



## 4<sup>TH</sup> QUARTER 2022 CLIENT LETTER

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January 13, 2023

It has been said countless times that, “History doesn’t repeat itself, but it often rhymes,” a quote attributed to Mark Twain. In reality, history occasionally does repeat itself. The 30-year bull market that came to an end in 1972 and the one just ended a year ago are examples. In his book *The Intelligent Investor*, published in 1973, Benjamin Graham regretted it had become almost impossible to purchase stocks of great companies at reasonable prices, and that it was more common for investors to buy “low quality securities at times of favorable business conditions,” putting their money at high risk. He devoted an entire chapter to what he termed “Margin of Safety,” and it remains essential reading for anyone interested in investing today. He wrote, “the margin of safety is always dependent on the price paid. It will be large at one price, small at some higher price, nonexistent at some still higher price.”

Looking back at 2022 it is obvious that many investors, both amateur and professional, paid little or no attention to Graham’s precept, if they had even heard of it. It would be easy to single out for criticism those who bought shares of Tesla as it rose to its peak near the end of 2021 and then rode it down 70% to its recent low. But even if they had done fundamental analysis of the company, it would have been nullified by the actions of its mercurial CEO, Elon Musk. He was primarily responsible for its meteoric rise and then its precipitous decline. He received praise and adulation as its stock climbed into the stratosphere, like his SpaceX rockets, and he earned a reputation as an entrepreneurial genius. But the board of directors of Tesla must have shuddered when he purchased Twitter for \$44 billion late last year and then tried to back out of the deal. That prompted Nobel Prize-winning economist Paul Krugman to write, “I wouldn’t trust him to feed my cat.”

It is better for our purposes to look at three well-known companies with less drama surrounding them but with stock charts that also recently resembled a profile of Mt. Everest: Meta (formerly Facebook), Rivian and Beyond Meat. Each has been featured prominently in the news, each has a business that is relatively easy to understand (with the possible exception of Meta), and all three have conscientious chief executives who appear to be primarily concerned with maximizing returns to their shareholders. And yet all three have seen their market valuations decline drastically from their highs in the past year: 69% down for Meta, 90% for Rivian and 94% for Beyond Meat. Obviously, there are vast differences among these companies: a social media giant with a worldwide presence, an electric pickup and SUV builder that went public in late 2021 at a high price, and a manufacturer of plant-based meat alternative products. Likewise, there is a wide diversity of investors who have taken positions in these securities, from Silicon Valley titans to hopeful day traders. But it seems safe to say that margin of safety was not uppermost in their minds when they took the plunge. Instead, it was the assumption that earnings would continue steadily ascending on into the future; or in the case of Beyond Meat, it would eventually cease losing money and make a profit. I use these extreme examples to illustrate that the areas of the market making the boldest headlines in 2022 had an outsized influence on the investing community. And we were not entirely immune ourselves, as our Model Portfolio\* owns two of the Big Five tech stocks, sometimes referred to as FAANG.

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“In the short term, the market is not a weighing machine but a voting machine,” Ben Graham wrote. A graph of the stock price of most large public companies over time generally closely tracks positive earnings trends as well as disappointments, but the voting machine is always in control when predictions about the future are involved. At the start of the New Year forecasts are everywhere in the media: what the Federal Reserve might do to interest rates, how inflation will be affected by such actions, what may happen in Ukraine and whether China is likely to invade Taiwan.

To us, focusing on what we can control in our investment strategy is more important than trying to predict, or vote upon, what is outside of our sphere of influence. Price to earnings and price to sales ratios are easily arrived at, as are profit margins, balance sheet strength and dividend payouts. But today our analysis frequently reveals a problem: persistent overvaluation of excellent companies we would like to add to our Model Portfolio\*. Businesses like John Deere, Grainger and Honeywell remain fully valued with little or no margin of safety even after last year's 18.1% decline in the S&P 500. That drop was primarily due to such megacap tech stocks as Meta, Netflix and Tesla, since the S&P Index is weighted by market value. But we are patient investors who appreciate comfort and stability, and we know that opportunities to buy stocks of fine businesses have presented themselves in the past and will again in the future.

As mentioned in previous client reports, our bonds and fixed income funds in the past year were a drag on our performance, negatively affected by the aggressive action of Jay Powell and the Fed. The good news is we can now put cash to work at the short end of the fixed income markets and receive as much as 4.75% per year on short term U.S. Treasury Bills, up from 0.27% a year ago. These returns will likely improve from here as the Fed continues its tightening. As the year progresses we should accrue a welcome boost to the safe money segment of 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 information is available upon request.*