

October 13, 2020

The expansion is still far from complete. At this early stage, I would argue that the risks of policy intervention are still asymmetric. Too little support would lead to a weak recovery, creating unnecessary hardship for households and businesses. Over time, household insolvencies and business bankruptcies would rise, harming the productive capacity of the economy, and holding back wage growth. By contrast, the risks of overdoing it seem, for now, to be smaller. Even if policy actions ultimately prove to be greater than needed, they will not go to waste. The recovery will be stronger and move faster if monetary policy and fiscal policy continue to work side by side to provide support to the economy until it is clearly out of the woods.

Federal Reserve Chair Jerome H. Powell, October 6, 2020

We remain in a health crisis of unknown duration. In the U.S., since the COVID-19 pandemic began, we have reported more than 7 million cases and over 200,000 resulting deaths. For now, we seem to have plateaued at about 40,000 new cases and an additional 700 deaths a day. Globally, more than 35 million cases of COVID-19 have been reported and over 1 million resulting deaths. During the last nine months, the world has accumulated experience and tools to help reduce the risk of death from the virus, but the risk remains. Specific therapies and vaccines are being developed to combat the virus, but the risks of infection and illness continue. One way or another, we will learn how to live with COVID-19. In the meantime, our economy has already been adapting.

From a U.S. macro-economic perspective, there was an historic plunge in our economy in March and April as widespread “Stay at Home” orders from state and local governments were in force. During that time, total economic activity and the number of employed workers both dropped by approximately 10%. The magnitude and speed of the drops were truly unique. There was an aggressive monetary policy response from the Federal Reserve to provide liquidity to the financial markets and an equally aggressive fiscal stimulus from the federal government to try to fill the economic hole. As the economy “re-opened,” there was an impressive reversal of the plunge, though the recovery remains incomplete and uneven. Not surprisingly, the portions of our service economy focused on bringing people together remain depressed. Approximately half the number of jobs lost during the plunge have yet to be recovered. The recovery from here will likely be slower and more dependent on progress against the virus, on shifting consumer behavior and on potential additional stimulus from Congress.

On a more micro-economic level, changes in consumer and business behavior have created more extreme versions of winners and losers in our economy than I have ever seen before. Some of those extremes will reverse over time as the impacts of the pandemic recede, but some of the shifts also reflect the acceleration of existing trends that will only be reinforced over time. Illustrating some of these dynamics, it is probably no surprise to anyone that Zoom Video Communications’ business is booming, with revenue up 355% in the 2nd quarter over the previous year. Video conferencing has been and will likely continue to be a growth business even after the pandemic ramp-up ends, with services for business meetings, education, telemedicine and other applications driving the trend. On the flip side, Southwest Airlines’ revenue was down a stunning 82% in the 2nd quarter. Even in the last week of September, year-over-year U.S. airline passenger traffic was down 67%. While I certainly believe that air travel will be a growth business once again post-pandemic, I also believe there will likely be a slower return of business travel based on the comfort gained with online video meetings during the pandemic. Frankly, it is difficult for me to imagine what it would have been like to live through this environment without all of the digital technology that we have come to rely on.

The resiliency of the U.S. stocks market, as reflected by the S&P 500 index, has been impressive! Even as economic activity has remained below pre-pandemic levels and there is still uncertainty on the timing of a

full recovery, the stock market has embraced the positive rebound in economic data and business earnings and rallied to an all-time high. Below the surface of the stock market, however, just as in the real economy, there are divergences. At the end of the 3rd quarter, the total return of the S&P 500 index was a positive +5.57%. If you remove the 5 highest valued businesses (Apple, Microsoft, Amazon, Alphabet/Google and Facebook),¹ the combined return of the remaining stocks in the S&P 500 was negative. Similarly, the return on the “equal-weighted” S&P 500 index, which eliminates the outsized impact of the highest valued stocks, returned a negative (-4.75%) over the same period. There have been some real winners leading the stock market higher, but the the majority of stocks ended the 3rd quarter lower on the year.

From a portfolio management perspective, many of the stock market winners have reached price levels where the risk/return of purchasing those stocks today is just not attractive. There are a whole group of great businesses, primarily technology related, trading at 30 times sales or more (yes, sales, not earnings). Even many large, blue chip businesses are trading at higher price/earnings ratios than at any time in the past 20 years. Going back to one of my examples above, Zoom Video Communications is trading at a stunning 50 times sales.² The business has done amazingly well, and I have no reason to believe it will not continue to execute well in the future, but it is highly improbable that it will continue to grow at 355% a year. There are no barriers to entry to its business and they already compete with Cisco, Microsoft and Google.³ In brief, there is a real element of speculation in the stock market today. At some level, it reflects a scarcity of real growth opportunities, but it also indicates that animal spirits are alive and well (which, at least in this environment, I find strangely reassuring). While there are still plenty of attractive investments available in the stock market today, seeing the current level of speculation is a good reminder for all investors that the true profitability of an investment is based on a combination of the price you pay today and the cash flows that you receive from it in the future. It reminds me that long-term investing is a process, not an event.

Finally, in the quote that opened this letter, the Fed Chair raises the obvious concern that we are not yet through this pandemic. That the risk of the economy spiraling into something worse as a result of the pandemic has not passed. That in this critical period, it is not time for Congress to get conservative. That this is a time when an investment in our people, our businesses and our economy offers a very high return, now and in the future. And I agree.

We hope this letter finds you and your family well. We appreciate your business and we continue to work hard to earn the trust that you have placed in us. Please let us know if you have a friend or a family member that could use our assistance.

John McCorvie, CFA

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Business Note:

We are pleased to announce that Johnny Russell has joined Peak as an Associate Advisor. He will act as a part of our Client Service team as well as work on our Investment Committee. In 2019, Johnny transitioned out of the packaged foods industry and completed his Masters of Finance at the University of Denver. He also passed the Level 1 CFA designation exam. He is currently studying for the Level 2 CFA exam. He originally joined Peak for an internship in January and surpassed all our expectations. We are very excited to be working with him.

¹ Apple, Microsoft and Alphabet/Google are in Peak’s Model Portfolio. 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.

² I annualized Zoom’s 2nd Q revenue for this calculation. The traditional trailing 12 month calculation = 100 times sales.

³ Cisco is also in Peak’s Model Portfolio.