4TH QUARTER 2014 UPDATE

January 15, 2015

One of our most important missions at Peak is to be disciplined about saving ourselves and our clients from our own worst impulses. When the stock market last autumn began a steep decline from its mid-September peak, no one knew whether or not a big correction had started. During the next month the S&P 500 lost 7.4% of its value. The natural response was to run for cover, similar to what most people did in 2000-01 and 2008-09.

Sadly, the lowest levels of income earners in this country have been doing exactly that for the past fourteen years. The bottom 80% income group now controls only 26.2% of the wealth in the U.S., down from around 35% in 1989. At the same time the top 10% has become richer partly by increasing its stock ownership: 93% of this elite crowd owns stocks, and according to the Wall Street Journal now controls 61.9% of the nation's wealth. Clearly, the investing decisions made by the high earners and their advisors played an important role in increasing their financial security and their ability to retire comfortably.

The families that held on to their stocks at the depth of the financial panic in 2009 or added to them are now in a much stronger position. The decisions we made at Peak in that critical, frightening time continue to accrue to our and our clients' benefit. In an unusual burst of activity, we undertook six changes to our Model Portfolio* in the nine months from the fall of 2008 to mid-2009: three sells and three purchases. As the market began to climb steadily in 2010 we added five more companies and in 2011 we added three. In the following two years our portfolio turnover returned to its normal glacial pace of 10-20%, and in 2014 the only trade we did in the Model was to eliminate our half-position in Weight Watchers. In the words of Warren Buffett, "lethargy bordering on sloth" once again became our dominant portfolio strategy.

One of the tasks we performed during the past year was to revalue upward many of our companies as their financials became stronger and their flow of owners' earnings rose. This was accompanied by increased profit margins, dividend boosts and share buybacks. As the U.S. economy picked up speed from the recession, these companies became more valuable, not just in their market capitalizations but also in the numbers we look at when we do our analysis. The result is that we are able to continue to hold them as their share prices rise, rather than having to discard them one by one as they become over-priced. The company that appreciated the most in our Model in 2014 was Apple Computer, up 40%, followed by a three-way tie at 28% among Becton Dickinson, Berkshire Hathaway and Home Depot. Each of these businesses did what we had anticipated they were likely to do given the opportunity of a healthy and recovering economy.

On the negative side, the three bottom performers were Emerson Electric (down 11%) and Canon and ConocoPhillips, both of whose shares ended the year where they started. Emerson has a large international presence, and its flat European business hurt the outlook for both 2014 and probably for this year as well. Canon has a thriving digital SLR camera business, some of which has been poached by smart phone cameras, but not among true photographers. It continues to maintain a rock solid balance

sheet. And ConocoPhillips, which we purchased in 2007 largely as hedge against turmoil in the oil-rich Middle East, has been an active participant in the development of horizontal drilling in oil shale deposits, a technological advance with mixed blessings here at home. A couple of months ago the Arabian sheiks decided to spank us hard for our temerity in becoming less dependent on their only export, resulting in a precipitous drop in the price of oil. Conoco, with its strong balance sheet and high dividend yield, will continue to be a decent investment in the short term but probably not a great one. The petrochemical arena has once again shown that we live in a sometimes brutally competitive global marketplace. Wendelin Wiedeking, the former CEO of Porsche, once said with considerable understatement, “This world is not a playground where children are pampered by friendly nannies.”

Our Model Portfolio currently holds nineteen companies and one Exchange Traded Fund composed of pharmaceutical businesses. They share a common advantage in our minds: they have adapted or should be able to exist in a world of tastes and demands that is changing and mutating at a rate never before seen in our collective experience. We don’t own McDonald’s, Coca Cola, JC Penney or the New York Times (as much as I love to read it online). These are strong brand names that have retained some of their former appeal—but they’re stuck. McDonald’s management has no idea how to compete with upstarts like Chipotle (even though it initially owned part of it as a startup), Noodles & Company or Panera Bread. Coca Cola is wondering how to cash in on the Red Bull and Monster bonanza, while at the same time having trouble with the reality that its calorie-filled, sugary carbonated drinks are falling out of favor. We preferred to buy a position in Pepsi because it is diversified by its Frito Lay, Gatorade and Tropicana subsidiaries. And the paper version of the Times is being eaten alive by free access to news on our smart phones.

We are aware that none of our Model companies is immune to this sort of obsolescence or irrelevance. The fact that we typically hold these investments for years raises the risk that we could end up with an outmoded has-been or two. Our solution to the problem is to maintain a flexible and questioning attitude, to nurture our contrarian mindset, and to increasingly rely on younger partners. It also means paying attention to those taste-makers closer to home who are often the most observant and tough to satisfy—our own children and grandchildren.

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 client’s specific investment objectives and constraints.*