Peak Asset MANAGEMENT

4TH QUARTER 2021 UPDATE

January 14, 2022

"…the stock market is a wonderful arbitrage mechanism, but when it begins to anticipate earnings not just in the future but in the hereafter, watch out!"

John Bogle

Probably the best that can be said about 2021 is that it was more positive than 2020, but not by much. At least it felt that way, tainted by political divisiveness and a resurgence of COVID, accompanied by worries about inflation no longer being "transitory" and a persistent supply chain crisis. But the negatives were counterbalanced by: the economy expanding by an estimated 5.5% in 2021, unemployment dropping to 4.2 percent, and the S&P 500 being up nearly 29%, including dividends.

Those of us who make our living in the investment business often possess what is called a negativity bias, paying disproportionate attention to possible pitfalls and warning signs, a survival strategy that served our ancestors who roamed the savannas well. So in 2021 we were consistently amazed by the stock market's performance in the face of a steady onslaught of dire headlines.

A look at the companies in our Model Portfolio* reveals some of the underpinnings of a rising stock market, as their managements continued to stick to the basics and execute well. Ten of them were in the top 55 of the Drucker Institute's Management Top 250 rankings, based on their performance in five areas: customer satisfaction, employee engagement and development, innovation, social responsibility and financial strength. These same ten companies had strong earnings rebounds in 2021 compared to the year before, and in many cases were able to reduce their debt, buy back shares and increase their dividends. The one business in our Model that has been most directly harmed by COVID and its Omicron variant, Walt Disney, fortunately committed to creating its Disney+ streaming service prior to 2020, and although that new revenue source did not nearly offset the decline in Disney's parks and studio entertainment business, it did help return the company to profitability in 2021.

In general, an expanding economy combined with a desire on the part of consumers to spend money and take on short-term debt, along with continued federal government stimulus, has contributed to an atmosphere of prosperity. It has also been accompanied by an unwholesome and much discussed side effect: inflation. In November consumer prices in the U.S. rose 6.8% over the previous year. Jerome Powell at the Federal Reserve had targeted an inflation rate of 2% as desirable. Fortunately, he understands the necessity to keep inflation at bay in the long term, but the short term is now. The Fed has the tools to bring inflation under control and has announced plans to ease off on the stimulus, but will it be enough? If people didn't believe they could depend on the Fed, the price of gold would not be declining and bond yields would not remain low. But rising house prices fueled by low mortgage rates, a choked supply chain and a pricey stock market are powerful inflationary forces.

Bret Stephens at the New York Times writes, “Now we have an economy in which asset values keep going up because we expect them to keep going up, and in which easy money is creating speculative bubbles that seem obvious to anyone not living inside them. Rivian Automotive, to take an example, is an electric-vehicle maker that has been losing money hand-over-fist while delivering, as of November, a grand total of 156 vehicles. That month, it went public with a market cap just shy of $100 billion, larger than Ford’s or GM’s.” He goes on to opine that unchecked inflation “has a bad way of becoming a father to political instability and extremism.” Inflationary expectations, for those of us who remember the late 1970s, can be difficult to eradicate without causing a recession, which the Fed would like to avoid but failed to back then. Until recently, the assumption was that the Omicron variant would curtail consumer spending, but instead it is prolonging supply-chain disruptions and keeping inflation elevated. Fed Chairman Powell noted in December that people are learning to live with the disease, and the more people who get vaccinated, the less the economic effect.

At Peak, our collective experience has taught us that as bull markets mature and sometimes even gain momentum, we increasingly view keeping up with the S&P 500 Index as irrelevant to our long-term strategy. While we will always be focused on maintaining and increasing our and your financial security and prosperity, at such times we consider the return of your money to carry more weight than the return on your money. As always, we continue our commitment to owning top-quality companies bought at reasonable prices and have maintained comfortable cash and short-term bond cushions to guide us and our clients through the inevitable fluctuations of the next few years.

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 information is available upon request.*

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