HARRIS ASSOCIATES

PRIVATE WEALTH MANAGEMENT

Fortune Favors the Patient

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"When sorrows come, they come not single spies, but in battalions." **-- Shakespeare**

2022 is now behind us— that is perhaps one of the best things we can say about it. Concerns that started the year are still front and center, though some of those are beginning to moderate. Unfortunately, the war in Ukraine wages on, but inflation—still the overriding concern for the global economy— is showing signs that it is beginning to cool. A high profile blow up at crypto exchange FTX has now put people on notice, if they weren't already, that "alternative" asset classes come with risks that can be consistent with speculation at best and gambling at worst. The environment for equities was also weak, with the high-flying names of the pandemic era coming crashing down to earth, leaving some portfolio managers who were heralded as visionaries during that time with losses of nearly 70%. Nevertheless, there were few places to seek refuge this past year, regardless of asset class or investment style. Even the historically stoic bond market fell victim to the year-long sell-off, a rare phenomenon where stocks and bonds declined concurrently.

To quote Chinese philosopher Lao Tzu: *"If you do not change direction, you may end up where you are heading."* One of the generally agreed upon interpretations of this maxim is a warning, or call to action, encouraging people to change their path lest they end up sticking to one with little happiness, promise or opportunity. For us long-term equity investors, however, what he offers is sound financial advice! Our response should be, "Good. I want to end up where I'm heading." In other words, stay the course and the odds of achieving one's financial goals greatly improve. Too many investors begin on that path, but get distracted by some new shiny object that seduces them into hopes of immediate gains (e.g. dot-com stocks, crypto currency, NFTs, SPACs, Beanie Babies, Dutch tulips, etc.). People like the idea of owning stocks and accumulating wealth over time, but does it have to take THAT much time? Due to the insolvency of several crypto platforms, some people are accepting just pennies on the dollar in the hopes of getting any of their initial investment back at all. "It was a life lesson learned in that there are very few opportunities to rapidly gain wealth without massive risk" one investor reflects.

Reputable venture funds were not immune from the lure of some of these alternative assets. Sequoia Capital was forced to write off all of its $150mm investment in FTX and famed hedge fund investor Peter Thiel owned 19% of now defunct BlockFi. Governance was so poor at FTX that its newly appointed CEO lamented, "Never in my career have I seen such a complete failure of corporate control." And that's coming from the same person who cleaned up Enron's bankruptcy decades ago! We've touched on the topic of crypto currency in past letters. Even prior to the implosion of FTX and others like it, we at Harris Associates had not been able to determine either how to value or what economic function crypto currencies provided. In retrospect, their popularity came at a time when speculation ran hot, they were being heavily advertised and promoted by celebrities, and for a finite time at least, the trade was working, even if some of those trading it were unsure as to why. It looks to be inevitable that the crypto industry will be undergoing far more regulatory scrutiny, which would likely eliminate the anonymity that has driven so much of its appeal in the first place.

re·sil·ience
/rəˈzilēəns/
The ability of a substance to return to its usual shape after being bent, stretched, or pressed; the capacity to recover quickly from difficulties; toughness.

There have been few instances in history where there isn't some macro concern that could compel investors to get out of stocks. However, taking into account the many wars, recessions, bear markets, and geopolitical disruptions that this country and world have experienced over the past century, U.S. equities have proven to be as reliable a method for accumulating long-term wealth as any other asset. As unnerving as years like 2022 are, they happen with some regularity. In any given year we can expect a peak to trough move in stocks somewhere on the magnitude of 14%, and every five to six years we can expect a bear market with returns down in excess of 20%. The catalysts for these will always be different, but the occurrences shouldn't be surprising. And while there is never a guarantee that equities will recover and make new highs, as of this writing, there is no point in history where they haven't.

We will be the first to admit that some of the stocks we owned this past year performed miserably. Even with the most rigorous due diligence and vetting efforts, mistakes happen, or the market overreacts and drags down good companies whose fundamentals we believe should support a higher stock price. When money is cheap, the market is driven by disruptive and emerging technology stocks. In bear markets, dated terms like profit and free cash flow re-emerge. Harris Associates only invests in established publicly traded companies that by definition are regulated and have audited financial statements. We rely on experience, process, and discipline when determining investment opportunities. If we make a mistake in our analysis, we will dispassionately move on.

Whether or not we are in, or will enter a recession, is, according to Federal Reserve Chair Jerome Powell himself, "not knowable." I am not smart enough or dull enough to be an economist, so I don't have the appropriate pedigree to second guess Fed policy on how that ultimately plays out in the financial markets. However, with gasoline prices, apartment rents, and housing prices all on the decline, these signs of easing inflation provide hope that the Fed will have reason to dial back their pace of rate increases.

As far as what the year ahead holds for stocks, the short answer (and realistic one, for that matter) is we don't know. Pundits on TV make forecasts on such matters not so much because they know, but because they are asked, even though their track record is dreadful. The inability to accurately and consistently predict short term market outcomes diminishes these forecasts into nothing more than guesses, which is why we are resistant to offer anything that may resemble one. A promising data point, however, is that since 1950, stocks have historically been strongest the year after midterm elections, so let's hope that past is prologue. Regardless of market conditions, we advise trying to maintain at least 12 months of cash to cover living expenses so as not to be forced to sell stocks at an inopportune time.

The silver lining on the types of markets we experienced over the past year is that they provide plenty of good investment opportunities for those who are patient enough to let them play out. Alphabet (the parent company of Google), for example, is a market leader. However, it now trades at just a market multiple of earnings, which implies that it is no more valuable than the average company—this strains our credulity. Alphabet is just one example of many out there where we feel a company's stock price dramatically underestimates its business value. We at Harris Associates will continue our process of analyzing and investing in companies that we feel are cheap relative to their long-term value, have a clear path for growth, and are run by management teams that think and act like shareholders.

As always, we thank you for entrusting us with your investment assets and your continued support. Lastly, the best compliment we can receive is a referral from a satisfied client. We appreciate your referrals and handle them with the utmost care.

As a postscript, here are a few events from the past year that we can hopefully all celebrate:

- Maya Angelou became the first Black woman to be featured on a U.S. quarter.
- Ketanji Brown Jackson was confirmed as the first Black woman ever to sit on the U.S. Supreme Court.
- World poverty is down from approximately 50% In 1970 to less than 9% now.
- Italy recently implemented a law that requires all supermarkets to give unsold food to the needy. Starbucks has pledged to do the same in the U.S.
- Up from just 2,000 in 2020, the monarch butterfly population in California has increased to over 250,000.
- Jonathan the Tortoise, the world's oldest living land animal, celebrated his 190th birthday.

We wish you a happy, healthy and prosperous 2023!

Andrew M. Gluck, CFA
Portfolio Manager

Back Row: Zorica Zdravkovic, Tom Delaney, Andrew Gluck, Alix Havey, Ian Horvath, Clyde McGregor, Kate Feit, Alexander Cyrus
Front Row: Mark Small, Kaylin Price, Michael Mangan, Emily Neumark

Harris Associates, 111 South Wacker Drive, Ste. 4600, Chicago, Illinois 312.646.3600