ALTA CAPITAL MANAGEMENT
A member of Guardian Capital Group Limited

MARKET LETTER

March 2023

2023: The Battle of Bulls and Bears

The United States witnessed a somewhat rare outcome in financial markets in 2022: both bonds and stocks delivered annual negative returns, something not seen since 1969.   Even more significant, the investment returns were materially negative, with double-digit percentage losses in major US bond and stock indices.   As 2022 closed out, the markets were discounting elevated levels of inflation, uncertainty, and recession risk.

The opening weeks of 2023 suggested markets ended 2022 too bearish. January saw the S&P 500 return 6.2% and the tech-heavy NASDAQ return 10.7%.   Speculation grew that the Federal Reserve could pause interest rate increases by mid-year and markets tend to do well once a Federal Reserve rate-hiking cycle ends.

The January optimism was followed, however, by stubborn inflation data that again put the need for higher interest rates in the spotlight. Amid the continued inflation debate, the first significant fallout from rising rates surfaced: Silicon Valley Bank failed and other regional bank stocks faltered as the rapid move in interest rates increased unrealized losses on fixed income assets and an old-fashioned bank run ensued. The S&P 500 gave back most of its January gains by mid-March, only to rally back in the last two weeks of the quarter and close +7% for the quarter.

Alta Capital structures equity portfolios to weather both up and down markets, looking for quality companies that can sustain robust free cash flow and returns on invested capital through an entire economic cycle. One reason for this strategy is not necessarily confidence inspiring: we humans are notoriously bad at predicting economic and market movements over the near term, so it's best to prepare for both good and bad outcomes. Some of the most proven investors over time, Warren Buffett, Howard Marks, and Ray Dalio, have been successful while simultaneously admitting they don't have any special crystal ball to predict what may happen over the next six to twelve months, and in fact, actively avoid making investment decisions based on such predictions. We at Alta believe the success of these long-term investors is due, in part, to their decision to eschew reliance on short-term predictions to generate lasting, long-term investment returns.

With this preamble, we will make one short-term prediction: 2023 will likely be a year of fits, starts, and overanxious markets in either direction. Only hindsight reveals when a bear market ends, but according to a Wells Fargo Institute study, the average 12-month return after the end of a bear market is 43%. Bulls suggest the bear market ended in October 2022, while bears see a distinct possibility of still lower lows ahead. But with an average annual return of 43% if the bulls are right, greed is again competing with fear after being largely absent in 2022. Thus, 2023 may deliver a heightened bull vs bear battle.

Staying true to our process, we won't pay much heed to the 2023 prediction outlined above. We believe the companies making up our portfolios are poised to deliver solid free cash flows regardless of the exact timing of the end of the bear market. And if the economy inflects upward by the end of 2023, free cash flow growth within our portfolio companies should be robust.

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The S&P 500 is an index of 500 stocks designed to reflect the risk/return characteristics of the large-cap universe.

The NASDAQ (National Association of Securities Dealers Automated Quotations) is an electronic stock exchange where investors can buy and sell on an automatic computer network.