

These are stressful times for families, businesses, and our nation. We hope you and your families are safe and well. Our top priority continues to be the safety, health and financial well-being of our clients, co-workers and families.

ECONOMIC UPDATE

During 2020 we experienced:

- the worst pandemic in a century
- the shortest recession in our country's history
- the fastest bear market in the NYSE's history
- the most protest activity since the Vietnam War
- unemployment of 3.5% in February, 14.7% in April, and 6.7% in December
- a Presidential election and slim majorities in both legislative chambers
- a \$14 trillion increase in global central bank monetary supply
- a record US fiscal stimulus

CONTINUING FISCAL STIMULUS

In December 2020, the federal government approved another \$935 billion of pandemic relief stimulus spending, which includes a \$600 check for most US citizens.

The incoming administration references this stimulus as a "down payment." Those comments, combined with January's flipping of the US senate to Democratic control, advance the likelihood of additional federal government spending. This may include near-term stimulus spending as well as longer term programs such as infrastructure, green initiatives, healthcare and education.

Key Dates

01/08	Unemployment Report
01/18	Martin Luther King, Jr. Day – Stock Market Closed
01/20	Inauguration Day
01/27	Federal Reserve FOMC Press Conference
01/28	GDP 4Q & 2020 Advance Estimate
02/05	Unemployment Report
02/15	Washington's Birthday – Stock Market Closed
02/25	GDP 4Q & 2020 Second Estimate
03/05	Unemployment Report
03/17	Federal Reserve FOMC Press Conference
03/25	GDP 4Q & 2020 Third Estimate



CONTINUING MONETARY STIMULUS

Meanwhile, the Federal Reserve (the Fed) continues to “print money” by increasing its holdings of US Treasury debt and mortgage-backed securities (MBS) by \$80 billion and \$40 billion per month, respectively.

By 2020 year-end, the Fed’s balance sheet held almost \$7.4 trillion. At the current expansion rate of \$120 billion per month, it might exceed \$8.8 trillion by this year-end, more than twice pre-pandemic levels.

The Fed’s balance sheet first reached \$1 trillion in size in September 2008 during the financial crisis. Since then, the velocity of money (frequency of a dollar changing hands) has been muted due to consumer and corporate uncertainty, banking regulations, improving balance sheets of financial corporations, increased homeowner equity and the pandemic.

During the pandemic, businesses closed with great effects on all of us. Offsetting part of this economic decline was massive monetary and fiscal stimulus. Record levels of stimulus continue as we exit recession.

With goals of maximum labor market employment and inflation moderately exceeding 2% for some time, the Fed plans to keep overnight interest rates near 0% for the foreseeable future.

As multiple vaccines are distributed, overall uncertainty may abate and the velocity of money may increase. This would result in more money chasing capacity-constrained goods and services. Increased money-supply and spending in industries undergoing declining or stagnant production (like restaurant seating and airlines) could result in inflation. Pockets of inflation have already started to appear (in groceries, housing and shipping).

The combination of continued record fiscal stimulus and monetary stimulus should result in a strong economic recovery and the revenue of many cyclical companies should rebound. Nevertheless, rising costs (i.e., inflation) might squeeze profits at many companies.

CHANGING TRENDS

Many long-term trends such as climate control, demographics and technology adoption continue through the pandemic, albeit at different speeds. Other trends (remote work and eating at home) have accelerated rapidly. Some of these trends will continue while others will be altered or even reversed.

As the economy reopens, restaurant, retail and travel sales should rebound. Sports and other entertainment venues will reopen, increasing the need for expanded 5G services. Some might continue to work remotely or vary days in the office. Commercial and office lease rates should continue to decline while demand remains elevated for larger residential spaces.

Cooking and entertaining at home will continue for some. Oversold, inexpensive stocks of companies serving these areas (like shelf stable food manufacturers) might be attractive purchases, while overbought, expensive suppliers might be stocks to avoid.

In 2020, several large-capitalization technology stock prices surged as their fundamentals directly benefited from stay-at-home pandemic activity. Last autumn, five of these stocks (Microsoft, Apple, Amazon, Alphabet (Google) and Facebook) represented a combined 24% of the S&P 500 and 12% of the MSCI World stock index. Companies that benefitted from the pandemic could see their laptop, tablet and software sales growth decelerate or decline with the easing of stay-at-home orders this spring.

As profit growth rates slow at some technology companies, their market valuation multiples and stock prices may decline. Large-cap indices and index funds with heavy technology exposure should lag certain actively managed funds.

As post-election vaccine distribution lowers overall uncertainty, stock prices could surge for certain pandemic constrained companies. Many small-cap, mid-cap and dividend growth stocks experiencing sales, earnings and cash flow growth should be rewarded.

HOW TO FUND A SPENDING POLICY

A typical retiree, endowment or foundation might desire a 4% spending policy while maintaining inflation adjusted capital levels or wealth.

If administrative, accounting, legal and investment expenses combined only total 1% and inflation is somehow a low 2%, then the underlying investment portfolio must generate 7% annualized returns.

Similarly, a 5% spending policy with 4% inflation and 1% of total expenses would require annualized returns of 10%.

Yet, from today's levels, long-term bonds yield under 2% and mega-cap stocks could provide negligible or even negative returns. Moreover, most money market funds, CDs and short-term bonds cannot generate enough interest to keep up with 2% inflation and zero spending.

On the other hand, vast areas of the stock market have been ignored in recent years. Small-capitalization, mid-cap and dividend paying stocks generated impressive returns over the last century, yet many of these were overlooked in the last decade as investors sought next-generation, exciting companies.

Over long periods of time, stock prices tend to correlate with earnings growth. Thus, a stable dividend payer with a 4% cash dividend yield and 6% annualized earnings growth might produce annualized returns of 10% and be more attractive than a trendy, overvalued stock.

Dividend paying stocks can be less volatile than non-dividend payors. Diversification can further reduce volatility. A portfolio of dividend paying stocks of companies with long-term sales and earnings growth can include small-capitalization stocks, mid-capitalization stocks and even overlooked large-capitalization "value" stocks.

Portfolio holdings can span most (if not all) major economic sectors. Even a few dividend-paying technology stocks can be found at attractive prices.

Additional portfolio diversification can be gained by adding dividend payors with international revenue from exports or international subsidiaries. Foreign dividend paying stocks can also be included.

Our investment team has successfully managed through prior periods of crisis including investment bubbles, recessions, recoveries, high sector valuations, low interest rates and changing inflation. We have been in these environments before and have positioned portfolios for the near future and for the long-term.

We greatly appreciate your confidence in our team, services and results. Thank you for referring other clients like yourself to Capital Management Corporation.

Timothy C. Call, CFA, President & CIO



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Leading our investment team with over 25 years of experience is Tim Call. The team remains actively engaged with companies generating long-term growth of revenue, earnings and excess cash generation. Internally, our investment team shares pertinent information, knowledge and wisdom and has frequent investment meetings. Every employee of CMC is empowered to work remotely when appropriate.

