

FOCUS NEWSLETTER

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

JULY 2022

Looming Recession?

Are we already in recession?

We could be in one right now. The Bureau of Economic Analysis (BEA) last week reported their final estimate that the U.S. economy contracted at a 1.6% annual pace in the first three months of the year. If it falls again in the second quarter then technically, the US will be in a recession that started on January 1st of this year.

Traditional recessionary indicators include:

- Skyrocketing energy prices.
- A flattening yield curve. Interest rate inversion (i.e., the 2-year US Treasury note yielding more than the 10-year bond).

Today's economy appears strong and diverse enough that a recession should be mild and short lived. Here's why:

- Wages have increased due to the labor shortage. Companies have been raising wages to attract and retain employees. In 2021, many corporations raised their internal minimum hourly wage to \$15 in order to attract and retain quality workers. Today, many firms have raised hourly minimums to \$20 (including Charter Communications, Fifth-Third, MetLife, T-Mobile, Synchrony, Vail Resorts and Verizon). Apple and Bank of America will pay a minimum of \$22 per hour. This additional employment income is being spent and offsets some consumer inflation.
- Target, Visa and MasterCard each separately reported rising consumer spending (before inflation).
- While nominal consumer spending is growing, inflation adjusted consumer spending is waning due to inflation.
- Due to the pandemic, there is pent-up demand for travel and eating out. Hotel occupancy has rebounded to just 4% below pre-pandemic levels and restaurant traffic is 5% above pre-pandemic levels (before inflation).
- The unemployment rate (3.6% May) is the lowest it has been in 50 years.

KEY DATES

- 7.4 Independence Day
Stock Market Closed
- 7.8 Unemployment Report
- 7.13 June CPI (inflation)
- 7.27 FOMC Press Conference
- 7.28 GDP 2Q Advance Estimate
- 8.5 Unemployment Report
- 8.10 July CPI
- 8.25 GDP 2Q Second Estimate
- 9.2 Unemployment Report
- 9.5 Labor Day
Stock Market Closed
- 9.13 August CPI
- 9.21 FOMC Press Conference
- 9.29 GDP 2Q Third Estimate



- With more people working and wages rising, nominal consumer spending should continue to increase.
- When total domestic employment income rises faster than overall inflation, the economy is growing. This should occur next year as supply-demand imbalances improve.

Important to Note:

Since the 1950s, most US recessions have only lasted six-to-nine months.

Three months before recessions end (at the height of uncertainty and the depths of fear) is an opportunistic time to add to stock portfolios.

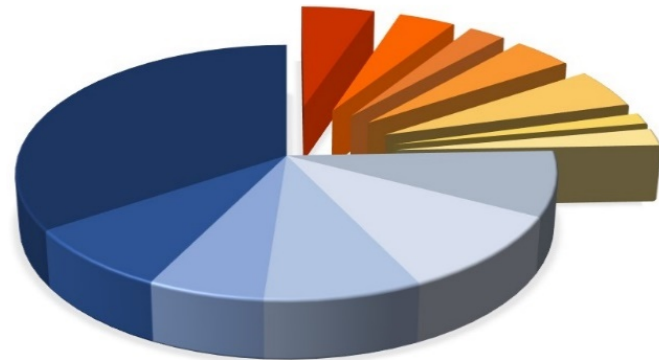
Consumer Inflation

As inflation dominates the headlines, it's worth sharing our viewpoints from last month's CMC Market Outlook webinar.

On the chart below, the items in blue and grey are non-discretionary, meaning consumers purchase them in both good and bad times. The orange tint reflects discretionary items consumers may not buy if they don't have excess income after paying their essentials.

As seen in the right column, consumer's non-discretionary prices (i.e., CPI) for food, gas and rent have been rising considerably due to many factors such as less domestic energy production, supply chain issues and the Russia-Ukraine war. As companies pass along higher costs for materials and transportation, the consumer eventually pays more at the cash register.

Trailing 12-Month Change by Category	CPI (%) (May 2022)
Nondiscretionary	
Energy	34.6
Used Vehicles, Repairs & Insurance	11.4
Medical Care	3.7
Education & Communication	0.7
Food at Home	11.9
Shelter	5.5
Discretionary	
Food Away from Home	7.4
Household Furnishings	9.7
Apparel	5.0
New Vehicles	12.6
Recreation	4.5
Alcohol & Tobacco	5.4
Personal Products	5.8



What's Ahead?

Over the next year inflation should moderate instead of spiraling upward at an accelerating pace.

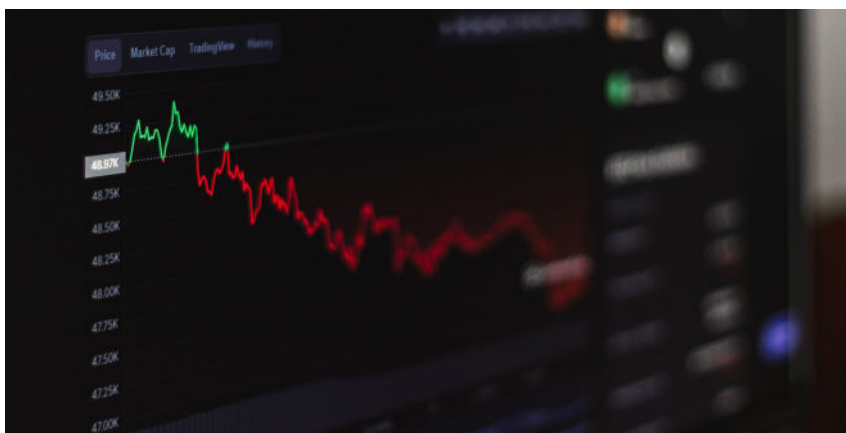
Some commodity prices appear to be stabilizing albeit at high levels. Lumber prices have declined in recent months. Last month, oil and gas prices experienced their first monthly decline since November 2021.

Expect inflation to be recurring, but not as elevated next year. As general inflation decelerates in 2023, economic growth should accelerate.

Source: Bureau of Labor Statistics
Consumer Price Index (CPI) table and chart created by CMC

Bear Market Territory

Recurring inflation, rising interest rates and a slowing economy pushed equity markets into bear territory last month. At the close of June 30, the S&P 500, which consists of large-cap companies, closed more than 21.08% below its Jan. 3 record closing – it's worst first-half performance in over four decades. The NASDAQ, heavily weighted with technology companies, closed down -29.50% year-to-date. Small caps as measured by the S&P 600 closed down -20.36%.



Bonds have not fared well either. Barclay's Intermediate investment grade index of bonds maturing in 1-10 years closed down -14.86%. The 30-year US Treasury (UST) bond fell -22.50%.

Are we near a bottom?

Over the last 93 years, after a 15% or greater US stock market decline, the first 12 months of recovery averages 55%.

The equity markets may be close to their bottom. There will be volatility ahead as The Fed tames inflation by raising interest rates.

Where to Invest

During market declines, heightened uncertainty and recessions, it is normal to feel pain, fear, grief and even panic. Such normal human emotions tend to drive some investments to oversold levels. However, selling low (just as buying high) is why emotions can be a long-term investor's worst enemy. After a stock market sell-off, one should remember the adage: "compounding is a long-term investor's best friend." For more information on how to handle market declines, click [here to read an article by Capital Group](#).

Interest rates could rise further due to recurring inflation, tighter monetary policy and loose fiscal policy. Long-term bonds can lose value as interest rates rise. Income oriented investors should continue to underweight bonds with maturities over 10 years and add to oversold stocks with growing streams of revenue, earnings, excess cash generation and dividend payments.

Certain areas of the stock market can outperform inflation over time. Given the current environment, we recommend overweighting value, dividends, small capitalization and mid-capitalization stocks.



While major indices remain concentrated in expensive, mega-cap stocks, investors should diversify their holdings across several undervalued sectors including: financials, industrials, healthcare, consumer staples, and communications.

Albeit present and recurring, inflation might moderate in future years. Cumulative inflation of 20% to 25% over the next five years is possible. Money sitting in bank accounts is unlikely to provide a similar return. Many investors who think they are in safe bank accounts could lose a large portion of their wealth to compounding inflation.

Even at just 3% per year, inflation cuts the value of money by 50% over 20 years. A 3% yielding bond might keep up with that low inflation rate if no bills or taxes ever had to be paid.

We ask clients regarding each of their investment accounts whether they would like growth, recurring cash income, rising cash income or wealth preservation. Most provide a one-word response: Yes.

A diversified stock portfolio of growing cash generating firms with shareholder friendly managements can currently provide a dividend yield of 4%. Attractive entry prices combined with an outlook for recurring sales, earnings and dividend growth should reward patient investors.

Stock market recoveries tend to proceed economic recoveries. Moreover, strong performance tends to occur early in a market cycle. Much of a stock market recovery can take place before people feel good about the economy and the markets.

Our conviction is in select cash cows and industry leaders expected to grow their profit margins through this recession and the subsequent recovery.



Thank You

Thank you for having the confidence in us. We think of you as part of our family and friends and strive to be the absolute best investment advisors we can be to you and your loved ones. If you have any questions, we are only a phone call or email away. We're here to help!



Clients have referred other family and friends to CMC. If you know of someone who would like to learn more about CMC, have them contact us. We don't like to toot our horn per say; our clients do that for us.

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