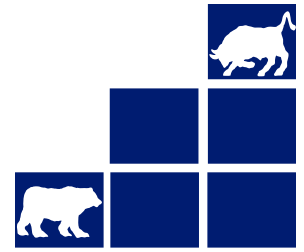


The Capital Management Corporation

INVESTMENT COUNSEL



2022: THE GOOD. THE BAD. THE UGLY

Starting with the Ugly.

2022 can be summed up in one word: Inflation. It inflicted pain on most asset classes.

2022 Total Return (AS OF DEC. 27, 2022)		
DOW: -8.52%	NASDAQ: -33.27%	10-YEAR US TREASURY NOTE: -16.33%
S&P: -18.35%	GOLD: +0.40%	30-YEAR US TREASURY BOND: -33.09%

The Bad...not so Bad.

Though inflation has moderated, the sustained high prices for goods and services remains a problem. While the Fed recently eased the size of its interest rate increase (50 basis points versus 75), it enters 2023 with a hawkish position.

Here's why:

- The Fed believes the labor market can remain strong. Employers are reluctant to let workers go because it's difficult to find talent.
- Consumers are still spending. Wage increases have put extra money in consumers' pockets to weather some of the price increases at the store, pump, etc. Many use their credit cards to supplement the difference.
- Shelter prices (cost of housing for both renters and homeowners) continue to increase and will remain high for a longer period of time. Shelter makes up about a third of the consumer price index.

Yet, signs of a sluggish economy are more apparent:

- Overall commodity prices, such as key metals, lumber, oil and gas decreased in the second half of this year. The expected slowdown in global economies may keep basic commodity prices down in the first half of 2023.
- Inventories have been affected by the pandemic, recession, and supply chain disruptions. The Fed's overnight interest rate hikes (from 0.25% in March to 4.50% within just nine months) raises the costs of financing inventories. Retailers are cutting or eliminating orders as a way to shrink loan balances and manage interest expense. Firms that were not financing inventory may win market share.

Now to the Good.

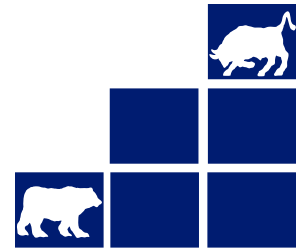
Investment portfolios can be positioned to benefit from attractive entry valuations into companies with near-term and recurring growth and excess cash generation.

Market leadership is shifting. Rising interest rates and recessions can change the valuation metrics for investment categories. In an era of easy money (near zero interest rates and rapid central bank balance sheet expansion), companies with imaginative growth stories can fetch premium valuations. Meanwhile, healthy, established firms with steady prospects and attractive dividends can be overlooked as staid and boring.

Low interest rates slightly discount future earnings. When the Fed's overnight interest rates were close to zero a year ago, some corporations were able to borrow at low interest rates too. With Treasuries paying close to zero, some investors found 3% corporate debt attractive. Using a 3% discount rate, about half of year 20 earnings are included in that firm's present value. At 7% and 10%, only one-quarter and one-eighth of year 20 earnings would be included in present value. In addition to overnight Treasury rates moving to 4.50%, credit spreads widen, tighter liquidity and economic uncertainty also increase corporate borrowing rates.

The Capital Management Corporation

INVESTMENT COUNSEL



A recession and/or rapidly increasing interest rates turn present value calculations upside down (or right-side up depending upon one's perspective). Stocks of firms with secure and rising cash dividends provide near-term cash returns (i.e., present value); whereas, firms with hope of distant prospects are no longer discounted with near-term government rates. Rising rates and slower economic growth result in greater discounting of distant prospects. With greater economic uncertainty and higher interest costs, investors become leery of future prospects (e.g., the potential for new competitors and disruptive technologies). With Treasuries now at 4.50%, more questionable borrowers cannot find lenders even at a 10% interest rate. A bond market in flux further exacerbates this situation.

Overlooked stocks of firms with improving balance sheets, excess free cash flow generation and positive outlooks should rise in value whilst some former leaders wane.

How long can the new trend last? After prior, extended ten-year large-cap growth cycles, history suggests the subsequent decade sees more strength in value, dividends, all-cap, small-cap and mid-cap styles. The recent 12+ year large-cap growth cycle appears to have hit a wall. Will the next value, dividend, active-management cycle last ten-years or twelve? The more important question is whether one's portfolio is positioned for near-term, intermediate-term and long-term growth? Will each holding generate excess cash which can be used to increase cash dividends, repurchase shares, pay down debt, acquire competitors and reinvest in future growth projects?

Capital Management has positioned portfolios to take advantage of compelling opportunities. As market leadership shifts, there will be plenty of winners. The managements of the companies in which we invest are prepared and ready.

We have studied cycles. We have invested through cycles. We are prepared, ready and positioned.

Wishing you and your loved ones a very happy new year!

NOTE: In order to effectively manage SMID product portfolios, as of December 31, 2022, SMID product deposits are limited to \$5 million per account.

Timothy C. Call, CFA

Mark W. Livesay, CFA

Scott R. Davila

Joseph J. Opiekun

