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CAPITAL MANAGEMENT GROUP

The Hefter Report – July 2020

As we see it, the great bull market that began on March 9, 2009 topped out on February 19, 2020. A bear market ensued until March 23rd of this year, producing a total decline of approximately 34% in the S&P 500 during that short period. Since then, the S&P 500 has rallied over 40% and we are hopeful a new bull market has just begun.

One can look at "the glass half empty" perspective of a surge in virus contractions, predictions of 100,000 new cases a day, and re-openings canceled in various parts of the country. Alternatively, one can look at "the glass half full" perspective by focusing on the virus death rate declining by some measures to less than ½ of 1% of total estimated cases. According to the National Institute of Allergy and Infectious Diseases (NIAID) we are also seeing some companies' monoclonal antibody treatments go to phase 3 trials. This treatment is designed "to prevent infection among uninfected people who have had close exposure to a covid-19 patient" (PR Newswire, "Regeneron Announces Start of REGN-COV2 Phase 3 COVID-19 Prevention Trial in Collaboration with NIAID," July 6, 2020). If and when fear of the virus is sufficiently reduced, we believe GDP and equity prices should go higher.

While very unfair, the covid crisis has distinct winners and losers: it is part of our job to focus on companies and industries benefiting from the consequences. The new stay at home economy has dramatically accelerated the world of digital communications and many of the managers we invest with are taking advantage of this. From our conversations, they are buying leaders in cloud computing, artificial intelligence, 5G communications, DNA and gene replacement therapy, financial technology, cybersecurity and overall healthcare. They are avoiding for the most part financials, energy, materials, industrials, etc.

Our managers that focus on value are buying companies that generally show exceptional long term growth within the value universe. We continue to believe our approach will work until global economic growth finally picks up and interest rates begin to rise to defend against inflation. We believe this scenario is at least one year away. When we see the 10 year US treasury rise to about 1.25%, we expect equity markets to be much higher and anticipate profit taking at those levels.

Many have asked us about the potential impact the November elections may have on the markets. We don't believe any result will derail the bull market, however various outcomes could favor some sectors while harming others. For instance, we believe that a Democrat sweep of the White House and both chambers in Congress should result in dramatic infrastructure spending helping companies in construction, railways, shipping, industrials, materials, etc. An expected tax increase for corporations and wealthy individuals could have an overall negative effect on the same companies that benefited the most from the Trump tax cut, including big pharma and those who domesticated income sources from abroad. Large cap tech companies who currently pay little or no taxes would likely be hurt by Democrat tax reform, and some further by increased anti-trust scrutiny under a Democratic Department of Justice. The likely emphasis and investment in green energy should favor alternatives such as wind and solar at the expense of coal and fossil fuel dependent companies. Increased regulations could also hurt an already depressed banking sector and it is possible that new limits may be imposed on prescription drug prices. *(continued on page 2)*

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The other scenarios would all involve a divided government where we do not believe major changes will be enacted. As the year progresses we expect to make adjustments based on our view of the likelihood of divided or undivided government. However, we expect to remain bullish overall based on the following:

- We believe the global Central Banks, the Fed, and the administration will continue to provide unprecedented liquidity to the financial system
- Covid transmission has slowed down in many countries outside the US
- US Money Supply M2 increased 20% in the past 60 days
- Sentiment remains extremely negative, which to us is very bullish
- Many investors remain on the sidelines and cash levels are near 2008 levels
- The US dollar has started to decline which should benefit US exporters
- The exponential growth in technology is increasing productivity and efficiencies in many industries from autos to agriculture

If you have additional cash on the sidelines or know people who do please give us a call to discuss various opportunities seeking to improve on the current cash yield of about 50 basis points. Cash is currently producing negative real yields since the current and expected rate of inflation is higher than cash now. We expect inflation to further rise due to the massive debt and spending taking place. We believe the increased return opportunities with moderate risk in areas such as preferreds, corporate bonds, convertible bonds, tax-free bonds, and government bonds is warranted in order to have positive real returns while real cash yields remain negative.

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S&P 500 Index: The S&P 500 Index consists of 500 stocks chosen for market size, liquidity, and industry group representation. It is a market value weighted index with each stock's weight in the Index proportionate to its market value.

Stocks are subject to market risk which means their value may fluctuate in response to general economic and market conditions, the prospects of individual companies, and industry sectors. Investments in equity securities are generally more volatile than other types of securities. There is no guarantee that dividend-paying stocks will return more than the overall stock market. Dividends are not guaranteed and are subject to change or elimination.

Investing in foreign securities presents certain risks not associated with domestic investments, such as currency fluctuation, political and economic instability, and different accounting standards. This may result in greater share price volatility. Investing in emerging markets accentuates these risks.

Investments that are concentrated in a specific sector or industry may be subject to a higher degree of market risk than investments that are more diversified.

Investments in fixed-income securities are subject to market, interest rate, credit and other risks. Bond prices fluctuate inversely to changes in interest rates. Therefore, a general rise in interest rates can result in the decline in the bond's price. Credit risk is the risk that an issuer will default on payments of interest and/or principal. This risk is heightened in lower rated bonds. If sold prior to maturity, fixed income securities are subject to market risk. All fixed income investments may be worth less than their original cost upon redemption or maturity.

There are special risks associated with an investment in real estate, including credit risk, interest rate fluctuations and the impact of varied economic conditions.

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