THE BIRCH LANE PERSPECTIVE

Preserving and Growing Wealth
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"Over-coaching can be more harmful than under-coaching. Keep it simple!"
– John Wooden

Cautions About Structured Notes

I have seen many investors with structured notes in their portfolios. While they make sense in certain situations, I believe they are oversold by financial advisors and not as beneficial to investors as they may first appear.

First, let's talk about what a structured note is. Structured notes are essentially debt issued by a financial institution. In most cases, this debt is unsecured, but in some cases, it may be a CD with FDIC insurance for the principal. The difference between structured notes and traditional debt that pays a straight interest rate is that structured notes are combined with derivatives that pay different interest rates depending on market conditions.

For example, a structured note might be tied to the S&P 500. If the S&P 500 goes up by a certain amount, the structured note pays a higher return based on the S&P 500 index, up to a limit (called the *cap*). It may also offer limited downside protection up to a certain amount (called a *barrier*).

There are good reasons why someone might want to own a structured note: they provide some market participation and potential upside beyond what a traditional bond would pay while offering some downside protection compared to a stock market investment. There may also be early redemption opportunities which improve liquidity in what is an otherwise illiquid instrument.

However, structured notes have the following drawbacks and risks, which make them appropriate only for certain investors:

- **High fees and commissions:** Banks tend to charge very high embedded fees for packaging the bond and derivatives together. It is more cost-effective, and you can better control risk by deciding what exposure you want to take and doing it directly. When you buy a structured note, it's not uncommon for the value to be immediately 5-10% or even more below what you paid. This difference is due to the embedded fees and commissions.

- **Credit risk:** You are taking on the credit risk of the issuing bank. If an issuing bank becomes insolvent, you risk significant loss. You should not buy more of an individual structured note than you would of an unsecured corporate bond.

- **Lack of compounding:** Most structured notes do not benefit from compounding. They are not like a stock where if you get a 10% return one year and a 10% return the next year, the second year's return builds on the first year's return. Instead, they typically reset every year. This is a note at par value, so your return is "interest" on the initial value and gets added to the payout at maturity rather than compounded. This can make a big difference over time.

- **No dividends:** In most cases you do not get the benefit of the dividends in the underlying index. With an S&P-linked note, this could subtract over 1% from your annualized return compared to the market. When they say they track the market, they're typically only tracking the price of the market, not the total return.

- **Not liquid:** If you need to raise funds, there are limited options for who you can sell your note to, and you may have to take a discount to sell before maturity. This is offset to some degree by redemption opportunities in certain types of structured notes if the benchmarks are at a specified level.

- **Potentially unfavorable tax treatment:** While not always the case, structured notes may receive ordinary income tax treatment rather than capital gains tax treatment. There may also be "phantom income" whereby you are credited with income that you will not receive until maturity, but you still have to pay taxes on it in the meantime.

- **Unfavorable terms:** Many types of structured notes track several benchmarks and choose the worst-performing one to base your return on.

- **Lack of transparency:** Due to the non-publicly traded derivatives involved, it's hard to track the underlying value of structured notes. Instead, you're dependent on a handful of market makers to determine pricing.

- **Limited collateral value:** If you manage your tax or market exposure by taking out a securities based line of credit, structured notes have little or no value as collateral.

All that said, they may fit your investment and risk profile. But I would advise caution when considering an investment in them. While they may seem like a sophisticated option, it is often the case that the simpler approach is the wiser approach.

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 wealth management. This includes tax planning, estate planning, financial planning, asset allocation, investment management, and risk management. We have found that clients with a net worth of $5 million to $50 million—including illiquid assets, such as business interests, executive compensation, real estate, etc.—benefit the most from our services.

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**
Crypto-currency	Natural gas
Gold & silver	Chinese non-Internet stocks
Brazil	U.S. tech stocks
Chinese Internet stocks	Auto
Theme stocks	Indian stocks
Financials, healthcare, housing	California muni bonds

I did not see a clear unifying theme to what did well and poorly last month, though there continued to be speculation in crypto currencies and gold and silver. The release of the DeepSeek artificial intelligence model boosted Chinese Internet stocks, while the general Chinese economy continues to be weak.

Weak performers had a variety of issues: U.S. tech stocks were hurt by the success of Chinese DeepSeek model, California municipalities were hurt by the cost of the wildfires, and natural gas prices were hurt by high levels in storage and limited demand for new production.

Stocks

	S&P 500	Dow Jones U.S. Select Dividend	Russell 2000	Bloomberg US Long Treasury
1mo Return	2.8%	2.7%	2.6%	0.4%
YTD Return	2.8%	2.7%	2.6%	0.4%
10yr Return	13.8%	9.7%	8.4%	-1.4%
20yr Return	10.6%	8.5%	8.2%	3.2%
30yr Return	10.9%	11.3%	9.2%	5.3%

Source: FactSet as of 1/31/2025. 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.

There continues to be speculative froth at the large cap and thematic ends of the market. However, outside of those areas, valuations are still reasonable given growth potential and profitability. I would expect the S&P 500 to perform below average over the next 10 years due to the dominance of a small number of expensive tech stocks, but I would expect other stocks to have a return potential similar to historical averages.

	Large Cap Stocks	Dividend Stocks	Small Cap Stocks
Dividend Yield	1.2%	3.3%	1.5%
Earnings Yield	4.8%	5.8%	5.9%
Earnings Growth	10.7%	8.1%	13.9%
Return on Equity	16.9%	12.1%	10.1%
% Losing Money	4.6%	4.9%	40.3%

Source: FactSet as of 1/31/2025. 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

"Blue-02" by Georgia O'Keefe (1916). Source: WikiArt.org.

Income Investing

Interest Rates	
1yr Treasuries	4.2%
10yr Treasuries	4.6%
10yr TIPS	2.2%
Municipal Bonds (5yr AAA)	2.9%
Corporate Bonds (5yr A)	4.9%
30yr Fixed Rate Mortgages	7.3%

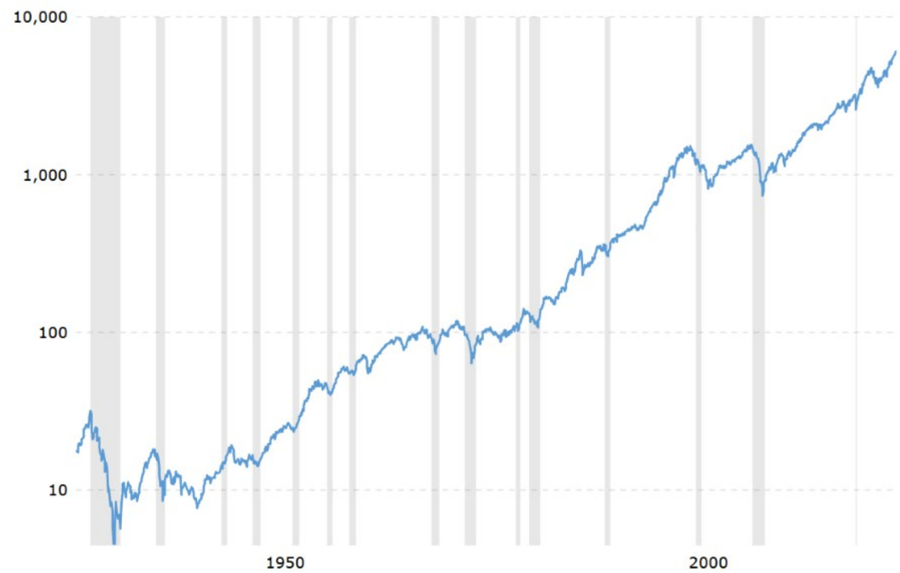
Dividend Yields	
Common Stocks	1.2%
—Top 25%	4.2%
—Next 25%	2.5%
Preferred Stocks	6.1%
Utilities	3.4%
Real Estate (REITs)	3.8%

Source: Interest rates from Raymond James' Weekly Interest Rate Monitor as of 1/27/2024 and The Wall Street Journal as of 2/1/2025. Source for the Dividend Yields is from FactSet as of 1/31/2025. 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.

The Federal Reserve held rates steady, which makes sense given the persistence of inflation, which has been above 3% for the last year. Short-term rates at these levels seem reasonable, however I do not believe long-term rates adequately compensate investors for the risks of ongoing inflation.

The Long View

S&P 500, 1928 to 2024



Source: MacroTrends.net

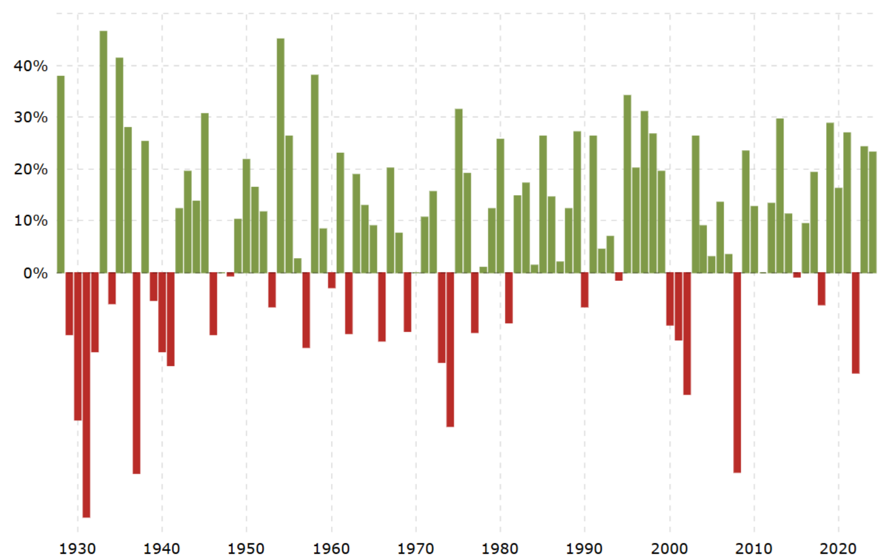
For the last 20, 30, and 100 years, stocks have averaged around an 8-10% annual return, driven by dividend yield, reinvestment of earnings, and earnings growth. Long-term bonds have yielded about 5% on average over the last century while inflation has been about 3%.

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 in general will average an 8-10% return over the next 10+ years. Large stocks have a wider expected range of 5-10% annual returns due to elevated valuation multiples, but also the possibility of higher-than-average earnings growth. 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. 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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