Peak Asset MANAGEMENT

# 2ND QUARTER 2023 CLIENT LETTER

July 12, 2023

*Hindsight, the ability to explain the past, gives us the illusion that the world is understandable. It gives us the illusion that the world makes sense, even when it doesn't make sense. That's a big deal in producing mistakes in many fields.*

*Daniel Kahneman*

Imagine you are the chief executive of the Finnish tire maker Nokian in late 2018. Your company is performing well and its stock price is near its all-time high. 80% of your tires are being produced in Russia, where labor costs are low and the energy needed to manufacture your product is reasonably priced. Then in February of 2020 COVID begins its sweep from China around the world, essentially shutting down the global economy and your business along with it. By the middle of the following year, in 2021, you are relieved to see a gradual loosening of the supply chain of the products your company needs to bring your manufacturing back to a nearly normal level. And then in February of 2022 Vladimir Putin decides to invade Ukraine and you must relocate the production of 80% of your tires. Some will go to Romania, another country within the European Union, part will relocate to your home base of Finland, and another portion to the U.S. All of this involves buying and selling properties, building factories and negotiating complex deals. During this time the stock price of your company has dropped by 80%.

Even in our United States, where international security and geopolitical risks have only recently risen to the top of our list of concerns, four things happened since year-end 2019 that were completely unforeseen and unpredictable. We have been blindsided by a global health crisis, by the January 6, 2021 assault on the Capitol in Washington, D.C., and Russia's invasion of Ukraine. But we have experienced a fourth surprise during that time that to us at Peak has been perplexing: a 37% rise in the S&P 500. Much of the rise has been due simply to the fact that a recession has failed to materialize in spite of the efforts of the Federal Reserve to slow the economy by raising interest rates. Consumer spending has remained strong, and the management teams at the companies we follow and own in our Model Portfolio* have executed well and navigated disruptions nimbly, in most cases. Probably the most important contributor to the rise in the stock market, though, has been investor enthusiasm, leading to what is known as "multiple expansion." The trailing price-to-earnings ratio (P/E Ratio) of the S&P 500 today is 25.76, compared to 19.33 at this time last year, according to Barron's.

Is this enthusiasm warranted, given that the Federal Reserve interest rate has had its sharpest increase in history and the manufacturing sector has continued to contract for the eighth consecutive month? Probably not. It is a mixed blessing: on the negative side, we have had a harder time finding great companies to buy at reasonable share prices, and the positive can be seen by a look at our second quarter client reports.

Most of these reports will reflect our emphasis on holding relatively large amounts of cash and short-term fixed income positions in addition to the high-quality stocks in our Model Portfolio. These cash and bond investments are currently paying much higher yields than they were as recently as a year ago, which is pleasing. A rule of thumb has been that one needs enough liquid assets to tide him or her over in the event of a year-long recession, probably accompanied by a reversal of the multiple expansion in the stock market. If we have learned anything in the past three years, it is to be defensive and prepared for more unexpected events that make no sense. These do not include a recession, the re-election of a controversial President or, worst case, the invasion of Taiwan by China. These are the most pressing of our concerns and have been for some time, but they're far from unpredictable.

Our managers put considerable time and effort into building individualized portfolios of fixed income and equities for our clients and ourselves, recognizing that everyone's risk tolerance is different. We are most satisfied when we believe we have contributed meaningfully to increasing peoples' feeling of independence, freedom from worry, and the amount of time available to do whatever it is they most enjoy. 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 objectives and constraints. Historical information is available upon request.*