January 15, 2022

For the year ended 2021, client accounts, in aggregate, finished modestly ahead of the S&P 500, which rose 28.8% for the year.

Stock price volatility returned late in 2021 and continued into January of this year. While large companies like Google, Apple and Microsoft finished 2021 near all-time highs, the stock prices of many smaller businesses declined. The fastest growing technology businesses, many of which soared in value in 2020, were particularly hard hit. We did not have much exposure to this group of stocks.

The recent market volatility largely reflects concerns about inflation and how the Federal Reserve will react. Since last April the consumer price index has increased at a concerning pace. That's partly related to temporary supply constraints meeting strong demand. Covid illnesses kept factory and logistics workers at home, slowing the delivery of semiconductors and other components. That in turn led to shortages of cars and appliances. Those supply chain pressures should ease this year. However, there is concern that price increases in housing, gas, and other goods will persist given continued strong demand. The Federal Reserve has suggested it will raise interest rates several times beginning this year to ease demand and pricing pressures. Investors worry that those moves will slow economic growth beyond the intended effect.

As a general rule I look for businesses that can prosper in a range of economic environments, including recessions. That said, I'm not pessimistic about the economy. Even after a series of Fed rate hikes interest rates will likely remain near historic lows. In addition, personal savings levels remain at historic highs, which should support consumer demand.

Notes on specific holdings

One of the few disappointments last year was our investment in Twitter. Twitter occupies a unique niche in social media as a network connected by shared interests. The site is an active forum for professionals and hobbyists, with topics that range from public health to entertainment. Twitter's large user base means you can find informed (and uninformed) commentary on most topics. That attracts more users, making the platform even stronger.

The company's challenge is that its format is ill-suited to "click-through" advertising, which accounts for much of online ad spending. In addition, Twitter has been unable to charge for invaluable marketing services that it provides to content creators. My investment in the company was based on the idea that Twitter would find new sources of revenue, such as subscription fees for premium content. Unfortunately, despite saying the right things, the company hasn't made progress. At the same time, the share prices of many high-quality businesses have fallen to more attractive levels. As a result, I decided to sell our investment in Twitter and reinvest the proceeds elsewhere.

As an example, I added to our holdings of Sea Limited after the share price fell. Sea owns a highly successful mobile gaming platform. The company has invested the profits from that business into Shopee, a leading ecommerce website serving Southeast Asia. The company has in turn used the Shopee website to develop a digital payments platform resembling PayPal.

Sea has an extraordinary track record of success, more than doubling its sales every year since 2017. The company introduced Shopee to the Indonesian market in 2015, a full decade behind two well-established competitors, Tokopedia and Lazada. In just a few years Sea became the most used internet shopping site in Indonesia. The company achieved this by offering a broader selection of personal care products as well as free shipping. Sea is now applying aspects of this playbook to India, Brazil, and other emerging markets.

The countries in which Sea operates are still early in their adoption of online shopping. As such, I believe Sea has many years of growth ahead. When that growth slows, the company will reduce its investments and should begin to report significant profitability. As shareholders, I think we will be well rewarded over the course of Sea's expansion.

I've also added to holdings of Adobe. Adobe's design tools like Photoshop, Premiere, and Illustrator have become industry standards for online image editing and graphic design. Most content creators will at some point need to purchase an Adobe software subscription. These subscriptions renew annually, creating predictable and recurring revenues. In addition, Adobe's user base grows steadily as more visual content is shared online.

Adobe has also expanded its legacy PDF business into digital forms and signatures. The company should grow with this market, as more documentation is completed online. Adobe is also one of the leading providers of data and tools used by businesses to market online.

Finally, I've made several investments in owners of urban apartments, the most recent of which is Clipper Realty. Clipper owns a mix of affordable housing and higher end apartments in New York City and Brooklyn. Through the first year of Covid, urban apartment rents stagnated, and vacancies rose as residents moved to the suburbs. That trend reversed last year, with students and other residents returning to cities, pushing up rents. Those rent increases are likely to outpace operational cost increases this year, leading to substantial profit growth. I think rent increases could continue for some time, given that the cost of the alternative, a new home purchase, has risen substantially.

As always, please contact me with any questions.

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