Peak Asset
MANAGEMENT

2ND QUARTER 2022 UPDATE

July 14, 2022

"We now understand better how little we understand about inflation."

Fed Chairman Jerome Powell

The first six months of 2022 were the worst first half of a year in the stock market since 1970. And the bond market didn't fare much better, with the 10-year Treasury note falling about 10% in price. So when the Chairman of the Federal Reserve admits to being unsure about how aggressively to combat inflation without causing a recession, it is at the same time unsettling and reassuring. Unsettling, because we would like to believe that the Federal Open Market Committee (FOMC) knew what it was doing when it raised rates by three-quarters of a percent in June, the largest hike in 28 years. And reassuring, in that a little humility and a willingness to learn and adjust in the face of the unexpected is never a bad thing. Hedge fund manager Seth Klarman once wrote, "It is much harder psychologically to be unsure than to be sure; certainty builds confidence, and confidence reinforces certainty. Yet being overly certain in an uncertain, protean, and ultimately unknowable world is hazardous for investors."

The years shortly before 1970 and in the following decade were full of the kind of uncertainty Klarman refers to. An unpopular war, the Arab oil embargo, runaway inflation accompanied by high unemployment, and the poisonous political atmosphere engendered by the Watergate scandal all contributed to a stock market that went nowhere for the better part of thirteen years. And at a time when the Prime Rate rose to 21% and long-term Treasury Bond yields climbed as high as 16% while their prices fell precipitously, any investor who fled to the perceived safety of the government fixed income market was looked upon as disconnected from reality.

Are there parallels to the present time in terms of unpredictable events creating a sense of unease? Absolutely, with COVID variants, climate change, Putin's war on Ukraine and a deeply divided U.S. political system all contributing. And the Fed's plan to aggressively fight inflation by continuing to raise rates three-quarters of a percent at a time signals it is willing to risk a recession in its commitment to combat rising prices.

And yet those of us who pay close attention to value when making our investment decisions are experiencing a feeling of optimism that has been lacking for quite some time. The chairman of one Value fund recently went so far as to enthuse that, "…from current levels, I think we're going to have a stupendous decade and most particularly a stupendous three to five years." He is obviously not worried about a stagflation scenario: the combination of slow growth, high inflation, and unemployment in the range of 9%, as in 1975. At Peak, our own positivity is fueled by two factors: first, the years-long drought of available bargains in the stock market may gradually be coming to an end; and second, with the 10-year U.S. Treasury now yielding 2.91% versus a meager 1.44% a year ago, if that rise continues we may in the not-too-distant future be able once again to build bond ladders whose secure interest payments will support retirees. Also on the positive side, Fortune's report on America's largest 500 companies shows critical measures such as profit margins, return on equity, and total assets are the strongest today that they have been in the 68 years since the magazine started its Fortune 500 ranking. The

companies also report comfortably low leverage (liabilities as a percentage of total assets) and large cash cushions totaling nearly $4 trillion.

On a more basic and personal level, the nation's jobless rate fell from 4% last December to 3.6% in May, and households are flush with cash, amounting to $18.5 trillion in checking and savings accounts and money market mutual funds, according to Fed data. Some $5 trillion of this cash hoard came from several rounds of relief checks sent to families and individuals in the past two years.

If a recession does come about due to the tightening by the Federal Reserve it will not be unexpected, and a good guess about the odds of that happening would be around 50/50 at this time. We believe the companies in our Model Portfolio* are financially solid and able to navigate even a major downturn. Our fixed income portfolios have been constructed to suffer minimally as interest rates rise; they are positioned on the short and intermediate end of the yield curve.

One positive lesson learned from the otherwise bleak years of the 1970s was that anyone who had the contrarian fortitude to put their money to work in both the stock and bond markets at that time reaped rewards in the coming decades that can best be described as spectacular. With that history in mind, we and our clients have a large amount of cash and near-cash to deploy when bargains in both markets become available.

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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