Barrett Capital Partners

4th Quarter 2022 **Newsletter #6**

	Q4	2022
S&P 500 TOTAL RETURN	+7.6%	-18.1%
US AGGREGATE BOND TICKER: AGG	+1.3%	-13.06%

Predicting the future is…difficult.

2022 won't make the Greatest Hits album

Happy New Year! 2022 was far more exciting than we would have liked. We had war in Europe, cryptocurrency collapse (which we watched from far, far, away), and a record bad year for stocks and bonds. On the positive side, Joe and his wife Christine welcomed Quinn Mary Barrett into the world in April!

Looking back on a record bad year, we can seek comfort in the continued strength of the economy, despite the Federal Reserve's best efforts to slow it down. The overwhelming expectation for 2023 is that the Fed's higher rates will bring the US into a recession[1]. ***But predicting the future is…difficult.***

Here are some important highlights from the last year:

The good:

- 2022 saw the largest number of people employed in US history: 153 million. And unemployment in December clocked in at only 3.5%. You would need to go back to the 1960s to find a lower unemployment rate.
- The US added 223,000 jobs in December. That's less than the 400,000 average over the year, but it's probably because there's nobody left to hire.

[1] There are ***two,*** very different, definitions of a recession.
The classic economic definition of a recession: Two consecutive quarters of negative GDP.
The National Bureau of Economic Research definition: A significant, pervasive, and persistent decline in economic activity.

- Mastercard reported that holiday spending increased by 7.6% over 2021, including a 15% increase in restaurant spending. Most of the increases were due to higher prices, so consumption was just about in line with last year.

The bad:

- -19.4% was the return of the Morningstar Total Market index
- >30% loss for the Technology index
- -15.7% for the Morningstar Corporate Bond index
- The Long-Term Bond index, which tracks bonds that mature in greater than 10 years, **lost 27%**
- Since 1940, the S&P 500 had bigger losses in only three years; 1974, 2002, and 2008.

Economic Outlook

Over the past year, we have remained more optimistic than most about the economy and believe that broad economic fears are overblown. As it stands right now, we have record employment numbers and healthy consumer spending. Business surveys are anticipating healthy revenue growth through 2023.

That being said, the Federal Reserve will continue raising rates until inflation is under control. We don’t believe that the economy has fully digested the 2022 rate increases yet, but we are beginning to see signs of inflation moderating (which is good!).

The economy *will* cool down. Growth will slow but it will likely still be positive, and unemployment will head towards a higher—and we think healthier—rate.

Will the economy register two consecutive quarters of negative GDP and fulfill the recession definition? Maybe.

Will we get a "significant, pervasive, and persistent decline in economic activity"? ***We think that's unlikely.***

Will 2023 reverse the losses?

Large corrections have historically had above-average market returns in the years following. In an analysis done by JP Morgan, the market returns an average of 83% in the 5 years following a correction of at least 25%.

Valuations across both stocks and bonds look attractive. In our view, the market sold off indiscriminately though 2022, leaving opportunities abound. The tech sector had a particularly rough year, but that was the result of too many companies whose business model was more focused on making the founders rich than rewarding their shareholders.

Tech companies that are *actually successful* and make money were caught up in the carnage, which doesn't look good on your statement but gives us more opportunity to participate in future returns. We can't possibly forecast if those returns will be in 2023, 2024, or 5 years from now, but we can invest now to take advantage of those returns in the future.

Revisiting Our Philosophy

This letter talks a lot about "value" and "opportunity." At the end of the day, the practice of investing is about receiving a return on your invested capital.

Our goal is to invest in growing businesses that generate meaningful cash flow and to buy them at good prices. I know that sounds simple, but history is littered with the failures of smart people who tried to make it harder than that.

Ideally, the management team will own LOTS of their own stock and have incentive to make good decisions. Take Amazon for instance. Chairman Jeff Bezos, owns 10% of the company, while CEO Andy Jassy owns shares worth $180 million. Jassy also has stock options in the nine-figure range that vest over the next 10 years. Almost all their net worth is tied to the performance of the company. That is a lot of incentive.

We like to see products and services that are "sticky" and have high switching costs. Software as a Service (SaaS) companies that work with large firms tend to have high switching costs, which also means pricing power and the ability to upsell other services. We like similar stories within consumer brands that have high loyalty. Think credit cards or alcoholic beverages.

Most importantly, we want to see companies generating ***cash flow*** and investing in future growth opportunities. This could be in the form of a bank fueling growth through the acquisition of smaller local banks. A technology company could be investing in cloud services. A soda company could be inventing new flavors or acquiring smaller brands, which in turn increases their market share and pricing power.

We hope that this gives you a better understanding of our process and how we invest your assets. As always, if you have questions, we would be happy to discuss any of this in more detail. ***We mean it***. It's Joe's favorite thing to talk about.

We'll see you soon,

Patrick and Joe

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