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# Quarterly Letter to Investors
## Fourth Quarter 2021

CRAWFORD
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"Why then, can one desire too much of a good thing?"
~ William Shakespeare from As You Like It

William Shakespeare, the ultimate wordsmith, is known to have invented many new words in the course of writing his plays. He also created new phrases, and, in the written record, was the first to use "too much of a good thing." Centuries later Mae West, the popular singer and actress of the 1930s, gave the phrase a light twist when she quipped, "too much of a good thing is wonderful!" Thinking about the economic and investment environment of 2021, it is fair to say that there were some instances of "too much," both good and bad. In the long run, balance is the desirable outcome, for extremes or occasions of "too much" can lead to overindulgence and bouts of economic indigestion. Let's look at some of the extremes of 2021 and consider possible implications for 2022 and beyond.

**TOO MUCH COVID.** Will anyone disagree with this one? It is hard to believe, but next month we will enter year three of the Covid pandemic, and we find ourselves enduring the Omicron surge. On more than one occasion we thought it was just about over, only to be disappointed by the emergence of another variant. Despite the availability of vaccines and boosters, we just can't get it behind us. Not only has it been threatening to our health, the requirements to fight it have been long and tiring. Economically, it has damaged consumer confidence, altered demand patterns, caused bottlenecks, and distorted the balance between supply and demand. The one positive is that we seem to be learning how to deal with it, at least partially. Human activity and business are no longer at a standstill, and as we look forward to 2022, the best we can do is hope that the Covid issues will increasingly be minimized by new and more effective therapies. If so, it will make for a more balanced economic environment.

**TOO MUCH INFLATION.** Inflation is the primary economic issue of the day. It is running stronger and longer than expected. Covid has something to do with the inflation we are experiencing as noted above in terms of its disruption in the tradeoff of supply and demand. Demand for goods has soared; demand for services has lagged. Although the Federal Reserve (the Fed) has abandoned the term "transitory," the debate over the sustainability of these high rates of inflation continues. We believe that more moderate rates of inflation are likely this year, although the degree of decline is uncertain. The Fed has decided that the risk of waiting longer in the hope that inflation moderates on its own is not worth the risk of its becoming entrenched. They have made a dramatic pivot in policy by signaling the end of quantitative easing to be followed by increases in their federal funds rate.

The task before the Fed is a risky one. In essence, they are attempting to pull off a "soft landing," that is, reduce liquidity in the economy, affect psychology, and slow down the pace of economic activity so that inflation pressures will retreat. The tricky part is knowing when to move: not too soon and not too late. We certainly wish the Fed well in their efforts, and we believe there is a decent chance of success, mainly because inflation should be moderating somewhat of its own accord. The risk in fighting inflation with more restrictive monetary policies is that they misjudge and drive the economy into a recession. History tells us that this unfavorable result happens more often than not.

The outcome of the inflation story is critical. We have been of the opinion that the economy could sustain a long and steady recovery/expansion cycle, similar to the one that ended in 2020. In order for this to occur, inflation needs to be sufficiently contained to allow more normal monetary policy, maintain confidence among consumers, and enable interest rates to remain at reasonably low levels.

**TOO MUCH INEQUALITY.** We believe that income and wealth inequality is one of the more pernicious trends of our time. In 2021 this condition was exacerbated by wealth increases in stocks and housing. Too much income and wealth is concentrating at the top end, and this creates an economic problem because wealthy people have a hard time spending a significant portion of their earnings or wealth. It just piles up in instruments that are of benefit to the saver but are not economically productive. Savings are the lifeblood of economic growth, but they must be transferred into job-creating investments such as computers, software, plants, and equipment. These investments not only create jobs, they enhance worker productivity. As these savings accumulate, they have to go somewhere, and the private sector's inability to absorb them means they have gone into savings instruments like stocks and bonds, which, taken to an extreme, can create bubbles and financial instability. Yet, the problem is not only one of individual saving. The corporate sector participates as well when they channel earnings into the repurchase of shares instead of capital investment. To be clear, we are not against the accumulation of wealth or wealthy people. We highlight income and wealth inequality as an economic issue of "too much," recognizing that it is a very difficult problem to solve. We can only acknowledge it and hope that it improves over time. It bears no particular risk to 2022 but is an ongoing issue that limits overall economic growth.

**TOO MUCH STOCK RETURNS?** Posing this question is sure to raise eyebrows. Like wealth creation, we are definitely not against high stock returns. In fact, here the Mae West version of the "too much" quote is the more appropriate one. By raising the question, we merely point out that things have been awfully good for stock investors in recent years. In fact, as we pointed out in our last letter, stocks have compounded at around 18% over the last five years. This is 80% more than the average returns from stocks over longer periods of time. There are certainly reasons for stocks having done so well, but the economic environment, while good, has probably not been good enough to justify such high returns. We are not predicting a recession or a bear market; we only suggest that we might have to go through a period of digesting some of these high returns and accept more average returns for a while. Having reasonable longer-term goals is always good practice, and should the extraordinary stock returns continue, we will be happy to admit that our caution was not warranted.

**TOO FEW BOND RETURNS.** As we celebrate high stock returns, we can also lament low bond returns. Here we switch the narrative from “too much” to “too few,” but since we are dealing with extremes, this one is hard to ignore. While bondholders have benefitted greatly from the long decline in interest rates in terms of total investment return, now, without the possibility of much appreciation from further declines in yields, they are left with low coupons only. This is not healthy. As we have written repeatedly, we all know why bond yields are so low: zero short-term interest rates, quantitative easing, structural changes in the economy over decades, and, until recently, low inflation. If the economy transitions back to its more normal state, interest rates should also normalize, at least to some extent. Again, balance is always the preferred state, and more reasonable interest rates would be a favorable development for the economy and bondholders. We believe some relief for bondholders in the form of moderately higher yields should be on the horizon in 2022. Meanwhile, bond holdings remain as a hedge against stock risk and can serve as a source of funds or reserves in the event of a stock market decline.

**HOW TO INVEST IN A WORLD OF TOO MUCH.** We have discussed some areas of excess in the economic and investment spheres, and lest we appear too one-sided in our assessment, there is much to celebrate in the current condition of the economy and markets. We have enjoyed a startlingly good recovery from the pandemic-induced recession of 2020, the economy is nearing full employment, the corporate sector is doing very well, and while there are tensions in the world, there are no major wars. Life is pretty good. With regard to investing, we remain consistent in our approach. Should the excesses that we have discussed manifest themselves in economic or market turmoil, we feel confident that the best way to maneuver through such periods is to invest in quality. For us, quality has always been our north star, and we expect to be guided by it in the future. Quality is not the only way to invest, but we believe it is the best way to invest through both good and challenging times.

As we begin the New Year, we do so with gratitude for the opportunity of working with you in the management of these assets, and we look forward to a continuation of our work together in the years to come. Thank you.

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