

*A quarterly update on the economy, financial markets and investment opportunities.*

### TAPERING RECORD STIMULUS

Both the US Federal Government fiscal stimulus and US Federal Reserve (The Fed) monetary stimulus remain at record levels. Currently, the Fed's monetary stimulus includes maintaining near 0% overnight interest rates and net monthly purchases of \$120 billion of US Treasury debt and mortgage-backed securities (MBS). Meanwhile, the Federal government plans to add \$1.1 trillion to its overall debt through its baseline fiscal 2022 budget.

Excessive deficit spending by the government is stimulative to the economy. Similarly excessive bond purchases via printing of money by the Fed is also stimulative. However, a growing economy does not need such stimulus. In fact, excessive spending and money creation during an economic rebound can create too much demand for goods which results in tight supplies and rising prices.

With inflation all too apparent, the Fed plans to taper (or reduce) its bond purchases while Congress might lower an additional spending proposal from \$3.5 trillion. If this takes place, the Fed will still be buying tens of billions of dollars of bonds each month and the Federal Government will still be running deficits well over \$1 trillion annually.

The Fed and the Federal Government might reduce their current record levels of monetary and fiscal stimulus, but they will still be printing money and growing deficits. They will continue to provide monetary and fiscal stimulus to the US economy, albeit at a reduced pace.

### RECURRING INFLATION IS NOT TRANSITORY

Price increases are broadly apparent.

Traditionally, shipping companies provided price increase warnings months in advance. Despite raising prices during the pandemic, package delivery firms have recently made statements regarding an almost immediate 5% price increase due to rapidly increasing costs.

Heating and air conditioner firms are readying their fourth price

### Key Dates

10/13	September CPI
10/28	GDP 3Q Advance Estimate
11/03	Federal Reserve FOMC Press Conference
11/05	Unemployment Report
11/10	October CPI
11/24	Thanksgiving Day – Stock Market Closed
11/24	GDP 3Q Second Estimate
12/03	Unemployment Report
12/10	November CPI
12/15	Federal Reserve FOMC Press Conference
12/22	GDP 3Q Third Estimate
12/24	Christmas Day (observed) – Stock Market Closed



increase since the pandemic. Expect that announcement in January.

Food companies continue to raise prices to offset higher costs. Many food companies and department store suppliers have contract agreements forcing three-to-six-month notices of upcoming price increases. Store contracts may have clauses limiting price increases to 4%-5% every six to twelve months. Those suppliers will face declining profit margins as it takes them years of price increases to offset recent cost increases.

Massive cargo ships were unloaded seamlessly pre-pandemic when there were just enough freight liners. Today, ships arriving in China are put into quarantine for a week before unloading can begin. Upon arriving at a clogged US port on the West Coast, ships can anchor in queue for weeks. As a result, the number of cargo ships actually moving at any point in time has dropped considerably resulting in capacity constraints.

Loading and unloading goods are further delayed due to a shortage of trailers, chassis and pallets. Due to limited pandemic labor hours, some of this equipment was left at other sites. Some terminals are clogged with excess shipping containers and equipment, while other locations facing shortages charge premiums. As freight is finally unloaded in the clogged port, tight work hours of ports and trucking firms provide additional delays and capacity constraints.

Due to similar congestion and tight labor, many warehouses are less efficient. This leads some firms to strategically delay delivery of their cargo from terminals. It is better for non-perishable goods to sit in a sealed container somewhere else than clog a retailer's warehouse. Some warehouses are in such disorder, they ask their suppliers to circumvent them by shipping items directly to their stores. One day this month, one of our investments shipped 8,000 boxes of their products to retail stores. Their superior capabilities enable them to win market share, but overworked employees are tired and demanding raises.

It is evident that some store shelves will show higher prices and less inventory. Finding holiday gifts this December may seem as futile as searching for paper goods in March of last year.

With near-term import, labor and shipping constraints, the availability of some goods will be limited. However, the Fed is printing more money and government is spending more money. When more money chases the same amount of goods, there is inflation. This is not transitory. It is recurring until numerous causes are treated.

Higher hourly wages and labor shortages are prevalent news. Next year, salaried workers will demand raises. As some workers are offered more money elsewhere, they will just not show up at their previous job. Recently, at one worksite six employees earning \$14 per hour did not show up for work one day because a new distribution center offered them \$20 an hour.

As companies strive to grow earnings over time, they will need to raise prices to overcome higher energy, labor, materials, shipping and various other costs. Many costs will continue to rise next year. Many price hikes will be implemented in 2022 to cover previous costs. Even more price increases will be needed to overcome next year's cost increases. This inflation is recurring.

### WHAT TO AVOID & WHERE TO INVEST

Not many investments perform well during times of inflation.

Interest rates tend to rise with inflation resulting in lower bond prices. If the 30-year rate rises by just one point to 3%, who will pay full price to lock in 2% for 30 years? The 2% bond's price declines approximately 20% under that scenario.

Even if interest rates and bond prices never change, investors never pay tax and never make a single withdrawal, their 2% bond interest income will still lose to inflation.

Many other investments have difficulty holding their own with inflation. Even basic commodities can produce subpar returns as few investors can both buy near the absolute bottom and sell near the top.

While stock indices may outperform other asset classes, they can still lose to inflation. Underneath the widely followed stock indices, some stocks will have horrid performance and others will shine.

Investment traits that might generate stronger returns during inflation include:

- Income – recurring and growing cash dividends
- Sector – energy, financials and materials
- Quality factor – excess cash generation
- Balance sheet – well-laddered fixed rate debt
- Market – few competitors, economies of scale and barriers to entry
- Product – unique & value-added vs substitutable

Even better than applying broad market screens, investors should dive into each company. Do managements return phone calls? Have their presentation tone and reasoning recently changed? Are they consistent and reliable? Do they have a history of disciplined decision making? How has management prepared for inflation? What steps are they currently taking in this regard? Are they ahead of inflation or well behind?

Many firms cannot fully offset rising inflation costs. They cannot raise the prices of their goods and services enough due to competition and product substitution. For the first time in the internet era, many firms will try to dramatically raise prices. Consumers and competitors have more pricing information today. As firms fail to raise prices fast enough to preserve profits, their stock prices should decline.

This is the time for stock selection. Investors need to know what (and who) drives each company in which they invest.

We have prepared for this environment. We invest in firms with pricing power, leadership in growing niches, economies of scale, innovation, strong barriers to competitive entry and excess cash generation. Their cash can be used to reinvest in growth, buy competitors, directly reward shareholders and/or retire debt as it comes due.

In almost any environment there are winners. We are excited about the future for each company in our portfolios.

### ABOUT: THE CAPITAL MANAGEMENT CORPORATION

Established in 1964, The Capital Management Corporation (CMC) is a SEC registered investment advisor (RIA) providing investment management services to institutions, foundations and high net worth individuals. Our singular purpose is managing long-term investment portfolios. We strive to maximize investor return and mitigate risk by applying a principled and disciplined process. Our firm holds itself to the highest standards of integrity and serves as a fiduciary for every managed account.

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 with a 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.

- *Timothy C. Call, CFA*  
President & CIO

### POST SCRIPT

My initial recovery from a separated Achilles tendon yet again renews my gratitude for our medical community, friends, family and coworkers.

I thank our Capital Management team for their professionalism and dedication that continues to see us through challenges. Despite difficulties during the long course of this pandemic, our redoubled efforts, passion to our calling and commitment to our clients and to each other enable us to achieve strong results.

This performance demonstrates our resilience and remarkable rebound from the global economic collapse Covid inflicted 18 months ago. Using precision, adhering to proven disciplines and maintaining accountability enhanced our delivery of customized, high performing investment portfolios.

Years of strategic decisions and investments well positions our firm for the future. Our streamlined, cohesive, interactive, experienced and talented team continues to invest client portfolios to achieve superior results in these unprecedented times.

