

UPDATE

October 2021

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

Markets Fret Over Fear of Change in Monetary Policy

The relatively steady rise in equity prices that we experienced the last 1 ½ years has shown some signs of stalling over the last month. The S&P 500's recent peak was on or about August 31. It declined about 4% in the first week of September and then quickly recovered back to its August 31 high by September 22. However, commentary from the feds meeting the third week of September caused fear and investors pushed the market down again to where the S&P 500 is now about 6% below the August 31 high. We saw a similar correction like this in March of this year as well as November of last year. When investors fear the economic cycle is ending they sell stocks and they tend to sell growth stocks first because of their high valuations. As a result technology has underperformed over the last month and value areas like energy, materials, and financials have done better but still have declined over 2%.

Steady economic data combined with accommodative monetary policy got the markets right back on course during these previous corrections. Will this correction have the same outcome? We believe so, however we are carefully watching the inflationary environment as well as the dynamics going on in housing for confirmation of our thesis that this market is being driven by Fed liquidity and expectations for modest earnings growth. We believe the Fed's liquidity pump will remain on for several more years, combined with a strong consumption theme of housing and business and consumer services. We believe the US economy will ebb and flow with modest to moderate growth. Asset valuations will remain very high as rates stay near Zero.

Will Consolidation in the Housing Sector Derail this Expansion?

Housing is always an area of concern when evaluating an economic cycle. The strength of this sector almost always dominoes over into several other sectors. Housing has historically been responsible for starting and ending economic cycles. If demand ends when there is excess capacity than the fall-out can be broad and deep and affect many sectors of the US economy. Most notably this happened in 2009 and the fallout lingered for almost 10 years keeping housing from being a problem throughout most of the expansion that occurred from 2010 to 2020. Now we are beginning a new cycle for housing that could be shorter than the last cycle because we have not had strong inventory to offset very strong demand that began doing Covid and continues today.

The strong increases in prices have caused buyer reluctance and consumers as a result have pulled back on purchases just recently. Residential home prices are up over 20% nationwide over the last 12 months. Affordability has become a bit of a problem and it could be that prices have to consolidate their gains before further gains can be achieved. It is highly unlikely that prices will fall or cave-in here because of affordability and buyer reluctance.

(continued on pg. 2)



Mitchell Anthony
President
Chief Investment Officer

Economic Review & Outlook (continued)

(continued from pg. 1)

It is much more likely that prices will stay on a plateau or they might move higher as consumer wealth is still a driver of housing.

Will Inflation Force The Fed To Change Course And Turn Off The Liquidity Pump?

The inflation rate has been over 5% at the consumer level and a bit over 10% at the wholesale level over the last year. These numbers are high and if they persist will be a problem for the economy and the interest rate environment. Fortunately it's very likely that these rates of inflation will not continue much longer if at all. There are a few areas that are experiencing inflation that are concerning but most are easily explained as transitory. The first would be housing. Housing prices have advanced considerably because of the increased demand during Covid and the lack of capacity because of Covid as well. Increased housing prices have pushed rent and other related areas up causing concern. Housing is over one third of the CPI index (pg. 4, fig. 1). The inflation in rent and housing will likely subside soon because affordability has changed dramatically resulting in buyer reluctance.

Wage inflation has been another problem but will likely be resolved as the termination of the government's aid for unemployed puts more people back in the labor markets allowing employers to hire at fair competitive rates. The last area of concern has been commodity prices that have risen because of bottlenecks in supply chains. As these bottlenecks are worked through, as they did in lumber, (causing a 75% decline in lumber prices [pg. 4, fig. 2]) we suspect the same will happen with steel, copper, aluminum and other metals. Energy prices could be more sticky because of the recent cohesiveness from OPEC members. However \$70 a barrel oil will bring new capacity online from U.S. frackers that are profitable above \$60 forcing OPEC to compete.

News from the Fed

The Fed has talked about keeping rates at zero for at least another year or more. The Fed may allow the longer end of the curve to rise a bit over the next six months as he tapers his purchases of intermediate to long-term treasuries. It is unlikely the treasury rates will move much beyond current rates as soft economic data is on the horizon combined with the taming of the inflationary environment.

As interest rate environment calms down money will return to the real earnings leaders in America and leave these growth challenged value areas like energy, banking and metals. The great secular growth names will return to favor as this temporary problem with inflation and interest rates subsides.

We remain optimistic.



Table 1: Stock & Bond Market Returns

09/30/2021

	Quarterly Change	Trailing 12 Mos		Quarterly Change	Trailing 12 Mos
Large Cap Growth (IWF)	1.1%	27.1%	Small Cap Value (IWN)	-2.9%	63.7%
Large Cap Value (IWD)	-0.8%	34.8%	Small Cap Growth (IWO)	-5.7%	33.0%
Europe Asia Far East (EFA)	-1.1%	25.4%	Emerging Markets (EEM)	-8.6%	16.0%
Invest Grade Bonds (LQD)	-0.5%	1.1%	High Yield Bonds (HYG)	0.3%	8.9%
Interm Treasuries (IEF)	0.0%	-4.7%	Mortgage Bonds (MBB)	0.1%	-0.5%

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

Table 2: Real Estate & Commodity Returns

09/30/2021

	Quarterly Change	Trailing 12 Mos		Quarterly Change	Trailing 12 Mos
DJ US Real Estate (IYR)	0.7%	30.8%	DJ Commodity Index (DJP)	7.5%	50.2%
Int'l Real Estate (IFGL)	-3.4%	20.0%	Goldman Commodity (GSG)	4.8%	56.8%
NAREIT Residential (REZ)	2.9%	43.9%	Gold (GLD)	-0.9%	-7.3%

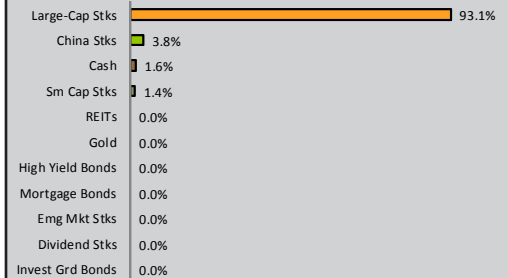
Source: Bloomberg, Barclay's Global Investors ETFs. Actual performance including dividends.

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.



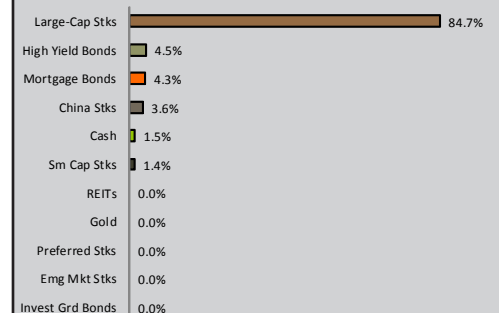
Focused REIT

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.



Fed Watch: Taper Time

Apart from “covid” and “inflation,” one of the most talked-about issues in financial markets these days is the Fed’s “taper.” People reference the “taper tantrum” of 2013, a period of market turmoil that many think could be upon us. What exactly is the “taper” we are now facing? Should investors be concerned? More generally – what should we expect from Fed policy as we finally move past covid?

After more than a year of tremendous support, the Fed is now beginning to gradually tighten monetary policy. The Fed sees the US as having made “substantial further progress” in recovering from covid – namely, recouping about 50% of the jobs lost, with inflation at or above 2% – to warrant removing some accommodative measures. However, the evidence suggests we are not on the cusp of substantial policy tightening.

What is the Taper?

Tapering refers to the Fed’s gradual reduction in the amount of assets – both Treasury and mortgage securities – it purchases each month. The Fed has been purchasing a combined \$120 billion of Treasury and mortgage securities every month to provide liquidity and help keep interest rates low in support of the US recovery from covid.

The Fed appears set to announce the official roll-off of this support, gradually reducing purchases late this year by approximately \$15-20 billion per month. This would put the end date of these purchases at mid-2022.

Different than the “taper-tantrum” of 2013, however, is the fact that this taper has been highly telegraphed. The 2013 turmoil was largely seen as a result of an unexpected announcement to taper. The Fed has learned from past experiences, and made an outside attempt to prepare the market for this coming taper. Having been digested for months, it doesn’t appear to be an event that should cause outsize pressure in markets.

What About Interest Rates?

Perhaps more important than the Fed’s asset purchases has been the Fed’s anchoring of its benchmark Fed Funds rate at 0. This has served to keep yields on fixed income instrument extraordinarily low, boosting valuations for equity markets and overall demand for risk assets.

In yet another example of the Fed having learned from its past mistakes, the Fed refined its policy objectives in 2020 and determined that the US must achieve inflation at (or above) its 2% target, and maximum employment, before it will consider tightening interest rate policy. Moreover, the Fed is willing to accept inflation over its target for an extended period, aiming rather for average inflation over time at its target. And generally speaking, the Fed changed its policy to be more backward looking – that is, waiting for data to confirm economic strength – rather than pre-emptive.

This harkens back to lessons learned from late 2018, where the Fed began to significantly tighten policy in the face of stubbornly low (but slightly increasing) inflation and some growth (with low unemployment). In essence, the US economy was possibly showing signs of finally achieving decent growth, and the Fed wanted to get in front of the curve and tighten policy before anything got too hot. This had been its historic stance, and was often coincident with an ultimate downturn in the US economy. Indeed, late 2018 saw significant turmoil from Fed tightening, which caused the Fed to immediately about-face and bring the Fed Funds rate back down to 1.5% from 2.5%.

Challenges Facing Fed

So, what might we expect from Fed interest rate policy heading out of covid?

Inflation has been running well above the Fed’s 2% target, which the Fed (and we at MACM) largely believe is due to transitory factors – supply

chain issues, for example, among other things. However, some signs appear to be cropping up that inflation may be stickier. Home prices and rents have been soaring, for example, which collectively make up about 30% of the inflation index. These increases should ease, but likely won’t reverse course. While the Fed has clearly stated its dual mandate – meeting both inflation and employment targets before it considers raising interest rates – we have to wonder how much inflation the Fed is willing to stomach before it considers taking action to raise rates in response. Overall, however, we anticipate inflationary pressures will ease back to the low levels present for over a decade pre-covid as transitory factors subside. We further don’t see the Fed ultimately breaking from its guidelines and raising rates based upon meeting one of two required criteria.



Kyle Aron
Senior Analyst

Unemployment is the other piece to the puzzle. With unemployment near 5%, we seemingly may not be too far off from Fed’s target of maximum employment. In 2018, for example, unemployment was in the 3% range with the Fed raising rates.

Generous unemployment benefits have kept people sidelined who have been, in many cases, enjoying more income from unemployment than they’d have had while working. Concerns about covid in the workplace have also kept people from working, as has the difficulty for many to find childcare amid school and other closures. As we fully reopen, with extraordinary unemployment benefits expiring this past September, it is likely that the unemployment rate should tick down somewhat.

However, this seems unlikely to cause the Fed to raise rates in the near term.

Bolstered by the wealth effect of soaring asset prices, many folks have left the labor force and simply retired early (perhaps also not interested in dealing with covid and the workplace). Estimates show that we’ve seen two times the number of typical retirees since the onset of covid. This has artificially depressed the level of unemployment by reducing the working population.

Moreover, the excess savings of the average consumer through the pandemic (both through less spending and stimulus programs) means the unemployed may not be in any particular rush to find jobs. Indeed, the most recent payrolls report missed estimates by a significant amount, despite being the first month following the roll-off of extraordinary unemployment benefits.

All told, we may not be on the cusp of employment levels that satisfy the Fed’s criteria of “maximum employment.” People may be slower to return than expected, and the level of unemployment consistent with “maximum employment” may be lower than before, given the reduction in the working population.

Outlook

While the Fed is set to begin tightening policy, it does not seem to be on the brink of any significant raise in interest rates that might be a shock to the economy and markets. Moreover, even if the Fed were to begin raising rates, we are merely coming off of rock-bottom levels. While this may make fixed income incrementally more appealing, this scenario remains generally favorable for equity markets overall. The Fed seems to have learned its lessons from the past, and would rather be late than early in tightening its policy, letting the economy run hot for some time. And, to be sure, the Fed intends to continue to telegraph any moves well in advance, so there shouldn’t be any true surprises. Indeed, keeping an eye on the inflation/unemployment paths and their implications for Fed policy is certainly top of mind here at MACM.

Equity Market Spotlight: Sector Performance

	Quarterly Change	Trailing 12-Months
Financials	3.0%	59.9%
Healthcare	1.5%	23.1%
Utilities	1.3%	11.2%
Technology	1.0%	29.4%
Real Estate	1.0%	32.4%
Comm Services	0.0%	37.0%
Cons Discretionary	-0.6%	24.8%
Cons Staples	-0.7%	11.5%
Energy	-1.2%	85.4%
Materials	-4.5%	26.1%
Industrials	-4.6%	46.2%

2021 Q3: Fed Worries Overhang Markets

Equity markets ended essentially flat in Q3, selling off sharply in September and eliminating gains for the quarter. Concerns and uncertainty over Fed policy tightening were the incoming storm clouds hanging over markets. Financials lead the way in the quarter as investors looked towards a rise in rates, considering the possibility that the Fed might raise interest rates sooner rather than later. This also pressured sectors like Technology and Communication Services, which had retaken leadership during Q2. While there may still be some pent-up demand waiting in the wings as we get through the Delta variant, the seemingly slower growth and ebbing inflation ahead should relieve any pressure on the Fed to tighten policy in any significant fashion.

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

Inflation Woes

Inflation is one of the biggest conversations happening on the street right now so let's dive in to get the current state of affairs. Questions we want to address:

- What is the cause?
- What does the Federal Reserve mean by inflation being transitory?
- What can they do if it does not prove to be transitory?
- How does it impact markets?

What is the cause?

First, let's identify what is driving the inflation we have seen over the past year. We've re-opened the economy with an unquenchable urge to spend alongside massive supply chain disruptions and a tight labor market. Looking back now, this was not an ideal situation to find ourselves in. Both consumers and businesses were flush with cash (provided by government handouts through transfer payments / PPP loans) and this created a significant amount of demand for goods, services and labor. This demand has far outweighed the supply we could bring back online after shutting down the economy. As you can guess, in this unique situation, we're bound to see prices rise sharply, and they did just that.

What does the Fed mean by inflation being transitory?

I think we can all agree we have seen inflation in our daily lives and it has stuck around longer than many expected, including the Federal Reserve (Fed). They have been catching a lot of heat lately as they still hold the position that inflation is likely to prove transitory. What do they mean by this? When the Fed says transitory they mean the pace at which the price level is rising today is unlikely to sustain for a long time. So let's think in prices. The Fed expects prices to rise next year, just not at the same pace at which it has increased over the past few quarters. This is still their base case but they are watching the data closely to see if they will be proven wrong (in some people's minds they already have).

What can they do if it is not transitory?

The Fed believes accumulated household savings, transfer payments from the government and supply chain disruptions are likely to only last a few more months. They have identified these outliers which they believe to be the cause for the higher than expected inflation we are seeing. But what if they are wrong? What if the increase in housing and shelter proves to be sticky and keeps inflation higher for longer? Well, it would mean they would have to start tightening financial conditions. First by slowing (or ending) asset purchases and then if necessary they would raise interest rates.

How will it impact markets?

As Kyle mentioned above, the market is anticipating the Fed to announce they will begin tapering asset purchases by the end of the year and finish by the middle of next year. In addition, the Fed has led the market to believe the first interest rate hike will occur by the end of 2022 and they will raise rates an additional three times in both 2023 and 2024. If the Fed changes either one of these timelines to be sooner than, or at a faster pace than anticipated we will likely see a negative reaction in equity markets. If the Fed is right and inflation does in fact prove to be transitory they will have more flexibility to keep the economy running hot while focusing on meeting their mandate of maximum employment and ensuring price stability. This will likely lead equity markets higher as financial conditions would stay accommodative for longer.

Economic & Financial Market Charts

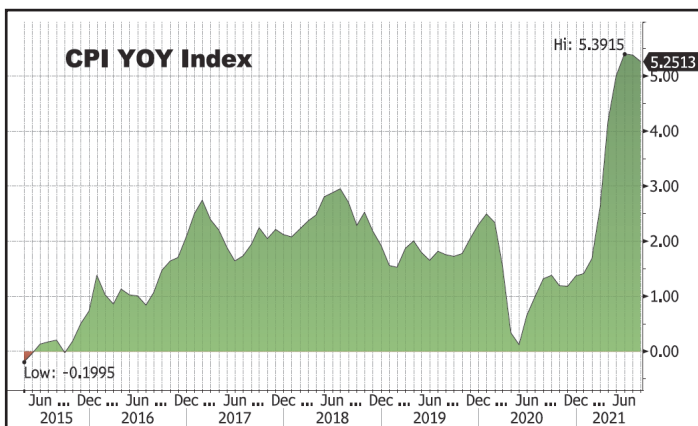


Figure 1 - Source: MACM / Bloomberg Financial
Graph of CPI year-over-year, while exhibiting big gains, showing signs of possibly topping and rolling over.

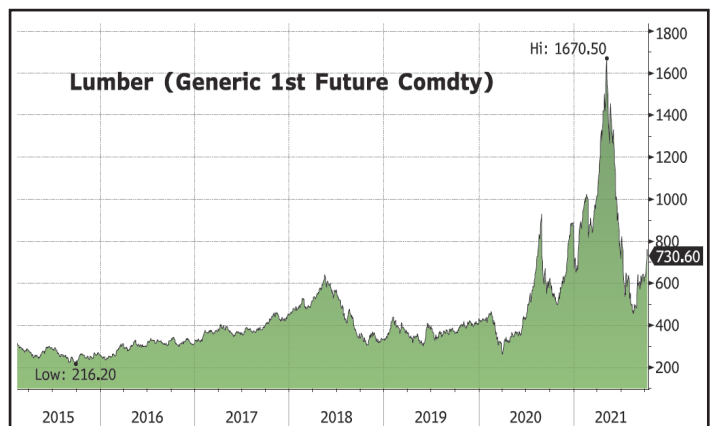


Figure 2 - Source: MACM / Bloomberg Financial
Graph of lumber prices plummeting 75% from their peak in Q2 as speculators seemingly fled