CAPITAL MANAGEMENT GROUP

The Hefter Report – December 2023

A year ago, we were dealing with high inflation and a heated economy that needed government action to slow it down and avoid a recession. The Fed's monetary policy became more restrictive as they increased rates by a total of over 5% in a relatively short period of time. The resulting effect was declining inflation (albeit slowly) and no recession. Looking forward we see a likely soft landing. We believe that the financial markets essentially underestimated the strength of the US consumer. Even with higher rates across the yield curve, equity returns have been positive this year due to improvements in commodity and labor supply, productivity gains from AI and strong demand from both the private and public sectors.   It's important to note that the rally this year was led almost entirely by mega-cap stocks such as Microsoft, Nvidia, Google, Meta, etc. The average stock in the S&P 500 has seen no gain. It's also notable that while Treasury Bond yields have increased significantly with the 10-year yield near 4.35%, bond market total returns have been near zero and for longer duration bonds, negative.

Looking to 2024, we believe that the Federal Reserve has probably concluded its rate hike cycle. US equities could continue to enjoy positive returns with both US and Global growth expected to come in around 2.5% and inflation as measured by PCE (Personal Consumption Expenditure) to end 2024 around 2 – 2.5%. With money market yields over 5%, it is currently posing a high hurdle rate for investors. We believe that equities will do better than that over the next 12 months. We currently favor high quality stocks with strong balance sheets and some of the core S&P stocks that have lagged in 2023.

On the fixed income side, the jury is still out and the inverted yield curve is still providing plenty of opportunities for high income on the short end of the curve.

Apropos of the season, we would like to thank you for the trust you place in us. We value you and are grateful for our partnership. We are always here to answer questions and discuss your portfolios at your convenience.

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The Hefter Report – September 2023

The US equity market remains strong. Leading the way have been the 7 largest cap companies which are benefiting from the new advances in artificial intelligence (AI). AI is not only good for technology stocks, but is also improving the efficiencies of companies in virtually every industry. These productivity gains should add to future earnings, the driving force in equity valuations. With the US being the major player in this space, capital has poured in, allowing the dollar to continuously outperform other currencies.

The rise in bond yields has spooked the market all year. It has created a wall of fear for equity investors and better yields, albeit lower prices for bond holders. Our view is that increased productivity has remained stronger than most economists predicted and helped fuel moderate global growth in 2022 despite the higher rates. It is keeping yields firm and we anticipate them staying higher for longer. However, the general belief is that rates won't rise further and that the FED is almost done with hikes. Some are even speculating that a rate cut could come as early as the first quarter of 2024. This scenario is bullish for stocks as long as the economy continues to grow and inflation continues to decline.

The global economy is expanding very slowly and this favors companies that can grow despite the muted environment. Another sector that we are monitoring is energy, mostly due to the recent drilling and production restrictions. We believe these cutbacks will lead to higher energy prices despite slow growth in economies across the globe. Unfortunately, higher gas prices may act like a tax on consumers and this factor may create a drag on GDP. We will be watching out for signs of recession which we believe could happen sometime in mid-2024. However, we think it will be short-lived, leading into the November 2024 elections.

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The Hefter Report – July 2023

Economic activity in the first half of 2023 has remained resilient despite the Federal Reserve's hawkish stance over the past 18 months. In our view, the risk of recession has not completely dissipated but seems to have been reduced. This is primarily due to estimated GDP growth trending at 1.7-2% for 2023, a recovery in real consumer disposable income, and stability in the housing market.

Inflation remains stubbornly high with the current PCE reading around 4.5%. Many analysts predict that this rate will decline to around 3.8% by year-end and fall to about 3% by December 2024. The Fed's stated target inflation rate remains at 2% but it may take additional time to get there, perhaps through 2025, due to a strong labor market and high wage inflation. It's worth noting that the labor shortage is improving in some sectors, such as manufacturing and retail, but in short supply in most other service industries. Job openings remain high at 10.1MM while the number of unemployed is 6.0MM.

Persistent high inflation, geopolitical risk (China/Taiwan, Russia, Middle East) and fear of recession are causing investor pessimism to remain elevated. Stocks, however, have rallied despite these concerns. Higher US equity prices in the first half of 2023 have been relatively narrow with a small number of mega-cap stocks contributing to most of the gain. We are now starting to see this rally broaden with more companies participating. On the fixed income side, the yield curve inversion remains in place with the 2-10-year treasury spread still hovering around 100 basis points. Money market rates and near-term Treasury bills are now exceeding 5% which makes a compelling case to keep at least some portion of our fixed income allocation short.

Our outlook for the remainder of the year is modestly bullish for stocks and we may add additional exposure to equities on market corrections. For fixed income, we plan on staying relatively short duration and will extend maturities at some point when the yield curve normalizes.

As always, we greatly appreciate your introductions and referrals!

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The Hefter Report – July 2023

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The Hefter Report – March 2023

In our view, the risk to equities is rising and the potential reward is diminishing. The recent failure and near failure of several US and European banks indicates to us that the Fed's persistent interest rate increases are slowing down the economy. With rates rising, inflation hovering around 6% and earnings estimates expected to ease, equity valuations look less attractive to us. Currently, the S&P 500 earnings for 2023 are expected to be around $220 per share. At this level, the index is now trading at an 18x multiple, which is high for the current economic conditions.

We believe US stocks currently have limited upside, especially considering that fixed income is now an attractive alternative. For example, today (March 17th), a 6-month T-bill yields approximately 4.7%, and we consider that a healthy alternative for some cash and stocks.

The Fed meets this week and although a 50-basis point increase was initially expected, the banking crisis could cause the Fed to reduce that to 25 basis points or even pause. While the market may react positively to a pause, we believe further rate hikes may be in store for the Fed to reach its 2% inflation target.

It may be prudent to consider cash or cash alternatives should the market decline to around 3600 in the S&P 500. This would put a more reasonable 16 multiple on expected earnings and is approximately 9% lower than current prices.

Given that the economy is slowing we think technology and other areas that can grow on their own will do better than cyclical sectors like industrials, materials and energy which depend on economic growth. Generally, it could make sense to consider tactical shifts as well as keeping some cash on the sidelines.

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The Hefter Report – January 2023

2022 was a difficult year for both stocks and bonds. The Nasdaq was down 33.1%, the S&P 500 was down 19.44% and the Barclays/Bloomberg global aggregate bond index was down 16.25%. Higher inflation resulted in multiple Fed interest rate hikes, sparking investor fear of slow economic growth. The major question is, how much will GDP fall and how moderate or severe will a potential recession be?

We believe that the Fed overdid monetary stimulus, leading to inflated prices in everything from equity prices to products and services. The Federal Reserve has turned 180 degrees and has engaged in a rapid tightening regime, hiking short-term interest rates by 4.25%. These hikes have resulted in lower gas and home prices; however, the labor supply remains tight, and wages have increased. The Fed seems determined to continue with tighter policies until they see greater unemployment and lower growth. We believe they will once again overdo it, this time raising rates, which would cause an economic recession in 2023. In our view, the severity of the downturn will depend on how soon the Fed pauses on hiking rates and it is extremely difficult to know when that will be.

Our view is that equity prices will not see a sustained rally until the Fed signals a pause. Once that occurs, we believe stocks and bonds can rally. As we did this past October, we see potentially excellent buying opportunities at around the 3600 level in the S&P 500. If the Fed pauses earlier, that level may not be reached, and the rally could begin sooner. Therefore, we are not selling at this time.

Coming into 2022, high growth and tech stocks had led the market for the last 5-10 years. We believe that there has been a fundamental shift to value, and we have moved meaningfully in that direction. With higher interest rates likely for the next few years, we think value stocks will do as well, or better than, growth stocks with less volatility. We also believe that we have seen the high in the dollar and that international equities, particularly international value equities, could outperform their US equivalents.

History shows that it is very rare to see US stocks down 2 years in a row. We believe that although stocks may move lower in the near term, the eventual Fed pause will result in an up year for equities in 2023.

We believe that we are near the end of this bear market and that the intermediate and long-term prospects for stocks are very positive.

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