THE BIRCH LANE PERSPECTIVE

Preserving and Growing Wealth
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"We're either officers serving our tsar and fatherland,
and rejoice in our common successes and grieve over our common failures,
or we're lackeys, who have nothing to do with their masters' doings."

– Leo Tolstoy, from War and Peace

If It's in the News, You're the Last to Know

One tempting trap I see people fall into is to base decisions on the news. I say it's tempting because the news seems important and you can imagine worst case scenarios coming true easily. However, there are a few problems with this:

1. **By the time some event is in the news, professional traders have already reacted and the news is in the price.** By being late to the party, you are likely to get poor results.

2. **Media is a business and they generate more clicks, views, and readers by sensationalizing and hyping things.** Stirring up fear and greed means more revenue for media companies. You can see this in "the sky is falling" pieces on politics, the economy, and world events. On the flip side, you can see it when they hype up a new technology or new company. Fear and greed are natural human emotions and even professional investors fall into the trap. Reacting late based on these emotions is probably the single biggest reason I've seen investors perform poorly.

3. **Even diligent, honest reporters are not experts in what they write about.** If you have ever read articles about a field you are intimately familiar with, you can easily spot the oversimplifications, exaggerations, and plain misunderstandings in the article or report. However, we tend to believe news stories in areas we are not so familiar with. This is even more pronounced in areas that stir our emotions, such as politics. The late Michael Crichton coined this tendency the Gell-Mann Amnesia Effect.

4. **Finally, even event-driven hedge funds, which specialize in predicting and reacting to news faster than the general investor, and devote substantial resources to it, generally have not shown outstanding performance.** What's more, their focus on short-term trading generates high tax bills for their taxable investors.

So what can we do?

Even being aware of psychological effects such as these does not prevent us from being drawn into their siren song. As I mentioned earlier, even professional investors frequently fall into these traps themselves. There are a few important ways we can protect ourselves and insulate what we do from overreactions:

1. **Base asset allocations on our own needs rather than events outside of our control**. In other words, determine our cash flow needs in the near-term, medium term, and long-term, and figure out the risk tolerance that makes the most sense for our unique situation. From this, we can determine the right allocation to safe and liquid assets, income-generating assets, and assets with long-term growth potential.

2. **Focus on the micro rather than the macro.** Macro events, such as politics, the economy, inflation, industries, etc. are hard to analyze. They have dozens or even hundreds of cross-currents that are hard to predict. We may read a few news articles or watch some videos, but these all follow a narrative based on simplifying the situation and are not generally useful in predicting how things will turn out. It's better to focus on something small, such as an individual company: Is this a good company? Does it have growth potential? Is its balance sheet, earnings, and cash flow strong? Is its valuation reasonable? Questions like these are more answerable than overly abstract macro questions.

3. **Focus on risk analysis rather than prediction.** Nobody knows what inflation or the economy will be like in five years. Nobody predicted Covid a year before it happened. Few people predicted the Great Financial Crisis (and those who did usually predict disaster all the time, so even a broken clock is right twice a day). Nobody knows if China will invade Taiwan at some point and, if they do, when that will be. What you can do is assess the risk to your portfolio, position-by-position. Is this security subject to geopolitical risk? Is this security subject to tariff risk? Is this security subject to inflation risk? What you want is to not be overly exposed to any one type of risk, so that no matter what happens it won't wreck you.

4. **Maintain a conservative posture in terms of debt, liquidity, and asset concentration.** While we cannot predict the future, we can help make our wealth more resilient no matter what happens. Asset concentration and debt may be useful for risk tolerant people while they're building wealth, but once you've accumulated enough wealth for financial independence, it does not make any sense to risk that for a higher potential return. Debt and over-concentration are two things that can wipe out even great fortunes.

Focusing on being strong at the things we can control, rather than reacting to news, makes for a more solid foundation in preserving and growing wealth.

Key Wealth Principles

- A foundation of good habits is more important than fancy techniques
- Invest in quality businesses at an attractive price
- Build a portfolio of good businesses in different industries
- Maintain appropriate reserves and income sources
- Consider your financial circumstances, liquidity and timing needs, goals, tax considerations, and risk exposure

Building Your Resource Network

Steve Jobs wrote an email to himself a year before he died to remind himself that he did not create many of the things that he relied on to innovate and grow. Things like the food supply, a legal system to protect his rights, medicine, technologies, math, etc. The fact is we all succeed by building on the efforts of others.

We can help directly with tax planning, estate planning, financial planning, asset allocation, and investment management.

To further help our clients, we have built a network of resources both internally and externally. These resources include M&A advisors, M&A attorneys, SBA lenders, fractional CFOs, CPAs, bookkeepers, business consultants, estate attorneys, mortgage lending, high yield savings, and more.

If you are looking to grow your business, considering a business exit in the next five years, or just want to preserve and grow your wealth, we are happy to talk. The conversation is no obligation and we may be able to help you, either directly or by introducing you to someone in our network.

To learn more, please visit my calendar online at Calendly or email me at Randall.Watsek@RaymondJames.com for a no obligation consultation. The earlier you start planning, the better prepared you'll be.

Last Month's Winners and Losers

Winners	**Losers**
Small cap	Precious metals
Momentum	Emerging markets
Crypto-currency	Developed markets ex-US
Theme stocks	Health care stock
Consumer discretionary	Semiconductors
Regional banks	Copper miners

November saw a divergence in performance between areas perceived to benefit from the election results and areas perceived to be harmed by the results. Overall, U.S. markets were strong and small cap stocks were even stronger, but foreign markets, both emerging and developed, were weak.

Riskier areas like crypto-currency, theme stocks, and consumer discretionary were strong while health-care stocks and semiconductors were weak. The regulatory changes that incoming administration want to make may be harmful to biotech and pharmaceutical companies and the proposed tariffs may be harmful to semiconductors and certain other import-intensive industries.

However, overall, the markets are taking the likely changes positively due to the outlook on taxation and regulatory reform.

Stocks

	S&P 500	Dow Jones U.S. Select Dividend	Russell 2000	Bloomberg US Long Treasury
1mo Return	5.9%	6.4%	11.0%	1.8%
YTD Return	28.1%	26.1%	21.6%	-1.1%
10yr Return	13.3%	10.4%	9.1%	0.2%
20yr Return	10.7%	8.7%	8.4%	3.8%
30yr Return	11.1%	11.6%	9.4%	5.7%

Source: FactSet as of 11/30/2024. We use the S&P 500 index as an illustration of the performance of large cap stocks, the Dow Jones U.S. Select Dividend index as an illustration of the performance of high dividend stocks, the Russell 2000 index as an illustration of the performance of small cap stocks, and the Bloomberg US Long Treasury index to illustrate the performance of treasury bonds with maturities greater than 10 years out.

Despite all the worries, this year has turned out to be one of the better years for equities. With that, however, means stretched valuation, particularly among large cap stocks. Small cap and dividend stocks have started to get a bit expensive as well, but are still within reason compared to historical averages. I would be cautious about large cap equity exposure overall at this point in terms of asset allocation, though I am still finding individual stocks I think are attractive.

	Large Cap Stocks	Dividend Stocks	Small Cap Stocks
Dividend Yield	1.2%	3.0%	1.5%
Earnings Yield	4.6%	5.4%	5.4%
Earnings Growth	10.2%	7.6%	14.4%
Return on Equity	17.3%	11.7%	10.2%
% Losing Money	5.4%	5.9%	38.3%

Source: FactSet as of 11/30/2024. Dividend Yield is an estimate based on the weighted average of all companies in the category (by market cap). Earnings Yield, Earnings Growth, and Return on Equity are estimates based on the median profitable company. The % Losing Money statistic represents the percent of stocks with negative earnings in the preceding 12-month period. Large Cap stocks are defined here as the stocks in the S&P 500, according to FactSet. Dividend Stocks are defined here as the stocks within the S&P 500 that pay an above-median dividend yield, according to FactSet. Small Cap stocks are defined here as U.S. stocks ranked 1,001 to 3,000 in market capitalization, according to FactSet.

Artwork

"News from the Front" by Viktor Vasnetsov (1878). Source: WikiArt.org.

Income Investing

Interest Rates	
1yr Treasuries	4.4%
10yr Treasuries	4.4%
10yr TIPS	2.1%
Municipal Bonds (5yr AAA)	2.7%
Corporate Bonds (5yr A)	4.8%
30yr Fixed Rate Mortgages	7.2%

Dividend Yields	
Common Stocks	1.2%
—Top 25%	3.8%
—Next 25%	2.3%
Preferred Stocks	5.9%
Utilities	3.2%
Real Estate (REITs)	3.4%

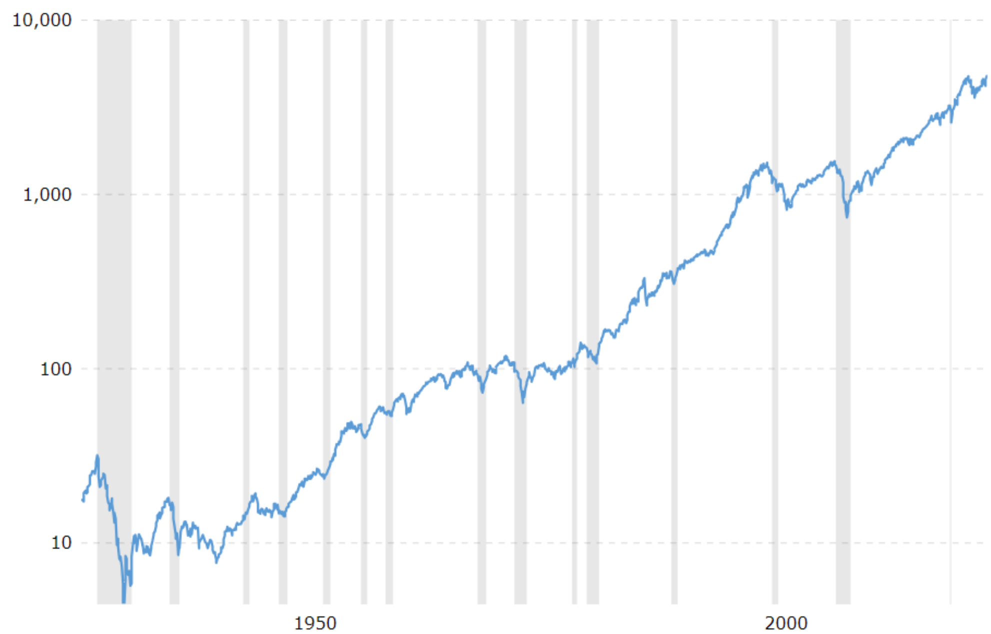
Source: Interest rates from Raymond James' Weekly Interest Rate Monitor as of 11/25/2024 and The Wall Street Journal as of 11/30/2024. Source for the Dividend Yields is from FactSet as of 11/30/2024. Common Stocks uses the estimated weighted average dividend yield for the S&P 500. The top 25% yield is the median yield of the top quartile of dividend-paying stocks out of the largest 1,000 stocks. The next 25% yield is the *median of the second quartile. Preferred Stocks is the median dividend yield of the 100 largest traded preferred stocks (by dollar volume, per FactSet). REIT and Utilities dividend yields are the median of those sector stocks included in the 1,000 largest common stocks.*

Long-term rates have risen as inflation continues to come in at the 3-4% level, suggesting a lower likelihood that the Federal Reserve will cut rates further. While long-term rates are still below their 100-year average, large cap equities are also expensive vs. history. So, there are not any broad asset classes that are attractively valued for long-term investors.

Short-term rates, on the other hand, remain attractive and short-term bonds carry less risk than long-term bonds of the same quality. Therefore, for conservative investors, I would still favor short-term bonds, CDs, high yield savings, and money market funds over long-term bonds. For more aggressive investors, I would be selective about the individual securities I find attractive rather than buy the market as a whole.

The Long View

S&P 500, Jan. 1928 to Dec. 2023



Source: MacroTrends.net

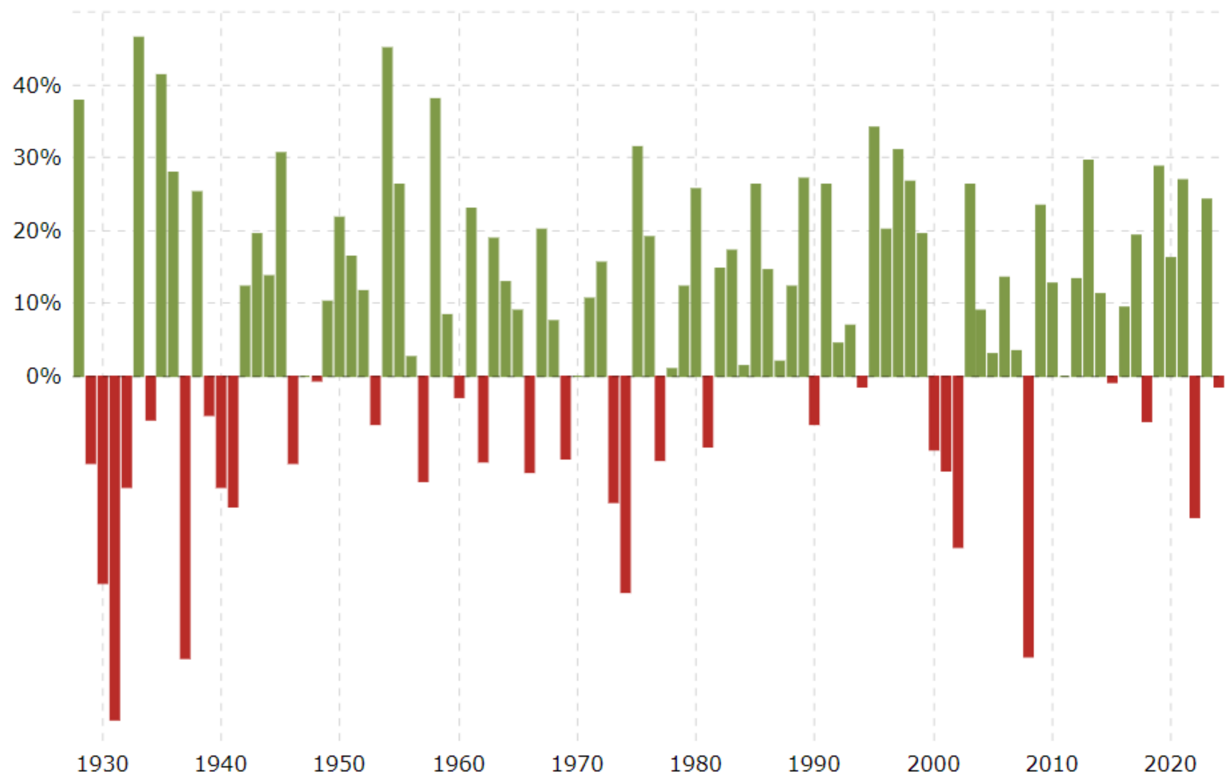
For the last 20, 30, and 100 years, stocks have averaged around an 8-10% annual return, driven by dividend yield, reinvestment of earnings, and earnings growth. Long-term bonds have yielded about 5% on average over the last century while inflation has been about 3%.

Throughout this period, there have been major upheavals, such as the Great Depression, World War II, The Korean War, The Vietnam War, dropping the gold standard, 1970s high inflation, 1987's Black Monday Crash, the Dot.com bust, the 9/11 terror attacks, the Global Financial Crisis, and the Covid Crash, among others.

These events led to severe market downturns about once every decade, with a median price decline of 33% and a median time to recover back to the previous high of 3.5 years. If we were to include dividends, the recovery to previous highs is actually a little faster. *

Meanwhile, a 3% inflation rate results in a 59% decline in the value of a dollar over 30 years. Meaning that people who retire at 60 years old on a fixed income face a high risk of a lower quality of life as they get further into retirement. *

The Price of Market Returns: Significant Volatility



S&P 500 Yearly Returns, 1928 to 2024. Source: MacroTrends.net

** Source: Morningstar Direct via cfainstitute.org, FactSet. Past performance is not necessarily indicative of future performance. Depreciation of the dollar: $1 / (1 + 3%)^30 = $0.41 real value 30 years later.*

Market Outlook

Now I'll put on my "Nostradamus Hat" and make some predictions, for whatever they're worth:

- Inflation will average 2-5% over the next 10 years.
- Interest rates will fall in the 3-6% range for 10yr Treasuries over the next several years, in line with inflation and historical experience.

- The economy will grow 2-3% in real terms over the next several years.
- Stocks will average an 8-10% return over the next 10+ years. After subtracting inflation, this will translate into about a 5% real return, in line with the estimated earnings yield on the S&P 500. There is likely to be at least one big decline every decade or so.

From the standpoint of where you and your family will be in 30 years, none of this matters. What matters is finding good quality investments that are likely to grow over the decades. For this reason, I largely ignore my own general market forecast and invest whenever I find a business that I am confident in and that trades at an attractive valuation.

Help Secure Your Golden Years

I first began managing money in the late 1990s, right when the Dot.com boom was taking off. People who didn't know anything about business were making money buying whatever stock was hyped on TV. Wall Street firms were overflowing with profits by selling stocks to the public they knew were worthless. One notorious analyst earned $12 million a year, while privately putting down the stocks he was promoting.

Then it all came crashing down.

Most of the Internet stocks of that era went bankrupt or lost most of their value. The market went down for three straight years from 2000 to 2002. Millions of investors lost a huge chunk of their retirement savings.

Did people learn the right lessons? Only a few years later, we had the Great Financial Crisis from 2007 to 2009. Again, Wall Street was selling worthless financial instruments. This time it took down the real estate market too. Again, millions of investors lost a large portion of their retirement savings.

We want our clients to hold positions of real value, so we **personally research** all the positions in our strategies and review them regularly.

While it may surprise you, we believe this commitment to personal research and investment management sets us apart from other advisors. The vast majority of advisors outsource research to fund managers or their firm's cookie cutter options.

Instead, we personally research each position to develop the confidence that it is right for you. This commitment to research develops the trust, for us, that all the strategies we recommend are the right ones for our clients, in line with their risk tolerance, time horizon, and future goals. **Your finances are too important for a cookie cutter solution.**

At The Birch Lane Group of Raymond James, we work as a team to provide our clients with personal service, custom financial planning, and investment management tailored to your needs. I specialize in working with business owners, executive compensation issues, retirement planning, and investment management. Donna Colucci also does extensive financial planning, with expertise in life transitions, divorce planning, estate planning, and long-term care insurance. Tricia Jones works tirelessly on client service, trading, and account management.

We are dedicated to helping you achieve financial independence and a comfortable, stress-free retirement.

What Can a Comprehensive Financial Plan Do for You?

Having a well-designed financial plan and investment strategy is important for your financial future. It can help improve your security, confidence, and comfort. It can answer questions like:

- How much will you need to be financially independent?
- Are your assets structured in a tax-efficient manner?
- Does your estate planning protect you and your family from liability, the consequences of unexpected death or illness, and excessive death taxes?
- How will you handle unique circumstances, such as executive compensation, kids' college education, elderly parents, special needs children, and the other elements of life?
- Should you change any savings or investing habits?
- Could you improve your asset allocation or current investment choices?
- What are the odds that you will run out of money if market conditions are poor?
- Do you have a comprehensive risk mitigation strategy to incorporate business and career risk, concentrated wealth risk, market and economic risk, personal and family liability, liquidity needs, debt service, intergenerational risk, and unexpected death or illness?

If you have never had a financial plan run for you or have not reviewed yours recently, we would be happy to create a financial plan and investment strategy for you.

To set up a time, please visit my calendar online at Calendly or email me at Randall.Watsek@RaymondJames.com.

Sincerely,
Randy Watsek

P.S. If you know anyone who might benefit from the information in this letter, please pass it along.

Biography

Randall Watsek and the Birch Lane Group currently maintain or advise on over $250 million in client assets. He has managed money for over 25 years, first as a credit portfolio manager at City National Bank and then as an equity research analyst, sector portfolio manager, and quantitative researcher at DGHM, a quality value boutique managing money for pension funds, endowments, businesses, and high net worth individuals. He leveraged this experience to join Raymond James and advise business owners and executives.

Watsek earned an MBA from the University of Chicago in Analytical Finance and Accounting, and a BA from Claremont McKenna College in Economics and History. He also earned the CHARTERED FINANCIAL ANALYST (CFA®) and CERTIFIED FINANCIAL PLANNER (CFP®) designations.

Watsek has been quoted in a variety of publications on investing and personal finance topics, including *MarketWatch*, the *Wall Street Journal*, *Investor's Business Daily*, *Money Magazine*, the *Arizona Republic*, *ThinkAdvisor*, *The Business Journals*, and *ReThinking65*.

Watsek is the father of two young children and lives in Westchester County, New York.

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The Birch Lane Group of Raymond James

Raymond James held over $1.5 trillion in client assets as of 9/30/24, has been profitable for 147 consecutive quarters (since 1988), has equity research coverage of over 1,200 companies, and maintains investment grade credit ratings by Moody's and S&P.

The Birch Lane Group advises clients collectively holding over $250 million in assets. The team consists of:

Donna Colucci, CFP®, Associate Vice President
Tricia Jones, AAMS®, Registered Client Service Associate
Randall Watsek, CFA®, CFP®, CEPA®, Financial Advisor

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Inclusion of the S&P 500 index is for illustrative purposes only. Index performance does not include transactions costs or other fees, which will affect actual investment performance. The Dow Jones U.S. Select Dividend Index aims to represent the U.S.'s leading stocks by dividend yield and measures the performance of 100 high dividend paying companies, excluding REITs, meeting specific criteria for dividends, earnings, size and liquidity. The Bloomberg US Long Treasury Index measures the performance of US dollar-denominated, fixed-rate, nominal debt issued by the US Treasury with a maturity greater than 10 years. The Russell 2000® Index measures the performance of the small-cap segment of the US equity universe. It includes approximately 2,000 of the smallest securities based on a combination of their market cap and current index membership. Inclusion of these indexes is for illustrative purposes only. Holding investments for the long term does not ensure a profitable outcome. 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If bonds are sold prior to maturity, you may receive more or less than your initial investment. There is an inverse relationship between interest rate movements and fixed income prices. Generally, when interest rates rise, fixed income prices fall and when interest rates fall, fixed income prices rise. Treasury Inflation-Protected Securities (TIPS) provide protection against inflation by adjusting their principal amount annually based on the Consumer Price Index (CPI) and then paying interest on that new amount. The principal amount is readjusted every year based on the prior year's CPI, meaning it can go down as well as up. There are special risks associated with investing with bonds such as interest rate risk, market risk, call risk, prepayment risk, credit risk, reinvestment risk, and unique tax consequences. To learn more about these risks and the suitability of these bonds for you, please contact our office. Bitcoin issuers are not registered with the SEC, and the bitcoin marketplace is currently unregulated. Bitcoin and other cryptocurrencies are a very speculative investment and involves a high degree of risk. Certified Financial Planner Board of Standards Inc. owns the certification marks CFP®, CERTIFIED FINANCIAL PLANNER™, CFP® (with plaque design) and CFP® (with flame design) in the U.S., which it awards to individuals who successfully complete CFP Board's initial and ongoing certification requirements. The foregoing information has been obtained from sources considered to be reliable, but we do not guarantee that it is accurate or complete, it is not a statement of all available data necessary for making an investment decision, and it does not constitute a recommendation. Any opinions are those of Randall Watsek and not necessarily those of Raymond James. Links are being provided for information purposes only. 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