ALTA
CAPITAL MANAGEMENT
A member of Guardian Capital Group Limited

MARKET LETTER

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How long is transitory?

The third quarter brought a bit of reality back to markets with a return of just under 1%, taking the year-to-date gain to about 15%. The market declined nearly 5% in September as investors digested concerns around the Delta variant, gridlock in Washington and continued supply chain challenges. Concerns about a potential growth slowdown look only temporary as demand from consumers and corporations remains strong. Current estimates for GDP growth of 6.0% in 2021 and 4.0% in 2022 are well ahead of pre-pandemic growth in the 2.0% range. While a full reopening of the US economy may have been delayed a bit due to the Delta variant, corporate earnings continue to recover nicely from the pandemic with pent-up demand and improved productivity driving an increase in profit margins. Covid cases are down 25% from peak at this writing, fueling hope that an end to the pandemic is near.

Household net worth recovered at a record pace following Covid-related shutdowns and the subsequent recession, returning to pre-pandemic levels in just one quarter. In the twelve months since, net worth has expanded by an additional 20%, a level that took seven years to regain after the financial crisis. Government income support, strong residential real estate values, and the rapid recovery of financial markets left consumers flush with cash, increasing the overall household savings rate. You may suspect that debt levels are rising as consumers lever up to make purchases. Still, the data show that leverage as measured by debt-to-asset ratios is near its lowest level in decades, roughly 13.5% in the US. Wealth effects may very well drive continued spending throughout 2022 and into the future.

Inflation is apparent for anyone buying groceries, doing work around the house, replacing a car, or planning a vacation. While there has been a lot of talk of inflation being transitory, or temporary, the length of transitory has come into question. Pent-up demand for goods and services has coincided with labor shortages nationwide, possibly due to a combination of ongoing employee Covid concerns and government stimulus. Also, the quick recovery of the economy has coincided with ongoing international Covid-related shutdowns and bottlenecks at ports, resulting in key technological, industrial, and building-related product shortages. All of these factors, if they persist, could lead to rising prices and pervasive inflation. Having said that, Treasury Inflation Protected Securities, or TIPS, take into account market participants' expectation for inflation in their price. Their price level implies a relatively low 2.3% inflation rate in the coming years. We realize that is of little consolation to those facing rapidly rising housing and food costs.

Despite market expectations of relatively calm inflation, many are looking for ways to protect themselves against potential runaway inflation. We at Alta, along with investing legend Warren Buffet, believe the best way to protect against inflation is by owning a piece of a "wonderful business", one that has pricing power. Owning a piece of this business and many of the other quality companies are one of the best ways to protect against inflation taking a bite out of your hard-earned savings.

We have been managing quality-growth, high-conviction portfolios for nearly 40 years. Our strategy has always included buying the best companies at reasonable valuations. We view the best companies as consistent and growing revenue and cash flow, good returns on investment, and durable competitive advantages. These companies generally all benefit from pricing power due to their position in the marketplace. While it may seem appealing to chase high-flying, innovative, and yet-to-be-proven growth companies, we believe that the best risk-adjusted returns are delivered by owning quality growth companies with a proven ability to generate profit.