

FOCUS NEWSLETTER

A TIMELY UPDATE ON THE ECONOMY, FINANCIAL MARKETS AND INVESTMENT OPPORTUNITIES

JULY 2024

Walking a Tightrope

Since our May webinar the market has maintained a keen eye on several economic indicators.

Gross Domestic Product (GDP): The economy has expanded over the last seven quarters, but is cooling. The third estimate for Q1 2024 GDP came in at +1.4% — a significant drop from Q4 2023 GDP at +3.4%.

Employment: The U.S. added 206,000 jobs in June, just ahead of expectations. However, most of the gains were in just a few specific sectors, including part-time summer jobs. The unemployment rate rose in June to its highest rate (4.1%) since October 2021.

Consumer Confidence Index: The Conference Board's leading economic indicator of consumer confidence dipped in June to 100.4, down from 101.3 in May. Looking deeper into the data, consumer expectations for future financial and employment situations fell for the fifth month in a row.

What does it mean? The Fed's balancing act of restrictive policies to get inflation under control are slowing job growth and economic growth. How far (and long) will The Fed go to achieve its preferred 2% inflation target?

Consumer Inflation

Welcome news. The overall deflation trend continues to move in the right direction (toward 2%).

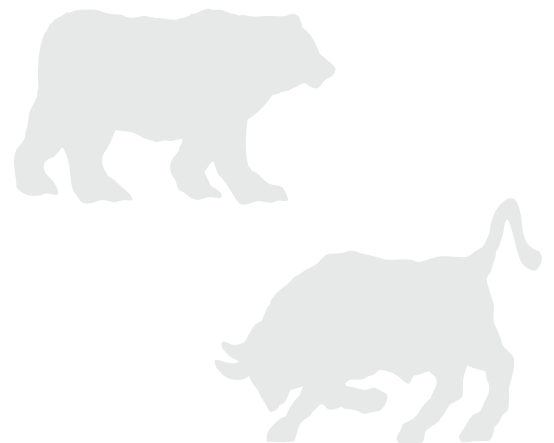
The Fed's preferred inflation index — PCE (Personal Consumption Expenditures) — fell in May to 2.6% from 2.7% in April and 2.9% in January. May's CPI report held steady at 3.3% from a year ago.

While inflation is moderating, the average consumer is trying to make ends meet.

1. Stubbornly high prices remain on everyday goods such as groceries, utilities and rent. Food is now roughly 25% more expensive than it was in 2020.

KEY DATES

7.11	June CPI
7.25	GDP 2Q Advance Estimate
7.31	FOMC Press Conference
8.2	Unemployment Report
8.14	July CPI
8.29	GDP 2Q Second Estimate
9.2	Labor Day Stock Market Closed
9.6	Unemployment Report
9.11	August CPI
9.18	FOMC Press Conference
9.26	GDP 2Q Third Estimate



2. For many consumers, wage increases have not kept up with inflation in recent years meaning that real incomes have fallen.
3. Savings from the pandemic are depleted causing consumers to max out on credit card debt and loans with higher interest rates and monthly payments.
4. Delinquency rates for credit cards and auto loans are now above the average levels of the last 10 years.

Consumer spending contributes approximately 70% of the U.S. economy. A significant drawback in both discretionary and non-discretionary purchases can undo the Fed's soft-landing goal.

What does it mean? Barring an inflation spike, The Fed may cut interest rates by 0.25% before year end. It could happen as early as September, though this would go against the conventional wisdom of a Fed rate cut two months before a November presidential election.

Investing In An Election Year

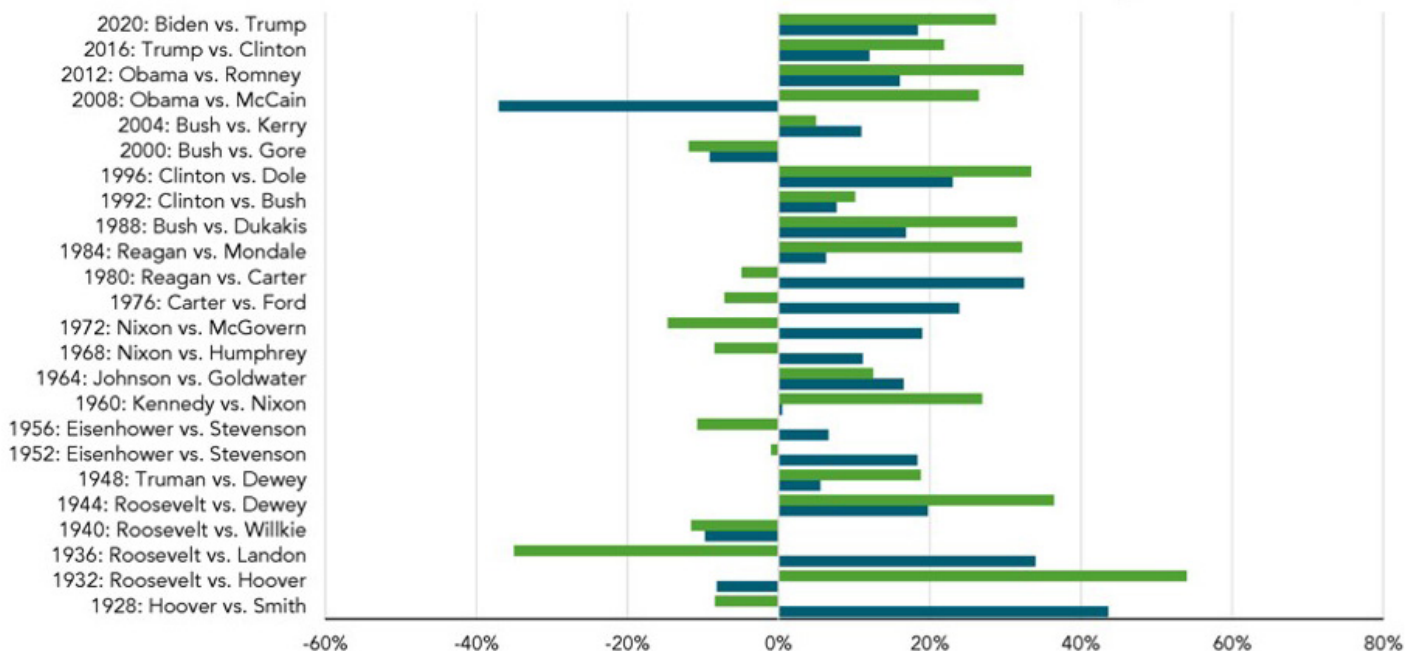
During our webinar, we shared historical data on how the political party winning the presidential election has little impact on annual market returns. Since 1933, the average 10-year annualized return of the S&P 500 starting with a Democrat in the White House has been 11.2% versus a Republican 10.5%.

What about the market volatility before and after an election? The stock market on average doesn't perform markedly worse or better in the months leading up to an election or one year after. Since Hoover vs. Smith in 1928, the average return during a presidential election year has been 11.6% and the year after each election, 10.7%.

Returns During and After US Election Years

S&P 500 Index: 1929–2023

■ Average Return Year Subsequent to Election = 10.67%
 ■ Average Return During US Election Year = 11.57%



Source: Dimensional Fund Advisors

Bottomline: Don't let the media hysteria around presidential elections detract from what really drives the market: economic developments, labor and inflation trends, and corporate earnings.

Excess Cash Is King

You may have heard the phrase — “Revenue is vanity, profit is sanity, but cash is king.”

In uncertain times those words hold even more true.

Investing in companies bleeding cash has become increasingly risky. Less than half of publicly traded companies generate excess cash...even in good years. Many others have minimal positive cash flow.



Some companies have enjoyed organic revenue and margin growth after several years of inflation-driven price increases. Those days are likely coming to an end. Consumers are tapped out, spending less and bargain hunting.

Today’s “Higher For Longer” rate scenario is putting pressure on companies. Most corporate debt is issued for just 5–7 years maturity. Think back to 2017–2019. Interest rates were hovering around 0.50%–2.50%. Corporations now will have to issue debt above 5.0%.

Cashless companies will struggle with higher interest expenses. Many will not be able to grow absent price increases. Some will go bankrupt.

CMC portfolios are positioned well. Our holdings are Cash Cows positioned to grow and reward shareholders.

Central to our research process is our multifactor, data-driven screens. These identify companies possessing superior cash flow growth and earning high cash returns relative to their cost of capital. Only about 10% of companies survive the initial Cash Cow screen.

Highlights of a few of our Cash Cow holdings include:

- Expect record revenue, earnings and cash generation this year from InterDigital (IDCC), Tegna (TGNA) and Veren (VRN). In addition to paying attractive dividends, these firms may pay down over 10% of their debt in 2024.
- Alphabet/Google (GOOGL) recently initiated a dividend. Altria (MO) announced its 54th year of annual dividend increases. Prudential (PRU) and Qualcomm (QCOM) each raised their dividends for the 16th time.
- ONEOK (OKE) and Kinder Morgan (KMI) are extending intra-state pipelines to new power plants required by new AI server farms.
- Bristol Myers Squibb (BMY) has been acquiring new drugs for their R&D pipeline.
- Gray Television (GTN) has rehabilitated over 100 acres near Buckhead which they call the Atlanta project. This \$600M investment has no debt and has now started generating revenue.
- Acme United Corp (ACU) entered healthcare in 2000 and it now represents over 60% of the company, adding higher profit margins and winning market share.

We expect holdings like these to deliver strong, double-digit sales growth and even stronger earnings growth. We are looking for high-quality, innovative firms — winning market share and generating excessive cash and profits relative to their competitors.

Webinar Question

We received several great questions last webinar, including:

Why don't you own NVIDIA?

- A.** It has made a remarkable run. NVIDIA can be a very volatile stock. It has fallen 80% in a given year period twice over the last 10 years.

We pay a lot attention to valuation when purchasing a stock. We won't risk our clients' wealth owning overpriced stocks that just happen to be in vogue for a short period of time.

The valuation of NVIDIA right now is extremely high — over 50 times PE ratio; whereas our portfolios are closer to 10–12 times PE ratio.

The chip manufacturing industry is highly competitive and hard for one company to stay dominant. Think Intel. It ended the year 2014 at 36.29. Just over a week ago (9 ½ years later) it closed at 30.97 on June 28, 2024.

NVIDIA also won't be the only winning company with AI. We highlighted several of our holdings that are well positioned to benefit greatly from AI in our April newsletter. [Click here to read more.](#)

Join Us in Congratulations!

In June our very own Joey Opiekun received his Chartered Financial Analyst (CFA®) designation. Joey joined CMC in 2020 and currently is a Junior Portfolio Manager responsible for supporting investor research, trading and portfolio management. The CFA program is a rigorous three-part exam on the fundamentals of investment tools, valuing assets, portfolio management, and wealth planning.



Way to go Joey!





Many of you have referred other family and friends to CMC.
THANK YOU!
 Your referral is the greatest compliment.

About: The Capital Management Corporation

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CMC is 100% employee owned and operated. We are one team, the same team; we are a family. This shared knowledge fosters camaraderie, communication and collaboration. We have a shared vision and passion for excellence. There is ownership over decisions, results and performance.

Together, we serve as our clients' fiduciary. We focus on growing wealth, preserving capital and generating rising, recurring streams of cash income. We greatly appreciate your confidence in our team, services and results.

Thank you for referring other clients like yourself to Capital Management Corporation. Due to clients like you, we are able to grow our organization and maintain a high level of service. Thank you again for your support.

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