

Mixed Economic Signals

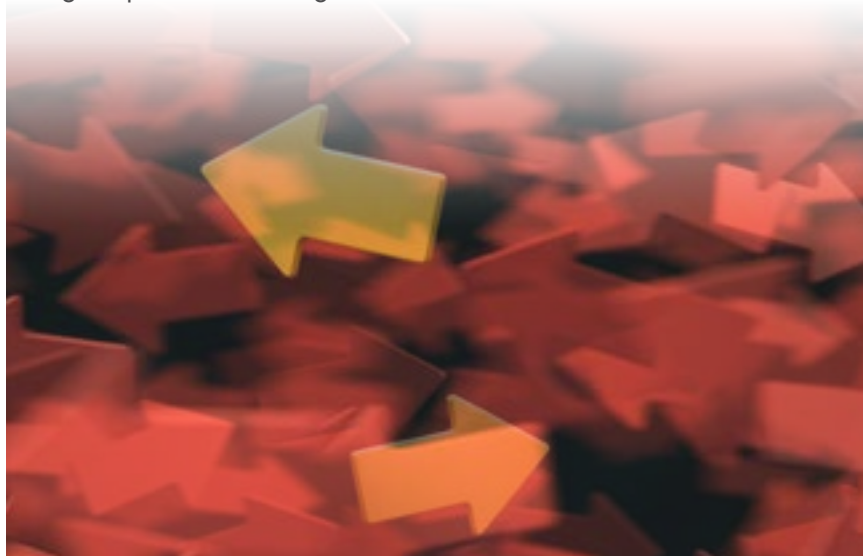
Economic data released since the beginning of the year sends a mixed message. The labor market remains robust, the supply chain sector has improved and consumer spending is surprisingly strong. Retail sales jumped 3% in January.

On the flip side, recurring inflation won't go away soon enough. In January, the consumer price index (CPI) rose 6.4% from January 2022. Higher energy, food and shelter prices contributed to the more than expected rise in CPI.

What does this mean?

The Fed has more work to do. With an inflationary target of 2%, we can expect additional interest rate hikes in the near future. This year's interest rate increases could be smaller and more spread out than last year because inflation should decelerate by year end as shelter prices (a lagging component) decline due to a softer housing and rental market. We expect total rate increases for the year to be in the range of 0.75% to 1.25%.

Equity and fixed income markets already have factored in some of this rate hike scenario so we might avoid the wild day-to-day volatility swings experienced throughout 2022.



KEY DATES

- 3.10 Unemployment Report
- 3.14 February CPI
- 3.22 FOMC Press Conference
- 4.7 Unemployment Report
- 4.7 Good Friday
Stock Market Closed
- 4.12 March CPI
- 4.27 GDP 1Q Advance Estimate
- 5.3 FOMC Press Conference
- 5.5 Unemployment Report
- 5.10 April CPI
- 5.25 GDP 1Q Second Estimate
- 5.29 Memorial Day
Stock Market Closed
- 6.2 Unemployment Report
- 6.13 May CPI
- 6.14 FOMC Press Conference
- 6.19 Juneteenth
Stock Market Closed
- 6.29 GDP 1Q Third Estimate



Recession Risk

The broken record of another recession skips along.

The risks are there. The Leading Economic Indicator index, which includes [10 components](#), continues to signal a recession in the near term with a 0.35% dip in January. This index has declined for 10 consecutive months. Though it was a smaller drop than expected, the report indicated “weakening manufacturing new orders, consumers’ expectations of business conditions, and credit conditions” could be signs the US economy may dip into a recession this year.

If it occurs, we believe the recession will be soft for three reasons.

1. The labor market remains strong. In January 517K new jobs were added, blowing away the 185K consensus. At 3.4%, we have the lowest unemployment rate since 1969.
2. Consumer sentiment is slowly rising, increasing in February to its best reading since January 2021.
3. Nominal consumer personal income continues to increase even after adjusting for inflation, the bulk of it coming from high wage growth.

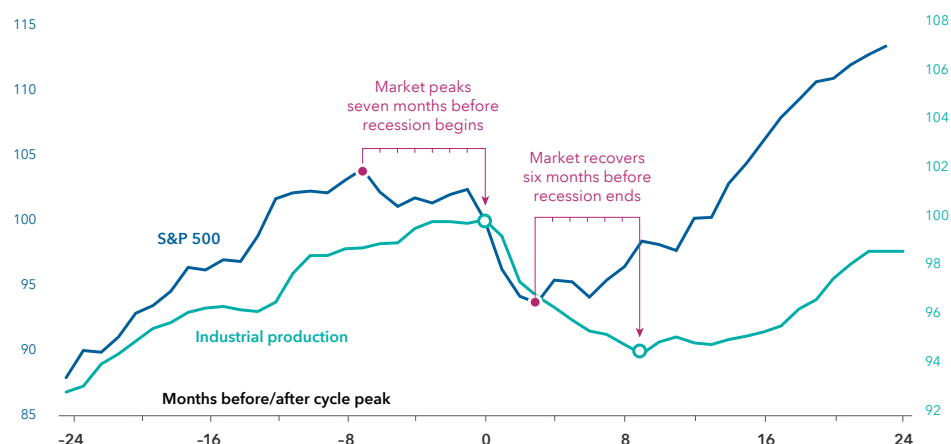
Past recessions have been painful in varying ways, but most don’t last long. The 11 U.S. recessions since 1950 have lasted two-to-18 months. The average is about 10 months.

What does this mean for stocks?

The stock market performance is a leading indicator of the economy. Since 1950, the chart on the right shows that the stock market tends to peak 7 months prior to the beginning of a recession. Conversely, it tends to bottom about 6 months before a recession ends.

We could be in a rebound period before year end. The benefits of staying invested can be significant. Since 1950, bull markets (lasting on average 67 months) have had an average return of 265% vs. an 33% loss for bear markets, which last on average 13 months.

Stocks have been a leading indicator of the economy



SOURCES: Capital Group, Federal Reserve Board, Haver Analytics, National Bureau of Economic Research, RIMES, Standard and Poor’s. Data reflects the average of completed cycles in the U.S. from 1950 to 2021, indexed to 100 at each cycle peak. Corporate earnings calculated by Strategas for all completed cycles from 1/1/28-11/30/22. Other data includes all completed cycles from 1/1/50-11/30/22. Industrial production measures the change in output produced by manufacturers, mines and utilities and is used here as a proxy for the economic cycle. Past results are not predictive of results in future periods.



Spotlight on Corporate Earnings

With inflation moderating and a little more certainty on the Fed's next moves, investors have turned their attention to corporate earnings.

By the end of February, most companies had reported Q4 2022 earnings. Overall, results have been "So-So" on top of lowered street estimates. The percentage of companies beating estimates fell from the average over the last four quarters. Those S&P companies reporting increases in revenue and/or profit achieved growth from raising prices, not unit sales growth.

2023 outlooks are being tempered as well. Many corporations noted the headwinds they face caused by the tighter monetary policy and economic factors.

Rising wages, utility costs, real estate taxes and interest expense are cutting into many corporations' profits. Moreover, unit sales for some discretionary items are falling as stretched-out consumers economize in order to afford higher priced necessities like food.

Rise of New Market Leaders

During our January webinar we were asked if now is a good time to buy mega-cap, technology stocks such as Apple, Microsoft, Alphabet (Google) and Amazon due to the sharp sector sell-off in 2022.

Proceed with Caution. The market is prime for new market leadership.

For 12 years, Wall Street has been infatuated with large cap growth stocks, especially in the technology sector. As of December 31, 2022, four of the five largest S&P 500 companies - Alphabet (Google), Apple, Amazon, Microsoft - along with Berkshire Hathaway, represent approximately 20% of the index. The 25 largest market capitalization companies still represent a whopping 40% of the S&P 500 index. Every dollar invested in the index has 40 cents going into those 25 companies and only 60 cents is invested into the remaining 475 stocks.

History suggests the mega and large-cap, growth stocks' impressive 12-year run may be over, especially in a low-to-no growth economy environment. Though their valuations have dipped over the last year, they still are relatively high compared to mid-to-small cap valuations.

Market overly concentrated



Source: Charles Schwab, Bloomberg, Macrobond as of 12/31/2022. Top 5 stocks in the S&P 500 are Apple, Alphabet, Amazon, Microsoft, and Berkshire Hathaway. Performance does not include the effects of taxes, commissions, or fees. Indexes are unmanaged, do not incur fees or expenses, and cannot be invested in directly. All corporate names and market data shown above are for illustrative purposes only and are not a recommendation, offer to sell, or a solicitation of an offer to buy any security.

Buy Cash COWS!!!

Historically, market leadership tends to change during economic slowdowns and bear markets. The previous 12-year cycle occurred during an extended period of near zero interest rates. Many firms will be hurt by continued rising costs (labor and materials), resulting in lower profit margins and borrowing money at higher interest rates (from 0% to approximately 4.50%).

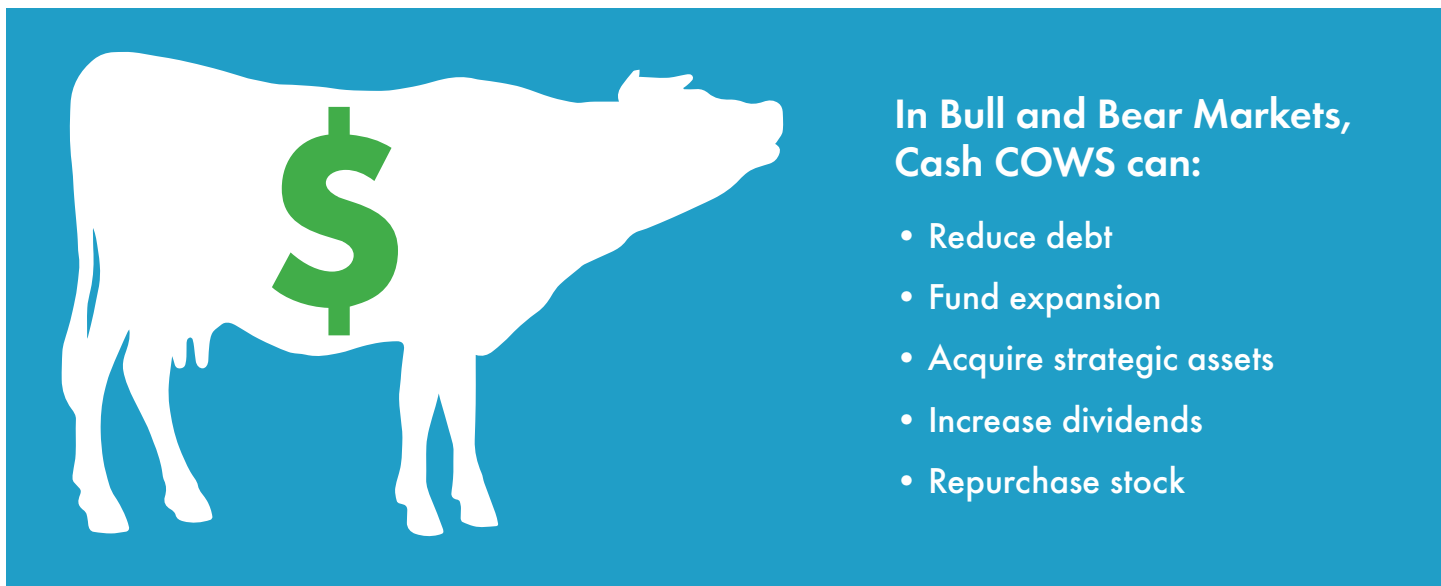
More than half of the 3,000-plus publicly traded stocks do not generate excess cash and/or turn a profit. Investors now more than ever should be buying overlooked, undervalued companies that generate excess cash.

We call them **Cash COWS**.

Cash cows tend to greatly reward investors over many cycles. In an environment of recurring inflation, rising interest rates and slow economic growth, most company managements must focus on survival. However, the managements of cash cows can focus on long-term growth and long-term shareholder returns.

Cash cows typically have these winning traits:

1. Have clean balance sheets with rising net interest income, which will add to their overall earnings growth.
2. Pay down debt to avoid higher interest expenses.
3. Pay dividends and raise their dividends annually.
4. Repurchase a material amount of their own shares, boosting earnings per share.
5. Fund internal capital investment projects; bring their products and services to more customers and/or acquire strategic assets to grow and beat out competitors.



IMPORTANT NOTE

More than 80% of CMC's approved stock holdings pay dividends and approximately 60% repurchase a material amount of their own shares.

Frequently Asked Question

Q: Given higher interest rates, should I invest in more bonds?

A: Last year the bond market performance was the worst it has ever been, dropping 13%. As yields rose with rate hikes, bond holders saw the price (i.e., market value) of their existing bonds decline.

The increase in interest rates and subsequent decline in bond prices provides an opportunity. Nominal returns on short term bonds are as attractive as they have been since before the financial crisis. The shape of the yield curve is inverted meaning that some shorter duration bonds are paying higher rates of interest than their longer duration counterparts. We believe investors with a need or desire to reduce volatility could be well served by buying short duration bonds with maturities within 5 years. These bonds tend not to lose as much value when rates head higher because principal repayments are not far into the future. When an investor does receive their principal back, they can buy another bond or use the cash to buy attractively priced stocks.



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