SMEAD capital management

Missive

DECEMBER 14, 2021

No Doubt Investors

Dear fellow investors,

You and me, we used to be together

Every day together, always

I really feel that I'm losin' my best friend

I can't believe this could be the end

It looks as though you're lettin' go

And if it's real, well, I don't want to know

In the depths of the lockdowns in March and April, we were together at home, day after day. The U.S. Federal Reserve Board pumped large amounts of liquidity in our economic system. The U.S. Federal Government followed by providing large amounts of fiscal stimulus in PPP loans, stimulus checks and other incentives to keep households and businesses afloat, while the economy took the worst body blow from a government-induced panic and recession it had ever withstood.

As we have walked forward from this moment, policy makers have begun to recognize that their entreaties toward the economy have been accepted and raised to a heightened level. The monetary and fiscal stimulus wasn't met with a tepid sigh, but a barbaric roar. We saw houses and cars take off to the forefront of inflationary pressure. These assets have often been inflections in economic history. Investors have decided that if it's real, they don't want to know. Ten-year-yields on Treasuries and break-even rates have in no way priced in the inflationary risks that are real in the present.

Don't speak, I know just what you're sayin'

So please stop explainin'

Don't tell me 'cause it hurts

Don't speak, I know what you're thinkin'

I don't need your reasons

Don't tell me 'cause it hurts

Chairman Powell has communicated to consumers that the Federal Reserve will be "retiring transitory." To us, this is the largest mea culpa in the last 40 years of Federal Reserve policy. It's embarrassing enough that even if Paul Volcker was alive, he would blush. He took as big of a political pounding to break the 1970s inflation than almost any Fed Chairman has taken.

The consumer and businesses, more than the academics today, know what the chair is sayin'. As Nassim Taleb wrote in his book *Skin in the Game*, "To emit a Yogiberrism, in academia there is no difference between academia and the real world. In the real world there is."

It hurts to see the amount of liquidity with this economic strength taking place. It hurts to see home prices climb for buyers. It hurts to find out how long you wait to get your appliances. It hurts to learn when cars will actually be available to purchase and that the used one is more expensive than new MSRPs. Regardless of the reasons for this error, consumers and business do have skin in this game and it hurts.

Our memories, well, they can be inviting

But some are altogether mighty frightening

As we die, both you and I

With my head in my hands, I sit and cry

Don't speak, I know just what you're sayin'

So please stop explainin'

Don't tell me 'cause it hurts, no, no, no

Don't speak, I know what you're thinkin'

And I don't need your reasons

Don't tell me 'cause it hurts

Investors today have these inviting memories of low-inflation, stable bond prices and booming stock markets. The flip side of these are "altogether mighty frightening." Plausibly negative equity returns, bond losses and an end to euphoric animal spirits is frightening. As our Chief Investment Officer, Bill Smead (occasionally called dad) recently wrote in his piece "Inflation is a Wolverine," the inflation that we are seeing is a wolverine. There is no natural predator to kill it off. It's not a cute, adorable puppy. The only thing adorable in 10 years will be listening to the stories of investors that thought they wouldn't have to deal with prior tough equity eras like the 1970s and 2000s. We refer to these as stock market failure. Many millennials that have just begun their investing journeys will have their "head" in their "hands" while they "sit and cry."

It's all ending

We gotta stop pretending

Who we are

Consumers and households across the developed world are fatigued by the first four waves of this pandemic. We believe this will only grow with the waves to come. We believe this translates to a spending of the excess savings and net worth that U.S. and developed economy households have. The pandemic-induced liquidity catalyzed habitual spending going forward. Down the road, borrowing habits will reinforce this spending and will propel the

economic success of the next 10 years. We are no longer pretending who we are. As British politician Steve Baker recently opined, "This is a moment where every last one of us should in good faith start thinking about what it means to live with coronavirus like we live with flu."

You and me

I can see us dyin'

Aren't we?

The number one cause of death is life. We will all die, even Elon Musk. The world has come to grips with the reality of that because of this pandemic. As Musk said last week, the biggest risk to economic growth is not enough people being born. We would say not enough life. Life being lived. In the face of COVID death, consumers are excited about life, private property ownership and getting out. This is acutely human in a finite life, but not what investors had been pricing in. We are "no doubt" investors in the economic story ahead. Few stand among us. Inflation is real. Poor stock and bond returns can be real. We believe pools of wealth will be hurt and/or will die from this.

Fear stock market failure,

Cole Smead, CFA
President & Portfolio Manager

This missive and others are available at www.smeadcap.com.

SMEAD capital management

smeadcap.com

2777 East Camelback Road
Suite 375
Phoenix, AZ 85016

Sales Desk US 877.701.2883
Sales Desk UK +44 (0)20.8819.6490
info@smeadcap.com