HEFTER, LESHEM, MARGOLIS

CAPITAL MANAGEMENT GROUP

The Hefter Report – October 5, 2021

After almost 12 months, the S&P 500 has finally had a 5% correction. The reasons for this pullback are varied, but one that stands out the most is the rapid rise in interest rates, particularly the key 10-year US Treasury which has risen from 1.29% in August to the current 1.53%. With supply shortages across industries from paper goods to private jet planes, inflation seems to be poking its disquieting head everywhere. The key question is whether this rise in inflation is transitory or more long lasting.

We believe that ultimately production will pick up and supplies will increase to meet demand. As COVID retreats, we see a second re-opening and a pick-up in global economic growth. This may lead to higher interest rates, but as long as the rise is gradual, stock prices should also rise. We also see deflationary effects that we anticipate will moderate inflation. These include an aging population, extremely low velocity in money supply, as well as the productivity and efficiencies of artificial intelligence and other technologies that should suppress prices.

The market is primarily driven by earnings. We estimate that 2021 will see better than expected S&P 500 earnings of about $220 per share followed by $240 per share in 2022. With relatively low interest rates, we believe that an earnings multiple of 20 is appropriate. That would put the S&P 500 at 4800 next year, a gain of about 11.5% from current levels.

We view the current move as a correction and not a bear market. Like all corrections, the timing is nearly impossible to predict. For now, we plan to ride through this correction and expect stock prices rise later this year.

HLM Capital Management Group
1849 Green Bay Road
Suite 200
Highland Park, IL 60035
847 563-3400 phone
800 247-1541 toll-free
847 563-3420 fax
www.hlmcapital.com

Charlie Margolis, Ben Leshem, Steve Hefter, Micah Nathan
Partners

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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.

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