

An Economy Poised For Growth

News media can inflate negatives to draw ratings, as human brains gravitate to bad news.

This year's economic news followed suit. Headlines were dominated by:

- Speculation of tariffs generating high general inflation.
- Artificial Intelligence (AI) causing massive layoffs.
- Government shutdown costing the economy billions of dollars and stifling growth.

Despite a sluggish start to the year, economists project 1.8%-1.9% U.S. economic growth in 2025. This might be revised higher. In the second quarter alone initial estimates for real GDP growth rose to 3.8%.

What's in store for 2026?

Economic trends in 2026 will be impacted by:

- Lingering effects of tariffs.
- Federal Reserve overnight interest rate cut decisions.
- Congressional midterm elections.
- Geopolitical events.

While reported news is nerve-racking, many underreported factors provide economic positive momentum heading into 2026, and beyond.

1. Federal policies are encouraging local production and reshoring. Estimates of \$21 trillion in U.S. business investments could be inflated, but adjusted estimates should still be at record levels.
2. Pro-business regulatory environment lowers business costs and restrictions on corporate growth.
3. Easing of capital requirements enable banks to accelerate loan growth.
4. Changes in tax code:
 - Encourage increases in cap-ex, R&D, and borrowing.

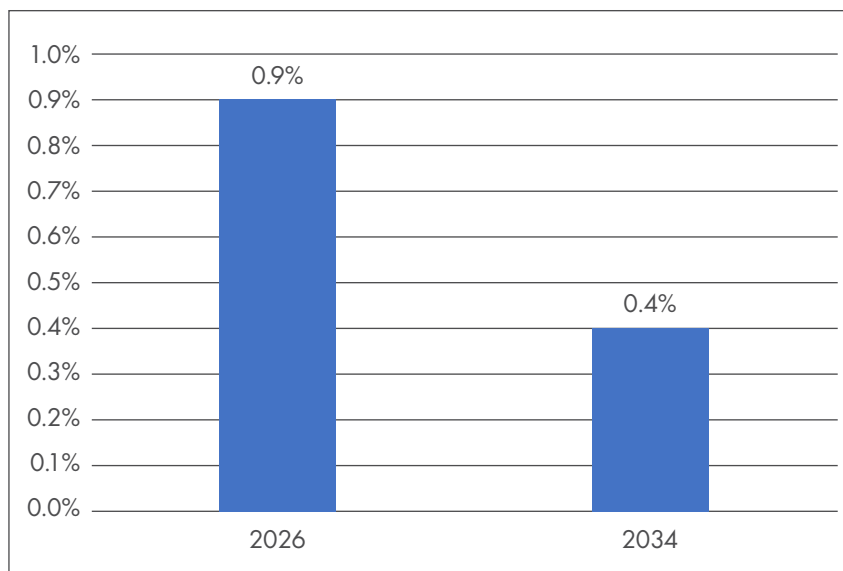
KEY DATES

- 12.25 Christmas Day
Stock Market Closed
- 1.1 New Year's Day
Stock Market Closed
- 1.9 Unemployment Report
- 1.13 December CPI
- 1.19 Martin Luther King Jr. Day
Stock Market Closed
- 1.28 FOMC Press Conference
- TBD GDP 4Q and
2025 Advance Estimate
- 2.6 Unemployment Report
- 2.11 January CPI
- 2.16 Washington's Birthday
Stock Market Closed
- 2.26 GDP 4Q and
2025 Second Estimate
- 3.6 Unemployment Report
- 3.11 February CPI
- 3.18 FOMC Press Conference
- 3.27 GDP 4Q and
2025 Third Estimate

- Boost interest deductions , increasing cash flow to use to pay debt and invest.
 - Increase in early 2026 federal refunds by \$200 billion providing extra cash for households.
5. Blue-collar wages are growing and consumers continue to spend.
 6. Lower overnight interest rates cheapens borrowing for consumers and businesses.
 7. Declining energy costs decrease business' third largest expense and lowers consumer utility bills and transportation expenses.
 8. Increasing productivity from automation and AI applications could also partially offset inflation.

Impact of One Big Beautiful Bill on Real GDP

The CBO estimates the One Big Beautiful Bill will boost GDP growth by 0.9% in 2026



Sources: CBO, H.R. 1, One Big Beautiful Bill Act, Apollo Chief Economist

The Fed's Split Decision

Current Fed monetary policy became less restrictive in 2025, starting with a 0.25% federal funds cut in September, followed by two more quarter-point cuts in October and this month.

The Fed's monetary policy remains split between two main concerns: supporting the job market and taming inflation. This divide is reflected in the Federal Open Market Committee (FOMC) votes. Some members advocate for interest rate cuts to boost employment, while others fret over inflation and tariff impacts. These disparate views cause uncertainty in the timing and magnitude of overnight interest rates.

The future of rates?

From December's meeting, the FOMC remained divided on the future of rate cuts.

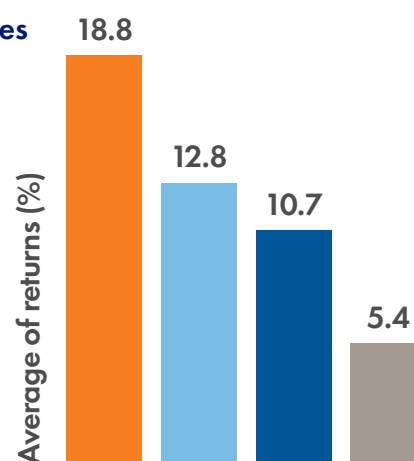
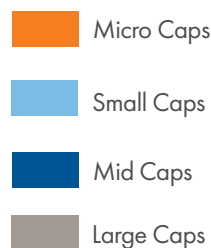
Current Chair Jerome Powell's term expires in May 2026. The Trump administration will appoint a successor favoring more aggressive rate cuts. The potential "aggressive" stance of a future chair could entail deeper and faster interest rate cuts to further stimulate the economy. More aggressive interest rate cuts would stimulate short and intermediate-term economic growth.

What does this mean for the financial markets?

Rate cutting cycles historically favor small and mid-caps stocks over large-caps as shown on the chart. Small and mid-cap companies tend to carry more short-term and floating-rate debt. Lower overnight interest rates lower their borrowing costs, increasing cash flow and boosting earnings.

Rate Cutting Cycles (1990-2024)

U.S. micro and small cap stocks have benefited most



12 Months Following Cut

Source: Morningstar, Federal Reserve Bank of St. Louis. Micro Cap: Wilshire US Micro Cap Index, Small Cap: Russell 2000 Index; Mid Cap: Russell Mid Cap Index; Large Cap: S&P 500 Index. Data provided 1/1/1990 through 12/31/2024. Rate Cut defined as reduction to Federal Funds policy rate upper limit. Indexes are unmanaged and cannot be invested in directly. Returns represent past performance, are not a guarantee of future performance, and are not indicative of any specific investment.

CMC Tax-Efficient Strategies

At CMC, we manage client taxable portfolios in a tax efficient manner.

One common tax-loss harvesting tool is the wash-sale rule. It allows unprofitable tax lots to be sold without lowering long-term exposure to the investment.

Wash-Sale Rule: A security tax loss cannot be claimed if sold and repurchased with the same or a “substantially identical” security within 30 days before or after the sale (a 61-day window).

Process of tax-loss harvesting:

1. Identify underperforming investments: We review every tax lot within each portfolio for securities that are trading below their original purchase price.
2. Sell at a loss: We sell specific tax lots to realize a capital loss for tax purposes. Note: For high-conviction stocks with an unrealized loss, we can buy shares at the current lower price and sell the original high-cost position after 31 days.
3. Offset gains: We use the realized loss to offset realized capital gains clients may have from earlier in the year, which can reduce or eliminate their tax on those gains.
4. Offset ordinary income: If the losses exceed a client’s capital gains, up to \$3,000 of the remaining loss can be deducted from their ordinary income.
5. Carry over losses: Any net capital losses beyond the \$3,000 limit can be carried forward indefinitely to offset capital gains or income in future years.
6. Maintain market exposure: Proceeds from the sale are reinvested to maintain asset allocation and market exposure.

Example of tax-loss harvesting:

An investor has a \$5,000 short-term capital gain from owning/selling Investment A, and a \$3,000 unrealized, short-term capital loss in Investment B.

- Without tax-loss harvesting: Capital gains tax would be paid on the full \$5,000 profit.
- With tax-loss harvesting: The \$3,000 loss from Investment B offsets the gain from Investment A, leaving a net taxable gain of only \$2,000.

If the capital loss is greater than the total capital gains for the year, \$3,000 can be deducted from ordinary income.

Tax-loss harvesting is a key strategy we implement yearly with portfolios to lower tax liability.



Seasonal Trading Can Impact Stocks

Tax-loss selling pressure in October and November, followed by historical patterns known as the “Santa Rally” and “January Effect,” can affect the financial markets.

Most mutual funds have their fiscal year-end on October 31st providing time to calculate and pay their year-end distributions in December. Tax-efficient mutual funds tend to complete their tax-loss trades during October.

Brokers and individuals tend to initiate tax-loss trades (sometimes using the 30-day rule) in November and complete them by early December. This allows for extended year-end holidays/vacations.

As Wall Street holiday vacations begin in mid-to-late December, tax-loss selling tends to ebb. Without massive selling pressure, recently oversold stocks can have their prices snap back up to prior levels. Wall Street commonly refers to these seasonal, post-tax trade December and January rallies as the “Santa Rally” and the “January Effect.” While nothing is guaranteed in the financial markets, it is that time of the year.

What about this year?

Heavy tax-loss selling in certain stocks can temporarily push their stock prices lower. In today’s market, many investors have gains in large-cap technology stocks and must sell smaller, overlooked stocks to achieve tax losses. If investors demand over-priced, large-cap technology stocks and sell smaller firms, who will buy the small and mid-cap shares being sold for tax losses?

Shares of smaller companies tend to be more affected by these short-term aberrations. When small and mid-size companies experience heavy selling and few immediate buyers, their stock prices can dip 10%, 20% or more. This year, several of our approved holdings experienced this phenomenon.

When this happens to a growing cash cow, an amazing buying opportunity can occur within a short window of time.

This is the first time we recollect over half of our approved holdings (22 of 42) having a price-to-earnings ratio (PE using est 2026 earnings) and/or a price to trailing free-cash-flow multiple (P/FCF) below 10.

For comparison, the forward 12-month PEs of the S&P 500, Dow Jones Industrial Average, NASDAQ and Russell 2000 indices are approximately 22½, 20½, 28½ and 24. Yet, most stocks in major indices do not generate excess cash. Even worse, many firms found in indices have negative earnings (i.e. losses).

Historically, a standard comparison for index PE valuations is the inverse or reciprocal of corporate interest rates. According to the Saint Louis Federal Reserve, the average interest rate of the lowest rated (i.e. BBB) investment grade corporate bonds is 5%. The inverse of 5% is 20 (i.e., 1 divided by 0.05), suggesting a 20 PE as a fair starting point for valuing stocks. In this environment, we consider a PE of less than 10 for a growing cash cow as a fantastic sale.

Long-term opportunities amongst tax-loss selling

At CMC, three stocks we have been able to use for tax-selling purposes (and repurchase once 30 days have passed) are: Gray Media (GTN), ACCO Brands (ACCO) and Concentrix (CNXC). Their estimated forward PEs are below 4. They generate so much excess cash they can pay down debt and make accretive, bolt-on acquisitions. Over the last year ACCO and CNXC repurchased shares. All three use their excess cash to reward investors with recurring dividends. Their current dividend yields are approximately 6½%, 8¼% & 4%.

Some of our holdings have generated so much cash that they have repaid all of their debt in recent years. These include Anika Therapeutics (ANIK), Exelixis (EXEL) and Mastech Digital (MHH). They’ve even built-up cash hoards. Currently, cash balances at ANIK, EXEL & MHH are equivalent to 42%, 8% & 36% of their stock value. Another

holding, Harmony Biosciences (HRMY) is close to paying down all of its debt. At the end of the third quarter the cash on its balance sheet was 32% of its stock market capitalization and four times its total debt load.

A newer holding, LifeVantage (LFVN), sports a 2.7% dividend yield, zero debt and quarter-end cash balance equivalent to almost 15% of its stock market capitalization. While LFVN has a projected PE of 6, its historical median PE has been closer to 16. LFVN's October acquisition of another firm immediately increases its sales, product portfolio and salesforce. LFVN initiated a dividend in 2022 and has raised it every year since. This firm also has a history of using its excess cash generation to repurchase shares.

Why don't more investors take advantage of these short-term pricing anomalies? Short-term pricing of financial markets is dictated more by emotions than by reason. While clearance sales attract holiday shoppers to stores, deep-discounts repulse many investors. Oversold stocks do not exude holiday joy. Many investors are more comfortable buying what the rest of the herd is buying (typically at premium prices).

2026: Avoiding Irrational Exuberance

Artificial intelligence (AI) has driven stock market gains over the last 2-3 years, largely from highly expensive, mega-cap technology stocks.

Today's AI market trades and mega-cap company plans of exorbitant spending on data centers provide warning signs of excesses and potential future losses.

The estimated cost of building a 1-gigawatt AI Data Center is \$80 billion. Currently, there are commitments to build 100 gigawatts of data centers with an estimated capital cost of \$8 trillion. Open AI's CEO, Sam Altman, has recommended the U.S. add 100 gigawatts of energy capacity every year. Apparently, he thinks today's commitments to build data centers is just a starting point.



The annual financing costs of the currently planned \$8 trillion of data centers could approximate \$500 to \$800 billion. Excluding environmental costs, each data center can incur additional daily costs for skilled technicians, millions of gallons of fresh water, disposal of millions of gallons of waste water, and electricity to run and cool tens of thousands of advanced servers. According to AI, a server farm's annual cost for one gigawatt of electricity from a natural gas plant could be \$368 million.

How do you cover cost, let alone return a profit? There are 330 million active cell phones in the US. A \$200 monthly fee increase on every US cell phone would raise \$792 billion per year. This should cover more than half of the annual cost of 100 gigawatts of data centers. Do you want to pay an additional \$200 per month for each cell phone in your household? Does every cell phone owner want to pay this? Who will pay the annual costs of the next wave of data centers? Altman thinks the U.S. needs to generate another 100 gigawatts per year. After ten years of this, will you want to pay an additional \$2,000 per month for each cell phone for these energy sucking, water depleting, windowless buildings to almost break even?

Remember paying a lot for a new computer that runs fast? After five years, that computer seems to run slow at best and needs to be replaced. In five years, how fast will each server farm's millions of servers be? How much would they be worth? Having to replace millions of servers adds yet another cost.

Is the herd approaching a cliff?

Wall Street's growth projections for many mega and large-cap technology stocks have benefited from the accelerating buildout of data centers.

Nvidia (NVDA) represents approximately 7% of the total U.S. market-capitalization (3,531 publicly traded stocks). It represents about 3½% of the world stock market's total capitalization. In five, ten or twenty years will NVDA's revenue or earnings represent this proportion of U.S. or world corporate earnings? If not, it might be overvalued.

At the peak of the Nifty 50 in 1972, investors paid premium prices for technology leaders. They were expected to continue to lead the U.S. and world technology for decades to come. Why own anything else? Three of these undisputed leaders were Kodak, Polaroid and Xerox. Their subsequent 10-year performance was dismal.

In the early 1980s, the largest household computing leaders included Commodore and Tandy. They had bright outlooks. Since then, they (or their successor owners) have filed for bankruptcy.

After "irrational exuberance" was coined in 1996 and Y2K hit in 2000, the largest technology leaders included Intel (INTC) and Cisco Systems (CSCO). At that time, their stock market capitalizations were amongst the five largest in U.S. history. Investors paid high prices for these tech companies as Mad Money's Jim Cramer proclaimed their strong future outlook. Today their stock prices are lower. Buying the largest, leading technology stocks does not guarantee positive future returns.

NVDA is the poster child of AI stocks. It's the largest market capitalization stock today. Many analysts tout its strong future growth based on the long-term buildout of hundreds of gigawatts of profitable AI Data Centers. However, NVDA has material headwinds such as:

- Increasing federal chip regulation.
- Hesitancy of municipalities to approve new server farms.
- Rising competition including Alphabet/Google and Qualcomm.

We have two words for those investing in NVDA and AI-reliant stocks directly or through index funds, good luck.



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