CAPITAL MANAGEMENT GROUP

The Hefter Report – December 2020

This has been a year like no other. Through no fault of their own, millions of Americans lost their jobs. Despite considerable sweat and hard work, countless businesses like restaurants, gyms and others permanently closed their doors due to the effects of widespread lockdowns. Meanwhile, front line heroes like health care workers and first responders continue to put forth a herculean effort to slow the rising death toll and suffering.

So it is with a heavy heart that as we reflect upon 2020, we take some solace in the message we have continued to share with clients since the onset of the pandemic: stay calm and don't panic. When the lockdowns began in March, we exited many cyclical stocks and began focusing on investing with managers buying innovative technology companies in areas such as cloud computing, DNA and gene therapy, artificial intelligence, and cybersecurity. As we mentioned in our prior Hefter Reports, it became a bifurcated market with the “work from home” related stocks doing well and many of the "old economy" stocks sinking as we entered into a brief but deep recession. Now that we can see the light at the end of the tunnel with the economy hopefully fully reopening as early as this summer, the rally in stocks has broadened out to many sectors. This gives us greater confidence in the sustainability of the recovery.

Today we remain invested with those managers and have added to economic recovery sectors such as leisure and entertainment, industrials, and materials as well as financials and energy to a lesser degree. On our November 11th HLM conference call, we noted that the level of fiscal and monetary stimulus is greater than the stimulus following World War I, the Great Depression, World War II, the double dip recession of 1980-1982, and the Great Recession of 2008-2009. We cited that after each of those periods, the S&P 500 had an average annualized return of 9.8% for the following 10 years.

We still believe we are in the early innings of a new bull market. There may be sharp, painful corrections along the way. But until our analysis indicates an imminent recession or end to the cycle, we remain bullish both in the US and globally.

Due to the efficacy of the Pfizer and Moderna vaccines, we believe global economic activity will return to more normal conditions by the second half of next year. With the high savings rates and low inventories that currently exist, we anticipate increasing demand for raw materials as industrial production could grow precipitously around the world. We believe GDP growth will continue to surprise to the upside and pent-up demand by consumers will combine to bring about a simultaneous global economic recovery. Given that assessment, along with a declining dollar, we expect international markets to outperform the US, which could lead us to add to foreign investments.

Currently, our least favorite asset class is cash and fixed income that is providing a negative real rate of return (less than the rate of inflation, or the annual rise in the cost of living). If you have cash positions, we would advise you to talk to us about considering alternatives including money markets, ultra-short fixed income, and stock/bond hybrids.

We at HLM wish everyone a very happy and healthy holiday season. And if you can please give to those in need.

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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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The Hefter Report – April 2020

As of Friday, April 24th, this year has really been a tale of two markets. Most of the market is down. Especially hard hit during this Covid-19 crisis are sectors including restaurants, hotels, autos, energy, financials, industrials, small cap stocks and more. A few areas have benefited from the new stay-at-home economy, including technology, consumer staples and health care. In the past few days we believe we're starting to see signs that this dichotomy may be changing.

A number of states have begun gradually opening for business. In the past few days the tale of the market has reversed: energy, financials, and the other beaten down groups have outperformed tech and health care. We believe this is a very positive sign for the overall market and economy. Stocks are often a leading indicator and the recent rally may be predictive of what could happen with the overall economy in 6 to 12 months from now. If this rally broadens out to include important groups like financials and industrials, we think there should be further upside for stocks as a whole.

According to various antibody studies including one conducted by Stanford scientist John Ioannidis, the mortality rate of Covid-19 may be between 0.25% to 0.625% despite the reported mortality rate of 7%. They arrived at this number after the antibody blood tests of people in Santa Clara County showed many more people had the virus in their system than those who had previously tested positive. A New York study just released and reported by the Wall Street Journal also suggests a decreased mortality rate, revealing the actual number of people in New York state exposed to the virus to be between 13.9% to 21.2% of the state's population. This is more than 10 times the state's confirmed cases, which would decrease the reported mortality rate of 7% to below 1%. If further studies corroborate a significantly lower mortality rate for Covid-19, it could accelerate the pace at which economic activity resumes.

In addition to the possibility that the mortality rate may be considerably lower than reported, any positive results with an anti-viral medication reducing Covid-19 symptoms would be a game changer. On April 29th, the US National Institute of Health announced positive early results for a trial of Gilead Sciences' coronavirus drug Remdesivir, with 50% of treated patients improving and more than half discharged within two weeks. While certainly significant progress, we believe there is more potential for both at-home testing and treatment to continue fueling the relief rally. At least 70 companies across the globe are currently working on various treatments. Over the past two months, huge amounts of money have come out of stocks and gone into money markets and bonds. If we don't see cases rise significantly upon states reopening and more good news emerges on the medical front, that money could go right back into stocks and propel the market higher. We're not predicting anything immediate, but our outlook for the next few years is positive. This assessment includes the likelihood of higher taxes, no matter who wins the White House.

Wealth disparity is an important issue that we believe needs to be addressed. Government is now playing perhaps the biggest role in the overall economy since Franklin Roosevelt and the New Deal. If these efforts prove constructive in getting people back to work, we may see more fiscal spending on infrastructure and other areas in the near future. It's definitely a brave new world and it will be fascinating to see how we progress from here. But we believe the US will progress, as it always has, and hopefully a broader base of the population will benefit.

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The Hefter Report – March 2020

After OPEC was unable to come to terms on a supply cut, oil prices plummeted adding to downward pressure on interest rates and equities. Lower oil prices typically discourage drilling and exploration. This can also lead to layoffs and an economic downturn in oil producing areas.

Some will argue that declining prices at the pump will benefit consumers, and that's true. However we think with the countervailing force of economic activity dropping globally due to the Coronavirus, lower oil prices add to deflationary pressure which could lead to recession.

The industries most adversely affected by this are energy, manufacturing, materials, financials, and more broadly cyclicals and industrials. We have been shifting away from these areas where possible.

We believe stocks could see more downside before bottoming sometime later this year. If you think you will need to withdraw funds from your account in 2020, please let us know and we can lower your equity exposure. If you will not be needing money from your portfolio this year, we believe that repercussions from virus fears will abate within a year and stocks will rally.

It has been reported that legendary investor Warren Buffett is buying stocks during this correction*. We think that although the near term will be volatile he will be rewarded in the long run. Our philosophy is to be long term investors, not to panic, and to look for opportunities when panic occurs.

Last week's unemployment numbers reflected an extremely strong economy that was firing on all cylinders prior to the "black swan" spread of the Coronavirus. The resulting big drop in stock prices is very painful and may get worse. However history has shown that those who are able to endure the suffering end up better off than those who sell on the decline.

As always, please call us with any questions.

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HLM Short Take – February 28, 2020

The financial markets have been in turmoil this week due to the Coronavirus scare. While this is concerning, we believe that the market is pricing for a worst case scenario. Fear has pushed market volatility to what we would interpret as irrational levels right now.

We have seen these types of events many times in the past. As such we are always aware of the possibility of increased volatility. We model such events into our thinking when constructing portfolios. However in our experience, making rash decisions in a panic ultimately proves to be ill-advised.

For now, we are closely monitoring the developments. We will continue to make decisions based on facts rather than speculation. We will make adjustments if they become necessary.

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CAPITAL MANAGEMENT GROUP

HLM Short Take – February 25, 2020

Historically, we believe equity markets do not fare well amidst uncertainty. The recent outbreak of the Coronavirus has fostered considerable scientific and economic uncertainty. Therefore we cannot predict with any reasonable conviction how long the virus will last nor how much it will spread. We also cannot confidently assess the degree or how long global supply chains will be disrupted.

We can, however look back at previous epidemics such as SARS and Swine Flu. In both of those cases, markets suffered in the short-term but came back to make new highs. Although we can't analyze the current crisis in terms of market severity, we believe the hit to earnings may be for just one or two quarters.

In addition to the Coronavirus outbreak which we believe will be a short-term impact, the recent rise in the polls of the leading Democratic presidential candidate could have a longer term impact on the market.

We are monitoring these developments closely and will make investment adjustments when we deem necessary.

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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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The Hefter Report – January 2020

Hostilities with Iran appear to have deescalated for now, the phase one trade deal with China is anticipated to be signed on January 15th, and the moderate candidates are currently leading the polls in the Democratic presidential primary race. As it stands, I don't know what to worry about. And that worries me.

This long term bull market has persistently climbed a wall of worry for over 10 years and now most fears, other than fear itself, have largely been mitigated. Of course, people are still nervous primarily due to the length and breadth of the rally. However as we've been saying, interest rates, unemployment and inflation remain low while the Fed remains on hold – providing sufficient support for the relatively high current P/E ratio of 20. So, what happens next?

The key to market direction in our opinion will be corporate earnings. We believe expectations are low and that 2020 S&P 500 earnings will be better than expected at about $175 per share. If we are correct about earnings and the multiple remains at 20, the S&P 500 should reach 3500, which is about a 7% return from current levels. With the US 10 year bond currently yielding less than 2%, I don't feel there are many decent alternatives to stocks.

So why am I worried that there appears to be no worries? With retail investors beginning to show net inflows to stocks and investor sentiment becoming more positive, I'm less comfortable than in 2019 when the headlines were more negative and worrisome. As we've said for the past 12 months, our belief is that this bull won't end until investors become euphoric and there's a capitulation to the upside. Although we're not there yet, we do believe we have entered into the initial stages of that predicament.

This does not mean we are negative or prone to immediate selling. With M2 money supply rising to 7.4% from 3.3% a year ago, we see plenty of liquidity and do not expect a recession through 2020. Central banks across the globe remain accommodative and we are beginning to see the effects of that as global GDP has begun to improve. We believe this pickup in growth will lead to slightly higher inflation and higher interest rates as the year progresses.

We anticipate a decent although volatile year for stocks in 2020. We believe performance for small cap, mid cap, and international stocks will begin to catch up with large cap US equities. Our favorite sectors are Industrials, Technology and Communications. If we see bullish sentiment reaching historically high levels, we will reduce equity exposure. But we do not expect that to occur until earnings are better than expected, GDP growth exceeds 2.5%, and inflation rises above 2%.

In our opinion, 2020 will not be a good year for fixed income. We prefer floating rate bonds and adjustable rate preferred stocks.

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