THE BIRCH LANE PERSPECTIVE

Preserving and Growing Wealth
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"There are old pilots and there are bold pilots, but there are no old, bold pilots."
– Harry Copland

Sound Decisions vs. Monday Morning Quarterbacking

Roger Federer, the tennis champion, recently made a commencement speech that held a lot of wisdom in other areas of life. He noted that out of 1,526 singles matches in his professional career, he won 80% of them. However, out of all the points he played, he won only 54% of them.

In other words, **even one of the greatest tennis players of all time won little over half the points he played**. But that small advantage added up over the course of a match and even more so over the course of a career.

It is much the same way in investing: each individual investment may win or lose, but the benefits of a sound decision making process accumulate over time. Even the greatest investors rarely have much more than 50% of their investments outperform. But the small advantage they have accumulates over time. They tend win over time both by having slightly higher odds and by having winners that do very while limiting the losses on losers.

Contrast this to a common flaw among investors: Monday morning quarterbacking. In other words, just looking at whatever has performed well or poorly recently.

By the time you know the outcome, it is too late.

The fact is, there is a lot of uncertainty and risk in the market. Many people look for some guru with a crystal ball, but the reality is many of those "gurus" are either charlatans or have been lucky in a particular market cycle and the risks in their strategy have not been uncovered yet.

It is tempting to look at a particular stock or fund that has done very well over the past year or so, but usually there is an enormous amount of risk as well. And this risk is not always obvious.

The quote above about pilots applies to investors as well: there are old investors and there are bold investors, but there are few old, bold investors. By taking bold risks, you might be lucky enough times in a row to become wealthy, but all it takes is one bold risk gone wrong to wipe you out.

A better way for most people is to take prudent, moderately diversified risks that balance growth potential with less exposure to catastrophe. Focusing on a sound decision making process and accumulated benefits is not sexy like looking for the big score, but most people would be better off with such an approach.

The Tax Benefits of Roth Conversions

Roth IRAs are attractive vehicles that allow for tax free growth and tax free withdrawals. One thing that can benefit many people is converting their IRAs or 401Ks into Roths after retirement. There are two primary benefits.

1) **Tax rate arbitrage.** If you contribute to a 401k during your high earning years, you reduce your income that is taxed at a high tax bracket. After retirement, your tax bracket will likely decrease. However, after your required minimum distributions kick in at 73, your tax bracket may increase. These years between retirement and your required minimum distribution offer an attractive opportunity to convert traditional IRA and 401k money into Roth money.

2) **Tax free compounding.** While traditional IRAs and 401Ks offer deferred tax compounding, you or your heirs must eventually pay ordinary income taxes on the growth. However, you never need to pay taxes on growth in a Roth IRA. This allows the tax savings from the difference in tax rates to grow tax free over time. Also, if you use regular assets to pay the taxes on the Roth conversion, it is equivalent to a large new contribution to your Roth, allowing growth that would have otherwise been taxed to grow tax free.

Figuring out the right path requires careful planning. We have experience with other investors and advanced modeling software that can help you figure out the pros and cons of a conversion plan.

Unless certain criteria are met, Roth IRA owners must be 59½ or older and have held the IRA for five years before tax-free withdrawals are permitted. Additionally, each converted amount may be subject to its own five-year holding period. Converting a traditional IRA into a Roth IRA has tax implications. Investors should consult a tax advisor before deciding to do a conversion.

Mortgages and High Yield Savings Accounts

Raymond James Bank offers competitive mortgages and high yield savings accounts, depending on your needs. Please contact me for more information if you're looking into financing or savings options. You can set an appointment directly on my calendar at Calendly or email me at Randall.Watsek@RaymondJames.com.

See important disclosures at the end of this newsletter.

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

Planning Ahead

We can help you raise growth capital, prepare to sell your business, efficiently manage executive compensation, improve tax efficiency, and organize your finances for a comfortable, confident, and stress-free retirement. If you would like to learn more, please visit my calendar online at Calendly or email me at Randall.Watsek@RaymondJames.com for a free consultation. The earlier you start planning, the better prepared you'll be.

Last Month's Winners and Losers

Winners	**Losers**
Large cap growth	Value, dividend, and small cap stocks
Bonds	Cryptocurrency
Real estate	Silver
Tech stocks	Chinese stocks
	Mexican stocks
	Natural gas

Large cap growth and tech stocks continued their outperformance this year vs. other stocks, which have only been up a little. Bonds and real estate also performed well on falling long term interest rates.

Losers for the month were a mixed bag of commodities (cryptocurrency, silver, natural gas), Chinese stocks, and Mexican stocks.

Stocks

	S&P 500	**Dow Jones U.S. Select Dividend**	**Russell 2000**	**Bloomberg US Long Treasury**
1mo Return	3.6%	-2.0%	-0.9%	1.7%
YTD Return	15.3%	5.0%	1.7%	-5.0%

10yr Return	12.9%	8.8%	7.0%	0.6%
20yr Return	10.3%	8.3%	7.8%	3.8%
30yr Return	10.8%	10.9%	8.9%	5.5%

Source: FactSet as of 6/29/2024. 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.

Value, dividend, and small cap stocks underperformed compared to large growth stocks, particularly artificial intelligence (AI). While it can be hard to sit out of the AI party, we all know what happens when the party's over. So moderation is the key, even if you want some exposure.

Aside from artificial intelligence, I believe there are plenty of attractive, growing companies that trade at a reasonable valuation.

	Large Cap Stocks	**Dividend Stocks**	**Small Cap Stocks**
Dividend Yield	1.3%	3.4%	1.6%
Earnings Yield	5.2%	6.3%	6.4%
Earnings Growth	11.4%	8.5%	17.1%
Return on Equity	17.0%	11.8%	10.8%
% Losing Money	6.0%	7.4%	38.7%

Source: FactSet as of 6/29/2024. 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

"An Incident on the Western Front" by Louis Weirter (1918). Source: Commons.WikiMedia.org.

Income Investing

Interest Rates	
1yr Treasuries	5.1%
10yr Treasuries	4.3%
10yr TIPS	2.0%
Municipal Bonds (5yr AAA)	2.9%
Corporate Bonds (5yr A)	4.9%
30yr Fixed Rate Mortgages	7.4%

Dividend Yields	
Common Stocks	1.3%
—Top 25%	4.4%
—Next 25%	2.5%
Preferred Stocks	6.3%
Utilities	3.8%
Real Estate (REITs)	3.8%

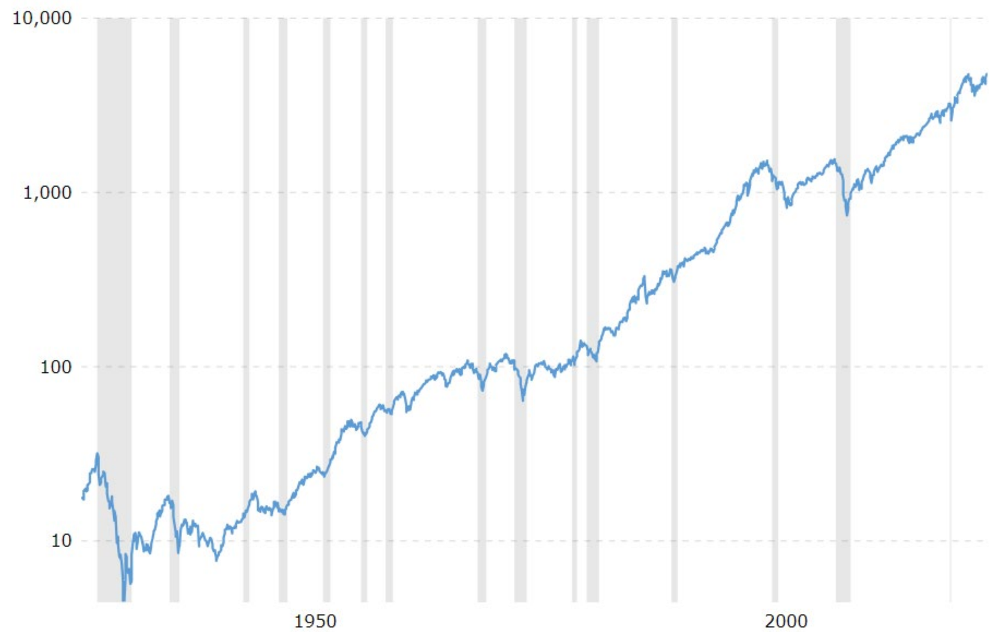
Source: Interest rates from Raymond James' Weekly Interest Rate Monitor as of 6/24/2024 and The Wall Street Journal as of 6/29/2024. Source for the Dividend Yields is from FactSet as of 6/29/2024. Common Stocks uses the estimated weighted average dividend yield for the S&P 500. The top 25% yield is the 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.

I continue to believe that short-term rates are attractive, but long-term interest rates are not particularly attractive given the risks of ongoing inflation, budget deficits, and overall debt load in the economy. I am keeping my eye on short term instruments of less than one year maturity and dividend stocks that have the potential to increase dividends faster than inflation over time.

Although commodities may offer a hedge, I prefer assets that produce independent sources of value, such as earnings, dividends, and interest, rather than betting on a particular economic outcome.

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% 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%.

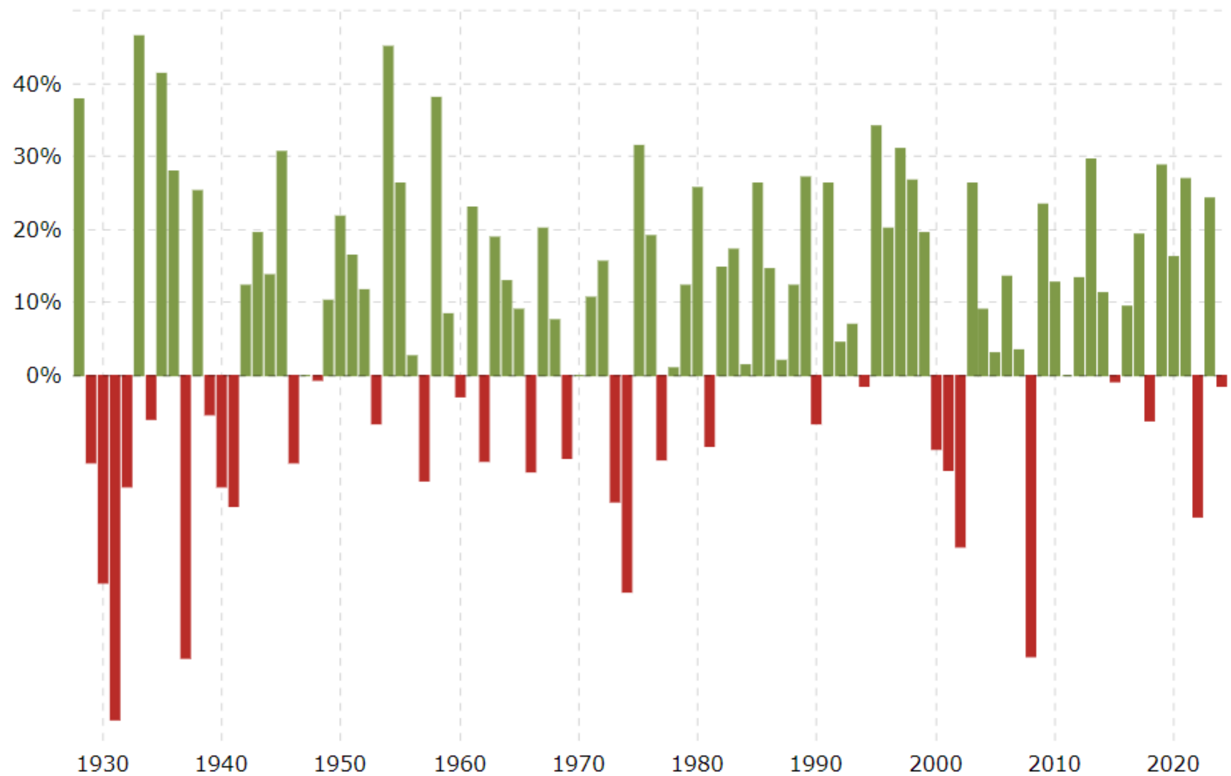
Throughout this period, there have been major upheavals, such as the Great Depression, World War II, The Korean War, The Vietnam War, dropping the gold standard, 1970s high inflation, 1987's Black Monday Crash, the Dot.com bust, the 9/11 terror attacks, the Global Financial Crisis, and the Covid Crash, 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 being 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 **<u>personally research</u>** all the positions in my 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. **<u>Your finances are too important for a cookie cutter solution.</u>**

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 retirement planning, executive compensation and equity interests, attorney practices, 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 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?
- What are the odds that you will run out of money?
- How will you handle unique circumstances, such as executive compensation, kids' college education, elderly parents, special needs children, and other elements of life?
- Should you change any savings or investing habits?
- Could you improve any of your current investment choices?

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

Also, I am also available to speak on educational topics such as retirement planning at events and lunch-and-learns you are holding, whether in person around the New York City area or by video anywhere in the country.

Biography

Randall Watsek and the Birch Lane Group currently maintain or advise on over $200 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. He leveraged this experience to start an investment advisory practice at Raymond James.

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

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®, Financial Advisor

Raymond James & Associates, Inc., member New York Stock Exchange/SIPC

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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. International investing involves additional risks such as currency fluctuations, differing financial accounting standards, and possible political and economic instability. Gold and silver are subject to the special risks associated with investing in precious metals, including but not limited to: price may be subject to wide fluctuation; the market is relatively limited; the sources are concentrated in countries that have the potential for instability; and the market is unregulated. Be advised that investments in real estate and in REITs have various risks, including possible lack of liquidity and devaluation based on adverse economic and regulatory changes. Additionally, investments in REIT's will fluctuate with the value of the underlying properties, and the price at redemption may be more or less than the original price paid. Bond prices and yields are subject to change based upon market conditions and availability. 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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