

July 15, 2019

At the end of our January 2019 client letter, we wrote, “By the time of our next quarterly letter, after some necessary debate and depending on what happens in the overall stock market, we may have welcomed a new addition to our portfolios.” At the time we had some open slots in our Model Portfolio* due to selling three stocks (Gilead, Home Depot, and Kimberly-Clark) and to our reluctance toward paying too much in a richly priced market. It took a few months longer than we had anticipated, but in June we did make a purchase: shares of Alphabet Inc., the parent company of Google, which operates the world’s leading Internet search engine as well as its ubiquitous YouTube service. Combined with our existing positions in Microsoft, Apple and Cisco, it is fair to say that we have a solid commitment to the large-cap software and tech companies that have been lifting the bull market inexorably higher over the past ten years. The Alphabet buy has followed some internal debate about whether we can continue to label ourselves value investors. There has been much discourse in the financial media about growth investing driving the stock market while leaving value investing in the dust, which has led to headlines like “Is Value Investing Dead?”. An article in Fortune magazine recently stated that the U.S. is moving toward an “ ‘asset-light economy’ driven by tech giants that generate floods of profits from mere trickles of capital....While they, too, face rising labor costs, they don’t need nearly as much labor (or plants, or inventories) to generate hefty sales.”

In the days leading up to our purchase of Alphabet in the Model, there was no debate whatsoever about whether it was a value or a growth stock. Perhaps that was because we were already aligned with what Warren Buffett wrote in his 1992 annual Letter to Shareholders: “Growth is always a component in the calculation of value....Growth benefits investors only when the business in point can invest at incremental returns that are enticing—in other words, only when each dollar used to finance the growth creates over a dollar of long-term market value.” Even though those words were written almost three decades ago, they still reflect the achievements of companies like Google, Apple and Microsoft in recent years as their share prices have climbed steeply, far more than the industrial, transportation equipment and retail sectors. They have been able to employ large amounts of incremental capital at very high rates of return (again, Buffett’s words) instead of having to spend it on the property, plant and equipment necessary to keep more average businesses running at moderate rates of growth.

One issue that has surprised almost everyone, including us, is that while the economic recovery in the U.S. over the past decade has now become the longest on record, the rebound has been a sluggish one. That explains why the Federal Reserve has recently shifted away from a policy of gradual rate increases to opining that it might instead cut rates before the end of the year. The most recent manufacturing numbers show that the economy is slowing and inflation remains at 1.8%, slightly below the Fed’s desired 2%, so a rate cut might actually be justifiable.

A superficial look at the numbers shows an apparent disconnect between the dreary economic growth of the past decade and the stellar performance of the S&P 500 from its bottom in March 2009 to its present all-time high. But digging further into the past reveals that during the 13 years from March 2000 until April 2013, stocks essentially went nowhere during a time characterized mostly by risk, drama and loss. Knowing that makes it a bit easier to judge whether the stock market is drastically overvalued or not, and the consensus here is that while it is expensive, we are not experiencing a bubble like we saw in 1999-2000. But we are aware that it has been an unusually long time since investors and speculators alike all rushed for the

exits at the same time, as they did in 2001 and again in 2008-09. For three months late last year it appeared that such a rush might again be underway, but in January most stocks resumed their strong upward momentum. The net effect at Peak is that we have continued to position our clients and ourselves to profit as much as possible while making sure that all of us are ready for and not caught unaware by a major reversal of fortune in the coming year or two.

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 results are available upon request.*