MH & ASSOCIATES • SECURITIES MANAGEMENT CORPORATION

INVESTMENT VIEWS

APRIL 30, 2024

ROCK AND A HARD PLACE

The Federal Reserve controls the short end of interest rates, by which it influences the US and global economies. Their monetary policy orthodoxy in simple terms is higher short-term rates - slower economy, lower inflation, and lower rates – faster economic growth, higher inflation. Recent incoming data suggests that US economic growth may be slowing, while at the same time some measures of inflation are hinting at a further rise in the general price level.

Policymakers have signaled that they are keenly interested in maintaining a healthy economy and getting inflation back to an "acceptable level." It appears that they may not be able to have both, since monetary policy prescriptions dictate opposing interest rate actions for growth and inflation.

Hence, the US central bank is not in an easy position and could be forced to make a stark policy choice sometime in the future. Past policy choices indicate that they may err on the side of letting inflation run hot, versus creating economic problems such a recession and high unemployment.

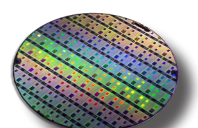
HOW MUCH CONTROL DOES THE FED HAVE?

It was pointed out in the previous article that the Federal Reserve conducts monetary policy only through the control of short-term interest rates. However, there is much more to interest rates than just the shorter end of the entire interest rate curve. In fact, there are different interest rates for different periods of time, ranging from 3 months out to 30 years and beyond. Some of those rates are even more important to the economy than short-term rates.

For example, many real estate, automobile and capital good loans are based on 10-year US Treasury rates. This rate is not determined by the Fed, but by market forces. That portion of the interest rate yield curve has been rising, independently of interest rate decisions or even outlook by the Fed. This makes mortgages, car loans and other business oriented loans much more expensive, thereby having a tightening effect on the economy.

If the Federal Reserve becomes concerned about US economic growth, it just might be tempted to implement something called Yield Curve Control (YCC) to lower longer term rates. This policy was tried in Japan, much the same way Quantitative Easing (QE) was tried in Japan before it was done here. We are hearing calls for YCC and will continue to monitor and as investors, find ways to benefit from it.

SEMICONDUCTOR TAILWIND



Sales of semiconductors in February rose just under 1% month-over-month, above estimates of just a minor increase. DRAM memory was the primary driver as unit sales and pricing both grew. Prices of other semiconductor compnoents were rising as well. Last year (2023), unit sales were down 19%, which was the worst correction since 2001. A big reason for this was large purchases during the pandemic to load up on scarce amount of available inventory which was being worked off during the year. This year though is starting to show an inventory replenishment and should be a tailwind for the remainder of the year. Pricing should also continue to see a boost as demand will outsrip supply, particularly in the aforementioned DRAM memory. Growth is expected to reach a cycle peak in the first quarter of 2025, which would likely argue stocks will discount this a short time before that.

GOLD AND SILVER

Precious metals have a significant place in our current portfolio. Gold has done quite well over the past 8 years, rising from about $1000 to a current record high that touched $2400. Silver too recently hit $30 an ounce from under $10.

Global demand for precious metals, which has served for millennia as currency and a store of wealth, has been strong in the US, China, India, Europe, Japan and numerous other nations. The primary driver of this trend is a lack of confidence in paper currencies due to large defricts and high levels of debt in many countries, including the United States. Additionally, there is the fracturing of global trade, with distrust growing between nations, forcing central banks to stockpile gold as a reserve asset and driving up demand for gold.

Gold and silver miners are a different story as far as investment returns are concerned. While the metals themselves have soared, the companies that mine them have struggled. The reason – gold and silver are rare and if it was always profitable to mine, they would not be rare. Only when the prices of gold and silver rise faster than their costs to mine do the gold miners do well. We believe that such a time is upon us and are prepared accordingly. Our portfolios hold several names in this space including GDX, NEM, PAAS, SGDJ and our gold bullion ETF is OUNZ.

APPLE AND AI

We wrote a couple months ago regarding our concerns about Apple and, while still being holders of the stock, felt that it might be in for a rough period going forward. A moderating smartphone market was a big reason behind this, but another part was their seemingly lack of ambition when it came to artificial intelligence (AI). Love it or hate it, AI is going to be a major component of spending on technology going forward and those who do not spend will be left behind.

Something though seems to have changed. Over the last couple months, Apple has been making more and more be known about its endeavors into AI. They have taken high level engineers from the likes of Google, Amazon and Microsoft and made some acquisitions as well. There have also been talks about them licensing technology from OpenAI or Google for the next version of the iPhone. This would not be unheard of as Apple has a history of licensing software while continuing to work on their own version for future phones. Recent news also shows that Apple has indeed been working on it's own Large Language Model (LLM), akin to ChatGBT and other, but also showing better results than those. Time will tell, but Apple may finally be publicly putting its foot into the AI race.

TURNAROUND STORY

PayPal (PYPL) is a turnaround story that we mentioned last year in our newsletter. PYPL is a household name, with hundreds of millions users across the globe. The stock has fallen hard since 2022, declining over 80% from the high as investors became concerned over slowing future growth and increasing competition. Since we added it to our portfolios, PYPL has basically been flat, having sporadic pops in price, only to give them right back.

Our investment thesis for PYPL is not that high growth will return, but that investors have written off the company and underappreciate the strength of the business. PayPal generates strong profits and cash flow that continue to grow, albeit at a slower rate than during the COVID pandemic, which occurred due to rapid expansion of contactless and on-line payments. A new management team is now in place and has begun to reveal plans to boost revenues, cut costs and further innovate in the mobile and on-line payment space.

We anticipate that in the coming quarters investors will begin to see results and revalue PYPL shares accordingly.

Recommendation List: A list of all previous specific investment discussions published over the past 12 months will be provided upon request. Please email lara@mhandassociates.com or call our office for this list.

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