# Barrett Capital Partners

**1st Quarter 2022** **Newsletter #3**

| | Q1 | YTD |
| --- | --- | --- |
| **S&P 500 TOTAL RETURN** | -4.60% | -4.60% |
| **US AGGREGATE BOND TICKER: AGG** | -6.12% | -6.12% |

## Baby Barrett!

On Sunday April 3rd, Joe and his wife Christine welcomed Quinn Mary Barrett to the family! Christine and Quinn are both at home, happy and healthy! Quinn is the first grandchild on both sides of the family, so everybody is very excited to spoil her, and she already has her dad wrapped around her finger!

## First Quarter Roundup

***Historically, the stock market endures a fall greater than 10% roughly every other year,*** and a 25% fall once every six years. We endured that every-other-year drop in Q1, losing about 12% through mid-March. But the good news is that investors saw value at those levels and the market rallied, ending the quarter down only 4.6%.

High-growth technology companies have been the hardest hit this year, with 40% losses looking almost ordinary. Investor appetite for unprofitable tech companies is waning, and investors are again seeing value in owning the basics like Coca-Cola and Walmart. We have long been weary of companies that lose hundreds of millions of dollars being valued at $50 billion. Instead, we prefer to own companies that *actually make* money and return that money to you, the owners. More on this later…

***The US bond market is roughly the same size as the US stock market.*** Through the end of the first quarter, the bond market lost more than 6% due to a combination of rising rates, high inflation, and increased market risk. While seeing the values of our bond holdings down 5-10% doesn't quite invoke happiness, it does make the *future* bond returns look brighter, as the interest rates paid by your bond holdings will be higher. In the meantime, we should all be prepared for continued volatility as the interest rate environment normalizes.

## Roaring (*of heavy artillery*) Twenties

Since February, the top story in every news outlet has been the war in Ukraine. We think we speak for most when we say that we're praying for the innocent victims caught in the middle of a brutal dictator's ego trip. ***We like to think that there is a room full of very smart people somewhere working on a solution, but that's probably optimistic.***

While the events in Ukraine are horrible, from our perspective as investment managers, the landscape has not changed dramatically. Russia has roughly the same GDP as the state of Florida, and Ukraine about the same as Nebraska. Their combined exclusion from the world economy should be akin to a small mosquito bite. It itches now and again, but you'll never notice it while walking to the beach.

Where the world *is* seeing fallout from this conflict is in the price of energy. Russia is one of the largest exporters of oil and natural gas, so the sanctions imposed by the US and European Union have increased the prices. We are by no means geopolitical experts, but it seems like Putin has crossed the line for the US and EU, who appear willing to endure higher energy prices to punish Russia. The sanctions are a much bigger pill to swallow for the EU than the US, as Russia accounts for somewhere around 40% of the natural gas imports (sources differ on this number, ranging anywhere from 35-50%).

## Moderating our Outlook

*We are optimistic about the direction of the economy*. Consumers have continued their spending sprees, and credit card debt has not increased meaningfully. The Federal Reserve is going to raise rates this year in an effort to fight inflation (a process that probably should have started a couple years ago) but we believe that the economy can handle rates in the mid-single digits and tend to believe that it would actually make for a healthier economy.

The low-rate environment over the last 20 years has allowed weak companies that should have failed to survive on cheap debt. It will be lovely to watch great companies with strong management teams continue to outperform, and slowly eat the weak.

## "Price is what you pay. Value is what you get."

*Welcome to this edition's "education" section. More than ever, we've been asked about our investment philosophy and how we choose certain investments. So we'll talk about how*

*the companies you own return value to you, and what we look for in a company before investing.*

At the end of the day, the practice of investing is about receiving a return on your invested capital. There are three main ways that companies return capital to their investors:

- **Value**: Probably the most popular way to return value to shareholders is through increasing the value of the company, AKA share price. It's also what investors keep their eyes on most.
- **Dividends**: The second most popular way to return value to shareholders is through cash payments to the owners of the company, representing a part of the company's income. We usually see dividends paid by companies with low growth prospects such as utilities, whereas tech companies use their cash to invest in growth opportunities to increase share price.
- **Increased ownership / Buybacks**: Companies that generate lots of cash can purchase their own shares on the open market, and essentially eliminate them. The decreased share count *increases* your ownership in the company and your share of the earnings.

Our process*:* Our goal is to invest in growing businesses that generate meaningful cash flow, and to buy them at good prices. I know that sounds overly 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 therefore have incentive to make good decisions. Take for instance Amazon. The Chairman, Jeff Bezos, owns 10% of the company, while CEO Andy Jassy owns shares worth $280 million. That's 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 such as athletic wear, beverages, and cosmetics.

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 small local banks that have excess reserves. A technology company could

be investing in cloud services. A soda company could be investing in new flavors or acquiring smaller brands, increasing their market share and pricing power.

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

As always, any feedback you have is appreciated!

We hope you get out and enjoy the weather, and we'll see you soon,

Patrick and Joe

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