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"If something cannot go on forever, it will stop."

— Herb Stein, Chair of Nixon's Council of Economic Advisors, 1972

Dear Friends,

In our 52 years as investment advisors, we have pretty much seen it all: bull and bear markets, manias, panics, bubbles, the "Nifty Fifty" (50 fast growing stocks in the early '70s) followed by a decade in which the Dow Jones Industrial Average ended up almost exactly where it started. We have witnessed a flash crash triggered by a massive computer failure and the 9/11 tragedy where the environs of Wall Street were targeted as ground zero. The Exchange closed for a week for the first and only time in history. Interest rates? The US Treasury issued a *30-year* bond yielding *13.45%* in 1981 and another a year ago but yielding a paltry *1.88*%. We have seen gold trade at both $35 an ounce and $2,000 an ounce. Michael Milken, the "Junk Bond King," and Bernie Madoff, the "Swindler," both did considerable time in the pokey. Enron acquired Portland General Electric and not long thereafter imploded as Enron's business was exposed as being rife with fraud. Ken Lay, chairman of Enron, passed away before *he* could be sent to prison. Thankfully stocks began to hit new highs with regularity for most of the past 20 years with the occasional time out for a pandemic and bubbly bitcoin. Enough to make an investor go bald. (It did.) Probably self-indulgent, but we thought it might be fun to take the occasion of your writer's last letter to take a serial walk down Memory Lane.

The Great Rise and Decline: 1971 to 1987

It is interesting that the last 52 years of stock market hysterics can rather easily be divided into two environments: high interest rates and low rates with *lots* in between. The 16-year period between 1971 when your writer got started in the biz and 1987 was largely characterized by rising interest rates and high inflation. How high was high? In 1981, our then firm was the co-underwriter for a new bond issue for Pacific Power and Light. Multiple nuclear power plants were being constructed and there was great demand for the capital required to support the construction. Interest rates were stratospheric. The 10-year-in-maturity bond issue for Pacific Power was priced to yield **18%.** (Not a typo.) We opened literally dozens of new accounts on this offering. In many cases, people sold stocks in order to purchase the bonds. Can you blame them? The mastermind of this interest rate scheme was a fellow by the name of Paul Volcker who was appointed chairman of the Federal Reserve in 1979 by President Carter and served in this capacity through 1987. It would be fair to say that borrowers do not hold fond memories of this remarkable period. The rest of us? *A bond-nanza.*

The primary intention of this radical policy was to Whip Inflation Now. WIN buttons were worn proudly by politicians of all stripes starting with President Ford and continuing into the one-term Carter presidency. It would not surprise you to hear that indeed the economy did grind to a halt and that inflation was eventually whipped as a result of punk demand. It also would not surprise you to hear that stocks did poorly in this time. Who needed them?

The Great Reflation: 1987 to 2008

Easy money became the standard for the period between 1987 and 2008, and easy money did what it is designed to do: stimulate. The economy rose sharply but not without some serious air pockets along the way. Partner Marcia Hull was employed by the Federal Deposit Insurance Corporation from 1985 to 1997. Her responsibilities included closing failing banks. If Marcia and her team showed up at your door late on a Friday afternoon, the week was not likely to end well. Y2K (the year 2000) brought with it a great stock market bubble focused on emerging technology companies, a number of which came and went virtually in the blink of an eye. We managed to avoid this trap (being a Luddite does occasionally have its advantages). Our clients' accounts were up nicely in a *declining* stock market in both 2000 and 2001. The following seven years leading up to the Great Financial Crisis of '08 and '09 were supported by an ongoing accommodative fiscal policy by the Federal Reserve, low interest rates and a vast amount of liquidity, which served to create an economic sugar high triggering explosive gains in both housing and the stock markets. The Dow nearly doubled from roughly 7,300 to over 14,000 between 2002 and the end of 2007. In the spring of 2003 the opportunity arose for us to hire Chris Klavins (who had interned with us in 2000) following his start on Wall Street as an investment banking analyst at Merrill Lynch in New York. Our business had been growing rapidly in part due to a cover story on us in *Money Magazine* followed by a *Barron's Magazine* article as among the Top 100 brokers in the country. West Coast Bank Corporation invited Steve to join their board, a wonderful 13-year-long opportunity to experience building wealth for shareholders from the inside out. The primary driver of the economy at the time was excessively cheap and readily available money supplied to the economy by governmental entities. It was a classic case of pouring gasoline on a fire. Led by Congressman Barney Frank, Congress came up with a home loan program for people who had *no* money for a down payment. When asked about the risks associated with this policy, Congressman Frank said he wanted to "roll the dice." Less than two years later we got a reading on the dice throw… snake eyes. From a high of over 14,000 in October of 2007 the Dow declined to a low of 6,470 in March of 2009, a decline of 54%. The great banking crisis that began with the failure of Lehman Brothers in September of 2008 spread into banking across the country and resulted in nearly 500 banks being closed. It was at this time that your investment team made a decision to accept an offer from Royal Bank of Canada to join their wealth management business here in the United States. RBC was ranked as the fifth safest bank in the world and we felt there was a mandate for your capital (and our reputation) to have such a warm home.

A Do-Over: 2009 to 2015

Those of you who have had the pleasure of raising children undoubtedly can remember your child's plea when something of importance to them ran afoul: it was common to hear a full cry plea for a *do-over*. That's basically what happened mid-year in 2009. While we had done a fair amount of purchasing stocks in late 2008 and early 2009 as prices fell, it's never enough once stocks begin to move back up. A dreaded case of FOMO (fear of missing out) was setting in. Cash earning one-quarter of 1% was no longer king and had, in fact, become a headwind for returns. The low rates and the vast amount of liquidity the Fed injected into the system stimulated the economy and eventually triggered sharp gains in the stock market. Thus began the market's six-year-long slog back. One piece of the puzzle we hoped and expected to see was a return to normalcy in the bond market. But the Federal Reserve would have none of it.

Fed Funds rates that were as high as 5% in 2006 fell to less than 1% in 2008, then stayed there through 2015. Under those conditions stocks understandably became the only game in town. Think here: stocks on steroids. In July of 2015 we wrote the longest client letter in our history of writing the letters at six pages. Our opening quote (we have a ball digging up metaphors) was taken from the 1976 film *Network* and reads: *"I'm as mad as Hell and I'm not going to take it anymore!"* And we were. Greece only allowed depositors to take 50 euro a day out of bank accounts due to a run on the banks which were, by the way, broke. China reported to the world growth of precisely 7% in the second quarter of 2015, *their target*, a figure the generous folks at the Wall St. Journal reported as being "unlikely." Puerto Rico lobbied Congress for a change in the law that would permit the commonwealth to file for bankruptcy which, if granted, would allow them to repudiate their debt at the expense of the bondholders. Cyprus, that warm, sleepy Mediterranean clime, found it expeditious to welcome Russian oligarchs' money, which in turn was invested in Greek bonds. See above. This strategy did not work out well for the Russians or the Cypriots. Our own Federal Reserve's hyper-low interest rate policy was designed to stimulate the economy and literally force capital to become risk assumptive. The result was that stocks became hyper-expensive in relation to earnings and other metrics we use. Between the market's 2009 crisis year-end low and the end of 2015, the Dow moved up in price by 67%. Our letter at the time offered, *"The current policy distorts the economy in ways we cannot fully understand. Not only because it is unprecedented but also because of the massive scope of the US economy. What <u>are</u> the good folks at the Fed thinking?"* The stock market declined 2.23% after dividends in 2015 despite the steroids.

The Home Stretch: 2016 to 2022

We headed our January 2016 letter by quoting from Shakespeare's Macbeth: *"Double, double, toil and trouble, fire burn and cauldron bubble… ."* The S&P 500 at the start of the year was trading at a fearsome *23.5x* earnings, a level which had been seen on only three occasions in the preceding 45 years. Interest rates on the two-year Treasury closed the year at a stingy 1.2%: all measures screaming *risk!* We referred to ourselves as resembling the *Cowardly Lion* who possessed the unique capability to even scare himself. Despite the odds the year finished up 12%. Given badly stretched valuations, surely 2017 was destined to finish in the red: your proverbial long overdue "correction." For inspiration we quoted Bob Dylan: *"The times they are a-changin'."* Wrong again. The S&P finished up *over 20%*. (Time to shop for a new crystal ball.) 2018 did produce a respite but, as buying opportunities go, down 6% hardly rated a footnote. A world class aberration *had* to be in the works. It was. But as it turned out, the aberrant behavior in 2019 arose in the *bond market*. The one-year Treasury started the year at roughly 2.6%. With the arrival of COVID came annual rates as low as ***0.14%*** (not a typo… and that's before tax!). The confluence of stunningly low interest rates and a dramatic 34% drop in the stock market gave way to a new acronym for stocks: TINA. As in *There Is No Alternative*. A substantial portion of the considerable cash we were holding on your behalf was widely put to work in bargain priced equities. Also helpful were holdings in both Pfizer and Gilead which seemed to trade up each time Dr. Fauci spoke. This may well have been a case of a blind squirrel finding an acorn, but we will take the acorns regardless of how we get them.

Between January 2020 and July of 2021, we penned a total of *seven* mini COVID client letters. As we think back about it, a certain reality emerges. We were trying to explain things as much to ourselves as we were to you. The playbook for pandemics was badly dated (the Great Influenza Epidemic of 1918).

The inspiration to invest aggressively in part arose from a Wall Street Journal editorial by the articulate Peggy Noonan: *"What do we know? We'll get through it. We'll learn a lot and it will be hard but we'll get through, just like all of the last times."* The S&P 500 fell 34% in just over four weeks. The Feds did their part by air dropping greenbacks serially. The economy proceeded to surge ahead despite the shortages of peanut butter and toilet paper. Pharmaceutical companies (which we widely owned) came through as 30-year mortgages fell to 2.75%. Home prices sky rocketed: an economy on steroids. The problem with this rosy scenario was predictable: runaway inflation coupled with gamification of the stock market. Read here: *RISK*. What else was there to do when "working" from home than day trading stocks while riding your Peloton stationary bike? In February of 2021 we expressed our concerns in a one pager headlined by a 1929 quote taken from comedians Laurel and Hardy: "*Well, here's another fine mess you've gotten me into.*" Between December of 2020 and the summer of 2021 we had two companies acquired outright and sold a few others, reducing your overall exposure to stocks in favor of short-term CDs and bonds. Good thing this, as the steroid induced stock market finally topped out very early in 2022 as the S&P 500 traded at among the highest valuations in relation to earnings in its history. The resulting nine-month-long decline of 26% did serve to unwind much of the excesses to include crypto, but markets are now struggling as they try and assess the odds of a recession. TINA has been chased out of town with the arrival of 4% plus returns on one-year CDs. Nothing remotely like the 13.45% we cited a couple of pages ago but certainly a welcome respite from *point-one-four-percent*!

Everything in Moderation. Including Moderation.

Much of the recent past can reasonably be characterized as one of the great if not the greatest speculative excesses of your team's years in the biz. Day trading options, crypto "currencies," which we have frequently editorialized against, and SPACS (Special Purpose Acquisition Companies) wherein you put up your money without knowing how it will be invested (can you even imagine such a thing?) are examples of the kind of excesses that tend to populate the market just before the big wheel goes into reverse. If the Federal Reserve is serious about getting inflation down to 2% as they say, interest rates most likely still have a way to go before topping out. A good deal of demand is in the process of slowly getting extinguished. If all of this is starting to sound highly opinionated, you are correct. But in bear markets it is the person who loses the least who wins. We aspire for you to be in that camp.

More constructively, we are witnessing a change in market leadership. It is no longer lodged in the likes of Tesla (down from over 400 to 119), crypto player Coinbase Global (down from 365 to 43), Shopify (squished from 177 to 37) nor Peloton which swiftly pedaled downhill from 171 to 10. Where we are beginning to see intrinsic value is in more prosaic companies that are transparent, extremely well financed, generate free cash flow, benefit from new technology and pay excellent dividends. *Wonderfully* old fashioned, eh? Companies meeting these criteria will also benefit from the opportunity to repurchase stock at bargain prices if they so elect. *Warning label*: Patience will almost certainly be required. More often than not it takes time for the stock market to fully reflect new realities. After 52 years we have come to accept that anything can happen. A recession before year end is not out of the question; but we will do well to remember that recessions are a swell time to scoop up bargains!

Warmest regards,

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January 20, 2023

Dear Friends,

There is an old adage which reads, “When you find your *one thing*, no matter what it is or how long it takes, *you will know it in an instant*.” That was the story for your writer. My maternal grandfather was, as they referred to it in the fifties, a “Customer’s Man” or, as we have rebranded ourselves today, Financial Advisors. I was fascinated by the scope of his work, the seriousness of his intent and his cover to cover reading of the *LA Times* and the *Wall Street Journal* daily. For him it was always about meeting the challenge to include the Great Depression. Then there was the fact that people genuinely respected and loved him. From the time I came to understand and appreciate what this collectively meant, there was nothing else I aspired to do in order to earn a living.

Just a few challenges stood in the way. I was 24 years old at the time, a freshly “retired” naval officer, had just slightly above average grades throughout college, and the only sales experience I had was selling women’s shoes at Leeds and Chandlers shoe stores on Saturdays and in the summers. I proceeded to interview with enough firms that I eventually figured out the right answers to the recurring questions. My favorite? “If we hired you today, how would you go about building a clientele?” Right answer? “All I need is a phone and the yellow pages.” The most aspirational interview I managed to land was with one of the top investment banks in the country at the time, Blyth Eastman Dillon. After interviewing at the branch followed by regional office I was given a plane ticket to New York where I interviewed with two of the partners and, for reasons not clear to me then nor now, landed the job. I worked hard and developed a substantial clientele over a four-year period despite a protracted bear market when I was summoned to the regional office and was offered the opportunity to move to Portland and manage the firm’s offices there. I had been to Portland only twice but loved everything about the place including Governor McCall’s very clever entreaties to “Please visit but don’t stay.”

I stayed. It is from these roots and subsequently with decades of support, hard work and commitment from “ancient” partners Marcia Hull and Chris Klavins (as well as retired partner Kip Acheson) that we built the business. In more recent times our resident planning wizard and CFA® charterholder, Sam Manafi, and our crack client service team, Kathy Crocker and Shana Heyden, have contributed greatly to favorable outcomes for our clients and to our growth. This “Gang of Five” is truly the best I have seen in my 52 years on the job. To you all I say, I will miss your smiling faces every morning and the degree of professionalism you bestow upon both clients and co-workers. Thank you from the bottom of my heart for what you all have done for our clients and for me personally.

Tempus Fugit

Before you reach for your Latin dictionary, allow me to translate: *Time Flies*. And it has. It occurred to me recently that eventually you reach a point when you stop lying about your age and start *bragging* about it. I crossed that line about 18 months ago. Probably a pretty good indication that your writer’s time has come. That and the increasing frequency with which I have noticed vultures circling over our back yard.

As you probably have observed from prior client letters, we are *BIG* fans of *Wall Street Journal* editorialist Peggy Noonan. Over the years we have quoted her often. Two years ago she wrote a piece in which she in turn quoted a writer by the name of Laurens van der Post dating to 1961. It read: *"We live not only our own lives but, whether we know it or not, also the life of our time. We are all making history together, we are part of an era, and we are responsible to each other and to this great project."* Hits <u>really</u> close to home! Truth often does.

There is literally no way I can express my appreciation for the opportunity to be a part of *your* lives, dear clients and friends. The fact is that, in a great many cases, our relationship goes back decades. The trust you have placed in us is humbling, inspiring and *deeply* appreciated. I cannot say *thank you* enough.

Last April now retired Duke basketball coach Mike Krzyzewski coached his last game, which ended in a loss to North Carolina. The Wall Street Journal reported the following final parting comments from Coach K at that moment: *"I'll be fine. I've been blessed to be in the arena. And when you're in the arena, you're either going to come out feeling great, or you're going to feel agony, but you always will feel great about being in the arena. I'm sure that's the thing I'll look back and miss. I won't be in the arena anymore. But, damn, I was in the arena for a long time. And these kids made my last time in the arena an amazing one."* Thank you Coach K for getting it precisely right for this soon-to-be former player. It has truly been *<u>fabulous</u>* for me to have been in the arena with all of you for a very long time!

Outside of the time Barb and I will be visiting kids, grandkids, and the occasional outing in the Salish Sea, we will be hanging out at our home on Orcas Island in the San Juans. The house line is 360-376-6103. Our physical address is 5596 Deer Harbor Rd., WA 98243, and our mailing address is PO Box 374, Deer Harbor, WA 98243. We are planning to do a tech reboot including a new email address for Steve in the coming weeks. If you are up our way, please write or call. The team will have our then current contact information.

Fair Winds and Following Seas to you all!

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