CAPITAL MANAGEMENT GROUP

The Hefter Report – September 2022

Global stock and bond markets are having a terrible year. The MSCI global stock index is down 21.62% and the international government bond index is down 25.23%. Especially hard hit this year are technology stocks with the NASDAQ down 29.27%.

The primary cause of the declines is inflation which doesn't seem to be going away. This is leading the FED to be more hawkish in their assessment of how much and for how long they will have to continue raising interest rates. With rates rising, forecasts for economic growth are coming down, with widespread speculation on how much corporate earnings will drop as a result.

The projections for S&P earnings are almost impossible to predict with lower range estimates from 200 to 240 a share. It is also difficult to assess the appropriate multiple of earnings stocks will sell for. With slow growth and rising interest rates, consensus seems to be as low as between 15 ½ to 16 ½ . If we take the middle of these ranges, we get a multiple of 16 which we multiply by 220 a share that projects potential downside of 3520 on the S&P 500. This would be our worst-case projection as of now. Our team believes 3600 is a more likely downside target at which point we believe investors would put money to work, finding bargain prices not seen in years.

A target of 3600 is about 5% lower from today's levels. If stocks get down to this price, or lower, we believe a rally will follow in the fourth quarter. We expect the FED will stop raising rates in December. This could provide impetus for a further rally with the possibility of the FED's next move being to lower rates to spur economic growth.

So there remains widespread uncertainty about earnings, interest rates and multiples, in many portfolios we have raised cash and shifted from higher volatility names to lower. It is important to note that we do not believe we are having or will have a financial crisis. It is more likely in our view that markets are adjusting from an overflow of money supply followed by a tightening which should put us back in a more normal liquidity environment. We think this will be good for stocks.

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***Index return information is provided for illustrative purposes only*. Index returns do not represent investment returns or the results of actual trading nor are they forecasts of expected gains or losses a fund might experience. Index returns reflect general market results, assume the reinvestment of dividends and other distributions, and do not reflect deduction for fees, expenses or taxes applicable to an actual investment. An index is unmanaged and not available for direct investment. Past performance does not guarantee future results**
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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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The Hefter Report – July 2022

Despite the recent rally, in our view, the bear market may last a little longer. We think inflation is trending downward but could persist in the 4-6% range for the near future. If the Fed is satisfied with a 4% inflation rate, they may only have to raise rates one more time. If the Fed indicates a pause after the next increase, equity indices can rally further.

These expectations lead to what we believe will be a slow growth economy. If this is the case, we believe technology, growth and biotech may lead the market higher. Generally, even if stocks decline, when the economy slows, companies that are less dependent on the overall economy for growth historically do better. For example, a biotech company with new drugs can grow earnings, whereas auto sales could decline as consumers tighten up. However, we must be prepared for lower prices and more volatility in the short run.

As stated above, this week sees a Fed meeting with a 75-basis point hike expected and company earnings reports from Apple, Amazon, Alphabet and Microsoft. These two upcoming announcements will go a long way towards determining market direction.

In our judgement, regardless of what the Fed says now, a year from now markets will be higher and patient investors will likely be rewarded.

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The Hefter Report – June 2022

The June 10th Consumer Price Index report indicates that inflation is worse than forecasted[1]. We believe that the Fed will now have little choice but to put the economy in a recession to stem the tide of higher prices. In our minds, the main question is how deep or mild the recession will be. If the Fed continues in its stated objective of bringing inflation down to 2% from the current rate of 8.6%, the recession could be prolonged and painful. If, however, they were to revise their objective to the 4-5% range, we believe less interest rate hikes would be needed, and the economy would fare much better.

We believe that the Fed should raise rates higher sooner than later, with monthly increases of 75 or 100 basis points rather than their indicated 50 basis point hikes. In our view, the sooner we get inflation under control the sooner the economy and markets will rebound.

We believe that growth and tech equities will continue to be under pressure during this initial phase of Fed tightening. However, once the economy shows that growth has slowed and inflation has approached the Fed's target range, we think that growth can once again lead the market back up.

Please feel free to call us to discuss this further and if you'd like to schedule an appointment to meet and review your portfolio.

Steve, Ben, Charlie and Micah

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The Consumer Price Index (CPI) is a measure of the cost of goods purchased by average U.S. household. It is calculated by the U.S. government's Bureau of Labor Statistics.

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Bloomberg News[1]

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The Hefter Report – May 2022

In October 2008, at the height of the financial crisis, Warren Buffett wrote: “Be fearful when others are greedy and be greedy when others are fearful.” Since then, the S&P 500 has rallied over 400%[1].

Investors who became nervous in ‘08 and sold near the market lows have likely missed a good part of the ensuing rally. Markets go through periods of distress from time to time but as long-term investors, we know that staying in cash, historically has been a poor alternative. It’s worth noting that over the past 4 decades, equity markets had 31 up years and 9 down years and have averaged about 8%[2].

The current rapid spike in inflation along with a recently hawkish Fed and quantitative tightening is reducing liquidity in the system and causing a repricing of assets. Consequently, as interest rates rise, valuations across the board are declining. The shift has brought down the current price earnings level for the S&P500 index from 22 to about 17 – 18 which is closer to the long-term average.

The question now is what will earnings look like for the rest of this year and what will the inflation trajectory be? We have recently seen softer earnings data from companies like Walmart, Target, and others. The companies attribute the slowdown to higher labor, transportation, and finished goods costs. These reports have already impacted the markets, raising the level of fear among investors, increasing volatility, and perhaps pushing us closer to so called “capitulation”- usually an early signal that we may be near a bottom. Following the 2nd quarter, corporate guidance should start to provide us with a better view of what inflation and the supply chain’s impact will be on earnings.

Equities may still have further to drop however, over time, most companies do gain pricing power as supply and demand reach equilibrium and valuations increase. Given the current low unemployment rate, improving supply chain issues and productivity gains, we think that inflation will start to decline later in the year and markets will stabilize.

As always, please feel free to reach out to any of us to review your portfolio. We would also welcome an opportunity to review other investment accounts you have elsewhere.

Steve, Ben, Charlie and Micah

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[1] Bloomberg News
[2] FactSet Standard & Poor's

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The Hefter Report – April 2022

This past Friday, April 22, US stocks fell about 2.5% in indiscriminate selling across virtually all industries including recent safe havens such as value stocks, commodities, utilities, and consumer staples. Thus far in 2022, the tech heavy NASDAQ has been hit the hardest, down around 19%, while the broader S&P 500 index is down around 11.5%. Per the Wall Street Journal, for the past few days value stocks declined more than growth stocks and investors seem to have nowhere to hide. This includes high quality US bonds which are down about 10%.

Technically, if the S&P 500 can hold above the March 8 closing level of 4170, we could see an end to the downturn and the beginning of, at least, a short-term rally. However, if we close below the March 8th low, we think the S&P 500 could drop to the 3900-4100 level (another 3%-8%). At that point, we would feel more confident that stocks could resume their long-term upward trend.

Although the economy appears to be relatively strong right now, we think that the Fed will raise rates aggressively, eventually slowing growth and perhaps inducing a recession. This is a normal phenomenon in the cycle of economic expansion and retraction and not a fundamental financial crisis. We remain optimistic about the market long term. We believe high quality stocks with strong balance sheets should hold up well and may lead to a rally in the second half of the year. For long term investors, we think that the Fed will be successful in slowing the economy and inflation. Once that is achieved, the Fed will be able to lower rates once again, if needed, to spur economic growth. We feel patient investors should be rewarded.

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Hefter Report Short Take – March 2022

As we said two weeks ago in our report, equity markets are experiencing a painful correction because of the Russian invasion into Ukraine. At this time, there is no way of knowing when and how this war will end.

The best we can do is outline various scenarios and analyze what we think each outcome portends for stocks. In the worst-case scenario Putin doesn't stop with Ukraine and goes after other countries. If that were to happen there could be a broader war, stocks would likely plummet, and the world would likely be at the precipice of nuclear war. However, we don't believe this is likely.

In our view, the likeliest scenario is that Putin captures Kyiv, and installs a pro-Russian government without annexing Ukraine to Russia. He might even negotiate an end to further Russian incursion in the Western part of Ukraine in exchange for sanction relief. Some Russian forces would probably stay in the country to fight what would most likely be an insurgency similar, but more widespread to, what occurred in various countries under Nazi rule in World War Two.

Potential changes in energy policy, in conjunction with increased production from the Middle East, may bring down oil prices, while economic incentives to farmers may reduce food costs. However, we believe these current higher costs will slow the economic recovery.

As we saw with COVID in 2020 selling into what looks like a hopeless situation doesn't always work. If there's any sign of an end to the war or even a cease fire, equities could see a sharp rally. If the war is prolonged stocks could drop further and selling could reach a capitulation level perhaps 5% lower from current levels. However, we think a capitulation would create a buying opportunity.

Some of our value-oriented managers are still up on the year and we continue to shift funds from higher to lower P/E stocks.

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Partners

The Hefter Report – February 2022

As of this writing (Sunday February 20) it appears more and more likely that Russia will invade Ukraine. If that happens we believe commodity prices such as oil, Liquid natural gas and grains would rise adding to an already accelerated rate of inflation. It would also lead, in our opinion to further stock market declines   If however, a war is somehow prevented or limited in nature commodity prices could come down and stock market prices could rally.

In past periods of such uncertainty such as the first Gulf War, 9-11, the Lehman Brothers bankruptcy and the onset of Covid 19, within 6-18 months stock prices were higher and buying after the event proved more profitable than selling. Given that the FED does not have any appreciable way of lowering interest rates on the dawn of this crisis, a full-scale invasion could mean lower stock prices for the next 3-6 months. If you anticipate needing cash from any of your accounts during that time please let us know. Otherwise on the balance we are and have been shifting out of growth stocks and into more value oriented managers with meaningful positions in energy oriented securities.

We believe we are in a painful correction within a bull market. With omicron on the wane and the economy on the cusp of reopening, earnings may surprise to the upside, especially for companies that can pass on rising costs to their consumers. As of now, for people who do not have near term needs for cash we remain invested and confident of an upward trajectory in equity prices for at least the next few years.

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Partners

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The Hefter Report – January 2022

The major US stock market indices have not seen a 10% decline since April 2020. We think that we are seeing that correction now.

The catalysts for the pullback and rapid rise in interest rates are elevated inflation levels, tightening monetary policy and higher labor costs. Fed Chairman Powell's comments and aggressive plans to curb inflation are weighing on the financial markets. The market is currently anticipating the first rate hike with the possibility of 3 additional increases later in the year.

This adjustment in Fed policy, we believe, is causing a shift in investor allocation, primarily out of small, mid and large cap growth stocks and into value and cyclicals as well as some international securities and commodities. We favor more value-oriented ETFs and funds that invest in companies that can pass on rising costs to consumers.

Historically, during periods of Fed tightening, equities have outperformed bonds and have still delivered positive returns. While the S&P 500 is currently down about 10%, many companies in the index have corrected even more (especially those with high price earnings ratios). That's true for the NASDAQ as well, with some companies already down more than 20%. That's a healthy correction and may be a little overdone.

Right now the entire market is getting hit and it is painful. However, we believe the bull market is still intact. As omicron subsides, the positive growth effects of the economy reopening will lead to declines in supply chain issues, a reduction in inflation and an increase in earnings. This, we hope will allow for another positive year for the stock market with indices ending the year up more than bonds, cash and inflation.

We do not believe it is a sign of a near-term recession or a bear market.

We therefore still favor large cap, well capitalized companies, especially over fixed income securities.

We believe that this trend will prevail during the first half of the year but may revert to outperformance in growth during the second half of the year. This is because once the Fed hikes take effect, cyclical economic growth could slow and investors may once again seek out the companies that can grow despite the overall economy.

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