. It seems that the stay-at-home theme may be here for a long period and not just until the virus is contained.

The Economic Outlook For The US Is Uncertain But The Probabilities Are High For A Full Recovery
The US economy does not quite have enough momentum to sustain itself and will need continued stimulus to get a positive feedback loop established for most of the industrial and cyclical areas of the economy. The tech sector and tech related consumer areas are more than 50% of the US economy and as a result this part of the economy has self-sustaining growth and will lead the rest of the cyclical sectors out of this recession. Home construction and remodels will lead the industrial sector as the interest rate environment remains ultra-friendly. The Fed may well begin a round of quantitative easing if for whatever reason investors abandon the bond market.

Financial Market Outlook
Stocks will continue to be the place to be in the year ahead. Domestic Equities will lead and Foreign equities will lag. Tech and tech enablers will lead the equity market higher. Cyclicals will lag in the near term but will likely lead within another few quarters. Fixed income will likely remain flat as prices are already extremely overvalued. Gold and REITS will trend higher. We remain optimistic.

Table 1: Stock & Bond Market Returns *09/30/2020*

	Quarterly Change	Trailing 12 Mos		Quarterly Change	Trailing 12 Mos
Large Cap Growth (IWF)	13.2%	37.2%	Small Cap Value (IWN)	2.5%	-14.9%
Large Cap Value (IWD)	5.6%	-5.2%	Small Cap Growth (IWO)	7.2%	15.8%
Europe Asia Far East (EFA)	4.6%	0.1%	Emerging Markets (EEM)	10.3%	10.8%
Invest Grade Bonds (LQD)	0.8%	8.9%	High Yield Bonds (HYG)	4.1%	1.2%
Interm Treasurys (IEF)	0.2%	9.9%	Mortgage Bonds (MBB)	0.3%	4.3%

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

Table 2: Real Estate & Commodity Returns *09/30/2020*

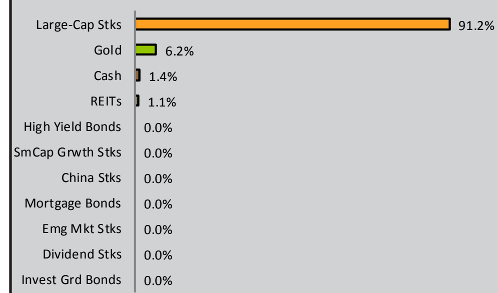
	Quarterly Change	Trailing 12 Mos		Quarterly Change	Trailing 12 Mos
DJ US Real Estate (IYR)	1.9%	-11.9%	DJ Commodity Index (DJP)	10.7%	-10.6%
Int'l Real Estate (IFGL)	4.2%	-14.0%	Goldman Commodity (GSG)	3.7%	-28.6%
NAREIT Residential (REZ)	2.3%	-20.6%	Gold (GLD)	5.8%	27.5%

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

MACM Managed Accounts

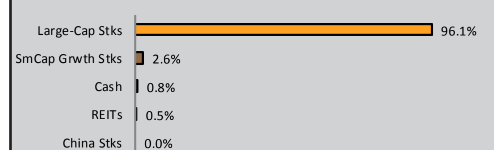
Growth Portfolios

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.

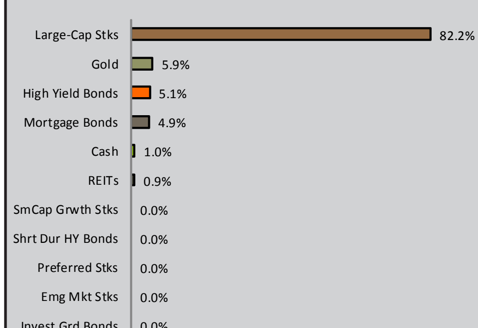
Diversified Equity
A global, all-cap equity portfolio following economic trends across capitalization and geographic ranges.



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

A Tale of Two Economies

As the world continues its battle with coronavirus, equity market performance has been starkly different across the globe. Let's take a look at the major US equity indices – the S&P 500 and NASDAQ – versus the major indices for Europe. Year-to-date, the major US indices are up 7.4% (S&P 500) and 26.5% (NASDAQ). Meanwhile, the European indices are all down significantly for the year, ranging from -19.6% (France) to -22.3% (UK). What gives? Let's walk through some important takeaways that have to do with key differences between the US and Europe.

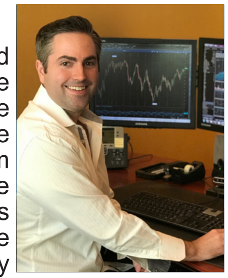
Key Differences

The disparity mostly comes down to the types of companies that exist in the US versus Europe. The US is dominated by fast growing, innovative, and mostly technology-oriented companies. Indeed, the composition of the broad S&P 500 is nearly 30% technology companies (the NASDAQ even more so). Most of these fast growing companies are riding secular trends – that is, they are enjoying strong and sustainable demand from a longer-term shift in consumption preferences. Think Amazon with delivery services and Apple with digital devices, for example. When economic turmoil hits, the companies riding secular trends tend to be insulated as their innovative offerings remain in demand. And, specific to the coronavirus, technology-oriented companies have been big winners in helping people adapt to the stay-at-home environment. Companies that are innovating and growing can help keep people employed, even in hard times.

In contrast, Europe is dominated by less-innovative, slower growing companies. The major French equity index, for example, is largely dominated by retail and industrial companies . In the Italian equity index, financials are the biggest sector exposure, trailed closely by utilities. These types of companies experience greater pressure when crisis times hit, as they don't receive the benefit of secular tailwinds with innovative products and services that consumers still highly demand. These types of companies, and their earnings, end up being very cyclical. When the economy goes through a rough cycle, these companies go through a rough cycle.

Which begs the question – where are all the growthy, innovative companies in Europe? Why are there no global technology companies being created in France? Italy? It's an important question. Clearly, as we can see through the existing pandemic, innovative companies can provide a cushion through hard times by leaning on their secular growth. As a country, having companies that innovate and are growing is a legitimate hedge against economic cycles, helping secure the growth of a given country for the future. Any country should conceivably want to be home to innovative, growing companies. And yet, these companies remain predominantly in the US.

The biggest reason is simple – the capitalistic framework in the US provides the best incentive for these companies and workers to be here. This is increasingly salient as we head into an election where one party seeks to steer the country more toward socialism – potentially endangering the future growth prospects of the US. While things like increasingly taxing the wealthy, raising corporate taxes, and expanding worker unions may seem good to some, it would be wise to look to Europe to see the long-term ramifications of taking this less capitalistic path. Europe, with its more socialistic structure, has become dominated by slow growing, highly cyclical companies. Europe in turn has been in mostly a growth slump for ages, and is arguably more exposed to economic shocks. There are clear risks in taking the path toward socialism.



Kyle Aron
Senior Analyst

The US vs France

Let's dig a bit deeper and do a quick comparison – the US versus France.

France, to support its expansive social programs, has some of the highest tax rates in the developed world. Granted, France's social safety nets help keep their citizens somewhat insulated from economic shocks. But this comes at the high cost of disallowing people from truly growing their wealth, including reaping the rewards of hard work and taking risks on innovation.

In the US, the top marginal tax rate is 37%, which kicks in for income over about $500,000. In France, the top marginal tax rate is 45%, which hits any income over just $185,000! This is merely a fraction of the $500,000 threshold in the US. Moreover, France taxes all capital gains at 30%, and has an annual wealth tax of up to 1.5% on any existing wealth over about a million dollars. For a time, France even had a "supertax" of 75% on any income over a million dollars as well. (This "supertax" was scrapped as several of the wealthiest people in the country promptly abandoned their citizenship).

This high-tax, anti-capitalist framework prevents innovative, growing companies from being created in France. Why would someone risk capital and seek to create an innovative, growing company in France, when taxes would eat away virtually all of the potential earnings the person makes from that company? This leads innovators to the US, of course. And the future growth companies end up being born here.

Looking Ahead

While this certainly isn't an exhaustive study on the different frameworks of the US versus Europe, the difference pointed out here is important. More important now than ever perhaps, as the path of the US may well be towards a more socialistic future. With the higher taxes required to support such an environment, the US may lose its growth and economic resilience borne from the innovative companies that thrive under a capitalistic structure. As a country, we would do well to remember the capitalist structure that has led us to maintain the lead as the global economic superpower for more than a century.

Equity Market Spotlight: Sector Performance

	Quarterly Change	Trailing 12-Months
Consumer Disc	19.0%	37.4%
Materials	12.5%	10.2%
Technology	12.1%	47.7%
Industrials	12.0%	1.2%
Consumer Staples	10.3%	7.6%
Comm Services	9.4%	19.6%
Healthcare	6.4%	22.8%
Utilities	5.8%	-6.1%
Financials	4.0%	-13.1%
Real Estate	1.5%	-11.1%
Energy	-19.3%	-45.0%

2020 Q3: Equity Markets Continue Uptrend

Equity markets continued to show strength in the third quarter. Cyclical sectors, like materials and industrials, attempted to gain ground on their secular counterparts like technology throughout the quarter. Ultimately, however, these cyclical sectors only matched technology's performance, as the reality remains that life will be driven largely by the virus and our response for the foreseeable future. Equity gains overall were slightly diminished in the last month of the quarter, as Congress failed to pass a second round of stimulus (despite repeated attempts) and benefits from the first package began to roll off.

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

Risky Business

Recently, CNBC reporter Steve Liesman interviewed the Dallas Federal Reserve President Robert Kaplan to discuss monetary policy amid our current economic recovery. There were two big take aways:

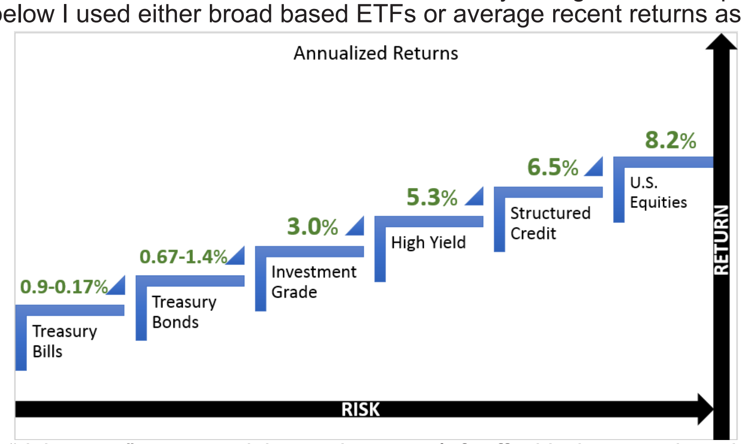
1. He stated the Federal Reserve (Fed) needs to keep interest rates at zero for the next 2.5 to 3 years.
2. He is worried that near zero interest rates will push investors out on the risk curve.

The first takeaway is understandable. The Fed wants to keep interest rates low to spur economic growth. Lower financing costs can encourage borrowing and investing. But what exactly does he mean by pushing investors out on the risk curve?

Typically when a crisis happens it is customary for the Fed to intervene, the first tool they often pull out of the toolbox is lowering the discount rate (lowering interest rates). When the Great Financial Crisis (GFC) occurred in 2008 they did exactly that – lower the discount rate. But when they felt they needed to do more they began Quantitative Easing (QE) where central bank purchases fixed-income securities from the open market to increase the money supply and encourage even more lending and investment. By using the QE tool this has artificially lowered interest rates which handicaps savers. Exactly how does that penalize savers?

Imagine you worked hard your whole life and accumulated a savings of $400,000. Back in the 1990s, you used to be able to go open up a checking account, get a free toaster oven, and purchase a 5 year Certificate Deposit (CD) paying 6-8% annually! You worked hard, paid your dues, and were able to see solid returns in a safe manner. Fast forward to today and that same 5 year CD yields 1.25% (if you're lucky). What once was annual interest of $28,000 is now a mere $5,000 per year at current yields.

Now do you see how QE has penalized savers? Okay let's get back to answering the original question posed in the beginning. How do near zero rates push investors out on the risk curve? Let's start off by taking a look at expected annualized returns across different assets. For the chart below I used either broad based ETFs or average recent returns as sources.



Now that you can visualize the "risk curve" we can pick up where we left off with the question above. In order for you to get the same income/returns on your $400,000 of savings back in 1990's, you would have to shift your current day asset holdings to High Yield Bonds, Structured Credit or Stocks! You went from sleeping easy at night knowing your Certificate Deposits were safe and carried little risk to now having to take on risk to see any chance at those previous returns you became accustomed to. Does this mean stocks are now inherently less risky as investors now pour into these "higher risk assets"? It would seem so, and as each individual, family office and pension plan chases yield stocks will continue to be an asset you want to own. This is a subject we are constantly thinking about and something we will continue to watch and monitor.

Economic & Financial Market Charts

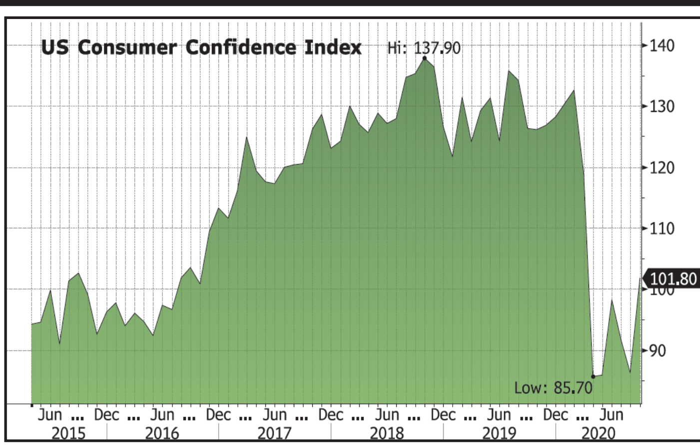


Figure 1 - Source: MACM / Bloomberg Financial

Graph of Consumer Confidence struggling to recover to pre-Covid levels

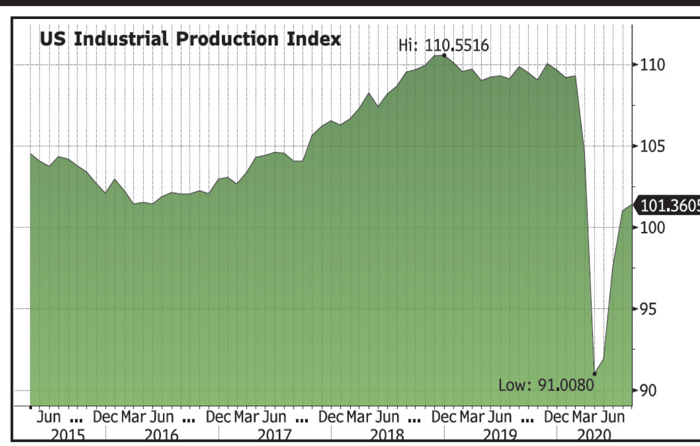


Figure 2 - Source: MACM / Bloomberg Financial

Graph of Industrial Production still below pre-Covid levels