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Your Mid-Year Letter

The first six months of 2022 saw the S&P 500 decline 23.6% from its all-time high at 4,796.56 on January 3 to a closing low of 3,666.77 on June 16th. The Index finished its worst first half since 1970 at 3,785.38.

More noteworthy even than the extent of the decline was its gathering violence: in mid-June, the market ran off a streak of five out of seven trading days on which 90% of S&P 500 component stocks closed lower. This is one-sided negativity on a historic scale.

Let's stop right there. Because regardless of any and all other points we wish to make in this report to you, the most urgent should already be clear.

Simply stated, the best way to completely destroy any chance for lifetime investment success has historically been to sell one's quality equity portfolios into a bear market.

But to sell when investor sentiment is sufficiently negative to drive 90% of S&P stocks lower on five out of seven trading days – *to sell, that is, when everyone else is selling* –must strike us as the height of long-term folly.

With that clearly on the record, let us attempt to make some kind of sense out of what is going on here. (We may have made some or all of these points to you earlier. If we have, please bear with us: they seem more than worth repeating.)

To do so, we need to take you back to the bottom of the Great Panic on March 9, 2009. From that panic-driven trough, the S&P 500 (with dividends reinvested) compounded at 17.6% annually for the next twelve years, through the end of 2021. At its peak this past January 3, the Index was up seven times from its low. This was one of the greatest runs in the whole history of American equities.

Moreover, the Index's compound return over the last three of those years – 2019 through 2021, encompassing the worst of the coronavirus plague – shot up to 24% annually.

But when inflation soared late last year, it became evident that equities' jaw-dropping advance over those three years had been fueled to some important extent by an excess of fiscal and monetary stimulus, mounted to offset the economic devastation of the pandemic. In one sentence: the Federal Reserve created far too much money, and then left it sloshing around out there far too long.

And since inflation, as Milton Friedman taught us, is always and everywhere a monetary phenomenon, we investors now find ourselves having to give back some of the extraordinary 2009–2021 market gains, as the Fed moves belatedly to sop up that excess liquidity by raising interest rates and shrinking its balance sheet.

Yes, the war in Eastern Europe and supply chain woes of various kinds have exacerbated inflation, but in our judgment they are irritants: monetary policy (seasoned as well with a bit too much fiscal stimulus) got us into this mess, and monetary policy must now get us out. The fear, of course, is that the Fed will overtighten, putting the economy into recession.

Our position in all our discussions with you has been and continues to be: so be it. If an economic slowdown over a few calendar quarters is what it takes to stamp out inflation, it would be by far the lesser of the two evils. *Inflation is a cancer, and it must be destroyed.*

With regard to our investment policy, nothing has changed, because nothing ever changes. That is: we are long-term, goal-focused, plan-driven equity investors. We own diversified portfolios of superior companies; these companies have demonstrated the ability to increase earnings (and in most cases dividends) over time, thus supporting increases in their value.

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"Alone we can do so little; together we can do so much."

- HELEN KELLER

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(continued)

We act continuously on our financial and investment plan; we do not react to current events, no matter how distressing they may be. After 30 months of chaos—the pandemic in its several variants, the election that would not end, roaring inflation (most painfully in stupefying gas price increases), the supply chain mess, war in Europe and so on—we are all understandably exhausted. (And we most certainly do mean *we*.) That is when the impulse to capitulate—to get to the illusory "safety" of cash—becomes strongest. So that is when the impulse must be resisted most strongly. And that is our job.

This too shall pass. We are here to talk all this through with you at any time. Thank you for being our clients. It is a privilege to serve you.

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WE HOPE YOU AND YOUR FAMILY ARE HAVING A WONDERFUL SUMMER!