CLADIS
INVESTMENT ADVISORY, LLC

180 S 32nd Street West, Suite 1
Billings, MT 59102
406-259-4939

Your Mid-Year Letter

As America continued to recover from the COVID-19 pandemic in the first half of 2021, the economy and the equity markets made significant progress.

Our midyear report to you is divided into two parts. First is a brief recap of our shared investment philosophy; second is our perspective on the current situation. As always, we welcome your questions/comments.

GENERAL PRINCIPLES

• You and our firm are long-term, goal-focused, planning-driven equity investors. We have found that the best course for us is to formulate a financial plan—and to build portfolios—based not on a view of the economy or the markets, but on our most important lifetime financial goals.

• Since 1960, the Standard & Poor's 500-Stock Index has appreciated approximately 70 times; the cash dividend of the Index has gone up about 30 times. Over the same period, the Consumer Price Index has increased by a factor of nine. At least historically, then, mainstream equities have functioned as an extremely efficient hedge against long-term inflation and a generator of real wealth over time. We believe this is more likely than not to continue in the long run, hence our investment policy of owning successful companies rather than lending to them.

• We believe that **acting continuously** on a rational plan—as distinctly opposed to **reacting** to current events—offers us the best chance for long-term investment success. Simply stated: unless our goals change, we see little reason to alter our financial plan. And if our portfolio is well-suited to that plan, we do not often make significant changes to that, either.

• We do not believe the economy can be consistently forecast, nor the markets consistently timed. We are therefore convinced that the most reliable way to capture the long-term return of equities is to ride out their frequent but ultimately temporary declines.

• The performance of our equity portfolios relative to their benchmark(s) is irrelevant to investment success as we define it. (It is also a variable over which we ultimately have no control.) The only benchmark we care about is the one that indicates whether you are on track to achieve your financial goals.

CURRENT OBSERVATIONS

• The American economy continued its dramatic recovery in the first half of 2021, spurred by (a) the proliferation of effective vaccines against COVID-19 and the retreat of the pandemic, (b) massive monetary and fiscal accommodation, and (c) its own deep fundamental resilience, which ought never to be underestimated.

• The S&P 500 ended the first half at 4297.50 an increase of 14.41% from its close at the end of 2020. Coming into the year, the consensus earnings estimate for the Index in 2021 was around $165; as we write, the consensus for the next 12 months has reached $200 and is still being raised.

• The economy continues to struggle with supply chain imbalances, as well as with a historic mismatch between the number of job openings available and continued high (though rapidly declining) unemployment. The chattering class of pundits and financial journalists continues to speculate on when these blockages will clear; to long-term investors like us, the key is our belief that they will, in the fullness of time.

• We are still in the midst of an unprecedented experiment in both fiscal and monetary policy; the outcome remains impossible to forecast. The possibility that we have overstimulated the economy was highlighted this spring by a significant resurgence in inflation. But as the first half ended, statements by Fed Chair Powell and Governor Bullard indicated a keen awareness of this risk, and a readiness to act against it. The markets evidently took these gentlemen at their word, as inflation hedges like gold and oil sold off, the equity market pulled back modestly, and the yield on the bellwether 10-year U.S. Treasury note retreated to the area of 1.5%. One does not want to read too much into short-term phenomena like these; suffice to say that the Fed appears acutely cognizant that its credibility is almost existentially on the line here.

• There is also the issue of the Biden administration's fairly radical tax proposals with respect to capital gains and estates. The best that can be said on this subject is that, as the first half ended, the momentum behind these initiatives seemed to be ebbing. But the political climate remains as inimical to capital (and capitalists) as it has been in quite a while.

• Nonetheless, for investors like us, we think the most important economic report of this whole six-month period came just a few days ago. It was that household net worth in this country spiked 3.8% in the first quarter of 2021—to $136.9 trillion—propelled by broad gains in the equity market and in home prices. Even more important, perhaps, is the fact that the ratio of household debt to assets continued to fall and is now back down to about where it was 50 years ago.

• The consumer powers this economy, and the consumer has rarely carried more manageable debt levels relative to disposable income—and has simply never been holding more cash—than he/she does today. In June, the National Retail Foundation raised its outlook yet again; it now expects retail sales to grow 10.5% to 13.5% (that is, $4.44 trillion to $4.56 trillion) year over year. Just this past month, the retail giant Target raised its dividend by a whopping 32%.

On February 19, 2020—the market's peak just before the pandemic took hold—the S&P 500 closed at 3,386. It then proceeded to decline 34% in

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"Never be limited by other people's limited imaginations."

- DR. MAE JEMISON

YOUR MID-YEAR LETTER

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33 days, amid the worst global health crisis in a century. But if you bought the Index at that epic top and were still holding it on June 30 of this year, your total return with reinvested dividends has been close to 28%. We have never seen—and do not expect to ever see again—a more vivid demonstration of Peter Lynch's dictum that "The real key to making money in stocks is not to get scared out of them."

We believe our firm was put here for just that reason: **to help you not get scared out of them.** Thank you for being our clients. It is our privilege to serve you.

SUMMER OFFICE HOURS: MAY 1 – SEPTEMBER 3
7:30AM – 4:30PM MONDAY – THURSDAY
7:30AM –3:00PM FRIDAY