January 14, 2019

On the first day of the New Year *The New York Times* reported, “After an unexpectedly bad year for the stock market, investors are looking for clues about what 2019 will bring.” From our point of view what is unexpected is that anyone would ***not*** expect a bad year after ten uninterrupted years of a bull market.

If the growth of the U.S. economy continues until next July it will become the longest expansion on record, which explains the extraordinary performance of the stock market. Corporate earnings remained extremely strong in 2018, growing at 22%, accompanied by a continuing expansion in the manufacturing sector. But to us it was starting to look like an aberration, propped up by an accommodative Federal Reserve and artificially enhanced over the past year by the Trump corporate tax cut. Looking forward to 2019, analysts expect earnings growth to slow to 7.8%, and manufacturing executives are sounding cautious or even pessimistic about the likely impact of tariffs on their profits. Combined with the unknown effect of Britain’s departure from the European Union (Brexit) and the possible slowing of consumer demand here at home, there are the makings of a market downturn that may be more than just a correction. In fact, at year-end 2018 both the NASDAQ Composite and the Russell 2000 Index were already in bear markets as measured from their late summer highs, and the S&P 500 was down slightly less. A swift decline like this can be alarming to clients and investment professionals alike and often causes them to reassess their risk tolerance as well as their overall strategy.

Weighing in on the subject in his 1997 annual report, Warren Buffett wrote, “If you expect to be a net saver during the next five years, should you hope for a higher or lower stock market during that period? Many investors get this one wrong. Even though they are going to be net buyers of stocks for many years to come, they are elated when stock prices rise and depressed when they fall….This reaction makes no sense. Only those who will be sellers of equities in the near future should be happy at seeing stocks rise. Prospective purchasers should much prefer sinking prices.” In the past few years holders of assets of all kinds, including homes and stock portfolios as well as highly desirable collectibles, have enjoyed the warm and comfortable feeling that accompanies a steady rise in the price of these assets. They may have felt secure because there appeared to be little risk. The reality in the stock market, of course, is far different. We know from experience that the last time market risk was historically low was at the bottom of the Great Recession of 2008-09 when the Dow Jones Industrial Average was at 6,547 versus its present 23,346. We remember that as a time of great discomfort, since buying individual stocks or equity funds was a stomach-churning but necessary discipline. Even though it was a low-risk environment, it felt like anything but. As it turned out ten years later, on average the rewards on these purchases have been handsome.

During a spell of declining stock prices, value-oriented investors such as ourselves have a couple of options: either hold on to cash hoards that we have accumulated as the market climbed higher and wait for a major buying opportunity, as in 2009, or stick to the discipline of buying consistently while the market is dropping. At Peak we have been doing both. Each method has its advantages and drawbacks. In either case we don’t pretend to be able to predict when the stock market will bottom, nor do we have any particular information edge as investors. It’s also not possible in the Information Age to find some unique investment that nobody else

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has heard of. So we stick to basic analysis, try to be right the majority of the time, and keep our mistakes small and our good ideas large and compounding over the long run.

During the last few years of the bull market that began in 2009, as stock valuations inexorably rose into fully-valued and even overvalued territory, we did some selling. We sold Kimberly-Clark and then reluctantly parted with Home Depot, purposefully raising cash for whatever future deals might arise. That left open slots in our Model Portfolio* that have not yet filled. There is a list of stocks we would like to buy at the right price, and now we are eyeing a few good companies: Procter & Gamble and Arrow Electronics, as examples. P&G is a company with products familiar to almost everyone, and it has been much in the news as its management has been under attack from an activist investor who runs a large hedge fund. Arrow Electronics is largely unknown and occupies a necessary but not particularly glamorous niche as a wholesale distributor of electronic components and computer products. During the recent downturn it has declined by 18% from its 2018 high, versus P&G's modest drop of 7%. Both have solid balance sheets, a history of consistent and predictable earnings growth in the high single digits (although P&G has had some stumbles in the recent past) and would make appealing additions to the Model. Only one is indisputably in bargain territory by my analysis, however, and it is Arrow. By the time of our next quarterly client letter, after some necessary debate and depending on what happens in the overall stock market, we may have welcomed a new addition to our portfolios.

We appreciate the trust you have placed in us and will continue to work hard to earn it. Please consider passing our contact information to anyone you know who needs help in building and maintaining financial security. We are happy to share our perspective with them and to explore if there would be a good fit for working together.

Best regards,

Noel F. Bennett

**The Model Portfolio is not a real cash portfolio. It represents the core direction of our portfolio management strategies. Individual client portfolios are managed in accordance with the clients' specific investment objectives and constraints. Historical results are available upon request.*