

2021 Year in review

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Happy New Year!

I have to admit that when I wrote last year's letter I expected the topic of Covid to fade away in 2021. I wondered about its aftermath. How long would it take for the economy to recover? When would all of those lost jobs come back? After the stock market's surprisingly strong performance in 2020, was it due for a pause? Well, as we now know, Covid is still in the headlines, and 2021 brought us the strongest (GDP) numbers in a decade.¹ Employment is still an issue, but with a twist—it's not jobs that are scarce, but rather workers to fill them. And stocks followed up 2020 with an even stronger 2021—at least for certain sectors.

The Dow Jones Industrial Average rose 18.73%. The S&P 500 index was up 26.89%. But many sectors lagged. Small cap stocks were up 13.70% Biotechs fell slightly. Outside of the US, a broad index of developed markets rose 7.67%, and emerging markets fell -3.58%. Other asset classes fared worse, with bonds falling to their worst year since 1999. Gold slipped -6.19%.²

We were fortunate to have seen a strong performance year for some of our top long-term holdings. Alphabet (Google), our largest position, was up 65%, and #2 Microsoft +51%.³ Other top holdings like JP Morgan, Proctor & Gamble, and Goldman Sachs rose. In general, our focus on stocks of large US companies—particularly technology companies—worked very well in 2021. But please keep in mind that the returns in 2021 were much greater than normal, and we expect that future years won't be as good. So why not take profits now and wait to get back in at a lower level? Ah, but it doesn't work that way. No one—not even those guys on TV—can effectively time the market, and long term investors will likely find that to be a poor strategy.

As the new year begins, investors ponder the risks for 2022. The list begins with inflation and Fed policy. Covid is on the list too, along with supply chain issues. As you probably know, our investment process takes a long term view, and often today's dangers fade away (only to be replaced by new ones). Regarding inflation, we're still watching warily but not yet inclined to take any action. It's possible that the current inflation pressures peak as the pandemic subsides. In any event, we take our primary cue from the bond market, which has shown little reaction to inflation fears (although last week's move is on our radar).



We're inclined to believe that Covid eventually diminishes, although we don't know when. The pandemic isn't itself an economic event, but it carries economic consequences and could serve as a catalyst for economic events. Like supply chain. We expect that the logistical issues will eventually be sorted out, but there will probably be some long-term changes. Remember the term "globalization"? It was once an economic miracle which lowered costs on a wide variety of consumer goods. How about "just-in-time"? The supply chain design of the future will be different. This will entail a different cost structure, but also some new investment opportunities.

Finally, as I reviewed some prior letters in preparation for this one, I thought that this paragraph from twelve months ago would work just as well for the coming year:

So now we look ahead to 2021. There remains plenty of uncertainty. Is it possible that the economic recovery and that of corporate earnings have been largely discounted in soaring stock prices, particularly those of the largest growth companies? Will a new variant of the virus create further devastation? Yes, of course it's possible and would not be that surprising. Now, how do we as long-term, goal-focused investors react to that? The answer: we don't, because one can't. Our strategy, as 2021 dawns, is entirely driven by the same steadfast principles as it was a year ago—and will be a year from now. We seek to build a portfolio of quality companies acquired at fair prices and hold them for a very long time. The short-term valuations will fluctuate; last year's winners can easily become this year's losers. Stocks like JP Morgan, Goldman Sachs, and Exxon Mobile were laggards in 2020 but top performers so far this year.

As we begin the new year, we're pleased to welcome Kristan Rowland to our team. You'll be hearing more about (and from) her in the coming months. Thank you for the confidence that you place in us, and please call or email with any questions or comments.

Best Wishes for a Happy New Year!

John, Grant, and Kristan

¹ US Bureau of Economic Analysis, tradingeconomics.com.

² Bloomberg, UBS.

³ Bloomberg, UBS.

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