THE BIRCH LANE PERSPECTIVE

Preserving and Growing Wealth
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"'Don't put all your eggs in one basket' is all wrong.
I tell you 'put all your eggs in one basket, and then watch that basket.'"
– Andrew Carnegie

Scary News and the Question of Diversification

In the past several months, and especially since the inauguration, I have fielded many calls from clients worried about the new administration. This is understandable given the rapid-fire news, rhetoric, and abrupt policy changes.

Whatever we think of this from a political or values perspective, professional ethics (CFP®, CFA®) requires me to act in the best interests of clients to help their pursuit of financial and life goals while managing risk. From this perspective, I think there is a useful distinction between what is good for your financial wellbeing and what may or may not be good from a political or values perspective.

In other words, a lot of the things we don't like may not have much, if any, effect on our investments. That's not to say we shouldn't care, just that they are separate questions and it can be harmful to your financial security to mix them up.

I think it's important to **base your asset allocation primarily on your own needs and risks** rather than the markets or politics (regardless of who's president or how the economy is doing). I do think considering market risks and growth opportunities is important for security selection within an asset allocation, but asset allocation is primarily to further your financial goals while allowing for liquidity needs, income needs, risk exposures, etc.

What Are You Trying to Accomplish with Diversification?

When I was in business school, I heard a version of diversification that strikes me as naïve given the world we've experienced over the last 30 years (and, indeed, have always experienced). This theory is that the most efficient portfolio holds every conceivable asset (stocks, bonds, real estate, private business, art, etc.) in proportion to their market value. Then the only question is how much leverage to take on based on your risk preference.

Of course, practical obstacles make it impossible to actually own such a portfolio. But I have seen many people try to do a simplified version: own every stock and every bond in every country either through broad index funds or through owning dozens of different funds (which collectively hold thousands of securities).

It is certainly easy to just own a little bit of everything, but ask yourself: what am I trying to accomplish by diversification? Here are a couple points to consider:

- If you own a relatively safe asset and diversify with a riskier asset, you have likely increased your overall risk.

- If you own an asset with a high expected return and diversify with an asset that has a lower expected return, you have likely lowered your overall expected return.

- In the worse case, if you own an asset that has a high expected return and moderate risk and diversify into an asset with more risk and a lower expected return, you have likely made your portfolio riskier while also lowering your expected return.

In other words, there is no substitute for intelligent investing.

From my perspective, there are two useful cases for diversification:

1. You do not have the ability or time to assess the potential return and risk of different assets.

2. You have found different assets with similar potential returns, but with different sources of risk. Therefore, you can lower your average risk while maintaining potential returns for the asset class.

So What Does That Imply for Your Portfolio?

The key to managing your **personal risks** is asset allocation:

- How much liquidity do you need for personal expenses, job or business volatility, retirement, kids' college, personal projects, etc.?

- How much income do you need to support your lifestyle?

- How much "dry powder" do you need to set aside so that you can stay the course during a bad market?

- How much can you set aside for long-term investments that have the highest potential long-term returns?

What Are the Options?

A lot of people are looking at international options, but in terms of safety, I believe that the most conservative assets continue to be short-term, high-quality U.S. based securities: treasury bills, CDs, money market funds, short-term investment grade credit funds, etc.

Because of the size of our country and economy, we naturally tend to focus on internal events. But I think the developed foreign markets (Europe and Japan) have problems at least as bad as the U.S. Debt levels in some of these countries is higher compared to the size of their economies, their populations are shrinking, and the tax base supporting their social benefits is under more pressure.

From a geopolitical perspective, if there are problems with Russia or China, it will be bad for the U.S., but it will be worse for Europe and Japan. I do believe we will work things out in one way or the other, so I do not expect a doomsday scenario. But the point is, under any foreseeable scenario, whether continued innovation and growth or geopolitical problems, the U.S. is a better place to be.

Most of the growth and innovation among companies over the last 20-30 years has happened in the U.S. and China. If you look at the companies in European and Japanese markets, they tend to be dominated by old line companies such as banking, oil companies, and heavy manufacturing. You see very few growing technology companies. Most of what's new has been brought by American companies and then quickly copied by Chinese companies.

This is reflected in the stock market returns over the last 30 years: around 10% a year for the S&P on average vs. around 6% for foreign developed markets. That compounds to a lot over time. And I would expect the U.S. to continue growing faster than the rest of the developed world.

Developing markets aren't much of an alternative either. Despite all the growth we've seen in China's economy, returns have been basically flat since 2007. In other words, any benefit has gone to insiders rather than to foreign investors.

Aside from their underlying risks, investing in foreign markets introduces currency risk to your portfolio, which doesn't make sense for most of us since our expenses are in U.S. dollars.

So, for better or worse, I believe the U.S. markets are the most attractive place for investors to be.

The Effect of Trump's Policies

In terms of what the effect of Trump's policies will be, I think there will be some winners and some losers. The net effect is unclear if we're just looking strictly at corporate profits, which are the driver of market returns (again, separating this from the administration's rhetoric).

To the degrees that companies import goods, tariffs are probably a negative. On the other hand, if the threat of reciprocal tariffs lowers trade barriers for U.S. companies, it may be positive for those. Robert Kennedy's policies may be harmful for biotech and pharmaceutical companies, but the administration's oil and gas policies will probably be positive for them. Given the tech-heavy list of advisors, I would expect policies to be positive for AI and other tech growth. Given immigration policies, I would expect it to be a negative for industries like restaurants, homebuilding, and farming.

So it's a mixed bag from an investment perspective and I take into account potential risks and opportunities when reviewing my managed strategies each month.

Finally, from an investment perspective, I am not worried about geopolitical events in Ukraine or the Middle East. Those are tragedies for the people involved, but of minimal impact to us directly. Whether the Ukraine war ends abruptly or continues for years, it would have only a marginal impact on U.S. companies.

Given the tough time Russia had with a much smaller country like Ukraine and Russia's own small economy, I seriously doubt they have the capacity to invade Europe even if they had the desire (which I don't think they do). To put it in perspective, despite their nuclear arsenal, Russia's economy is slightly smaller than South Korea's economy. It's also smaller than that of Germany, the U.K., France, and Italy individually, much less all of Europe combined.

Likewise with the Middle East conflict. The only potential conflict that would worry me is if China invaded Taiwan and I still believe that will be worked out because it's in everyone's interests for it to be worked out.

A Final Note

Regarding the future, I'll preface my comments by saying that no one knows what will happen and anyone who says they know is lying. But I'll give my experience and analysis.

Short of a true disaster, in which case no investing decision matters**, long-term returns of mature assets are driven by just two things: yield and growth**.

In other words, whatever happens over the next four years, I believe investors will do just fine if they buy assets that have growth potential and trade at a reasonable value. On a related note, Warren Buffett recently wrote his most recent letter to shareholders. I'm sad that at 94 years old we won't have many more years of his wisdom, but age has not diminished the clarity of his writing. Here is a quote relevant to our discussion:

> Despite what some commentators currently view as an extraordinary cash position at Berkshire, the great majority of your money remains in equities. That preference won't change . . .

> Berkshire shareholders can rest assured that we will forever deploy a substantial majority of their money in equities – mostly American equities although many of these will have international operations of significance. Berkshire will never prefer ownership of cash-equivalent assets over the ownership of good businesses, whether controlled or only partially owned.
>
> Paper money can see its value evaporate if fiscal folly prevails. In some countries, this reckless practice has become habitual, and, in our country's short history, the U.S. has come close to the edge. Fixed-coupon bonds provide no protection against runaway currency.

In other words, and I agree with this perspective, the greatest long-term potential returns and the most protection from currency debasement is in the form of growing assets, such as businesses and real estate. There is still an important place for safety assets based on your own situation (liquidity, planned drawdowns, a buffer for market downturns, etc.) but those decisions should not be based on your own needs rather than the markets.

Once you have determined the allocation for growth assets, then it becomes a matter of whether any businesses are attractive to own given their valuation, quality, growth potential, and risks. That is what I review monthly for managed accounts.

When I look at risk in the equity markets, I am primarily considering two things: the market's valuation and the outlook for corporate profits, which is the major driver of long-term returns. There is a lot of noise in the news, policies that we may disagree with, geopolitical risks, etc., but those do not have a major impact on my outlook either for valuation or corporate profit growth.

The major area of concern for me are the Big Tech companies, which trade at high valuations compared to their history. On the one hand, they also have extraordinary growth opportunities with the developments and uses of artificial intelligence. On the other hand, it's not clear how much of that growth will flow through to corporate profits.

Outside of Big Tech, my expectation for potential returns is similar to the long-term average of 8-10%, with periodic large market downturns. In Big Tech I might have a broader range of 6-10%, while acknowledging scenarios where returns in that group are flat for 10 years or scenarios where they have a renaissance and do even better; but the bulk of my expectation would be in the 6-10% range for Big Tech (still better than treasuries over a 10-year period).

Despite all the noise, I remain optimistic and focused on finding good quality businesses that trade at a reasonable value.

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
Natural gas	Crypto currency
Chinese stocks	Theme stocks
Long term bonds	Semiconductor stocks
Consumer staples	Small cap stocks
Gold miners	Retail and consumer discretionary stocks
Utilities	Housing stocks

It was an interesting mix of winners and losers in February. On the one hand, there was a clear movement away from risk, with crypto-currencies, theme stocks, small cap stocks, retail stocks, consumer discretionary stocks, and homebuilding stocks weak. Likewise, long-term bonds and some traditionally defensive sectors such as consumer staples and utilities were strong.

On the other hand, long-term bonds, while not that sensitive to market risks, are very sensitive to interest rate and inflation risks. Perhaps the market is seeing something that I am not, but I do not see any material improvement in the inflation outlook, particularly with the budgets going through Congress promising ongoing deficits. Although the direct cause of inflation is the Federal Reserve printing money, excessive deficits tend to require higher interest rates to attract investors and the Federal Reserve faces pressure to buy some of the bonds if there is not sufficient investor demand.

Of course, the overriding theme has been the rapid and quickly changing stream of news from the new administration. While the market overall has not been unusually volatile, the rapid changes and unpredictability has led many investors to feel increased uncertainty and this is reflected somewhat in where investor money has flowed.

Stocks

	S&P 500	Dow Jones U.S. Select Dividend	Russell 2000	Bloomberg US Long Treasury
1mo Return	-1.3%	2.5%	-5.3%	5.2%
YTD Return	1.4%	5.3%	-2.9%	5.6%
10yr Return	13.0%	9.9%	7.2%	-0.3%
20yr Return	10.5%	8.5%	7.8%	3.6%
30yr Return	10.7%	11.1%	8.8%	5.4%

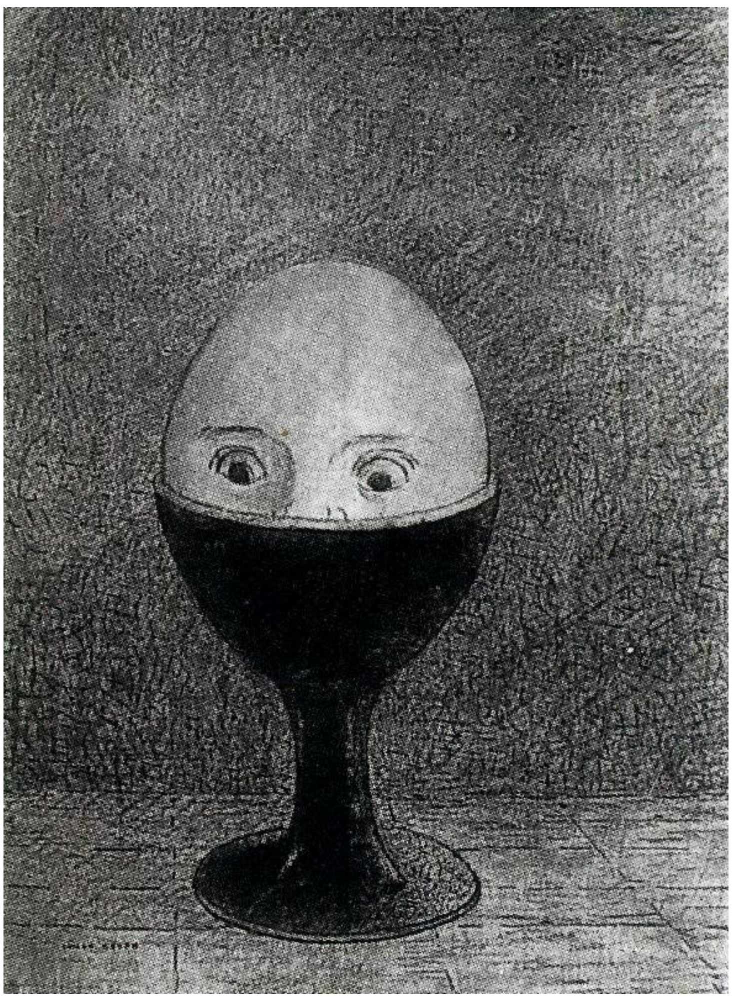
Source: FactSet as of 3/2/2025. We use the S&P 500 index as an illustration of the performance of large cap stocks, the Dow Jones U.S. Select Dividend index as an illustration of the performance of high dividend stocks, the Russell 2000 index as an illustration of the performance of small cap stocks, and the Bloomberg US Long Treasury index to illustrate the performance of treasury bonds with maturities greater than 10 years out.

Small cap stocks had a poor month, which has led to some attractively valued opportunities, in my opinion. Despite lower long-term rates driving the performance of bonds and dividend stocks, I still view dividend stocks as reasonably valued with some attractive opportunities. The S&P 500 is expensive, but that is due to the high concentration of Big Tech. The equal-weighted S&P 500 has dramatically underperformed the cap-weighted S&P 500 over the last several years, making the index appear a lot more expensive than the typical stock inside the index.

	Large Cap Stocks	Dividend Stocks	Small Cap Stocks
Dividend Yield	1.2%	3.2%	1.6%
Earnings Yield	5.0%	5.9%	6.4%
Earnings Growth	11.5%	8.7%	17.2%
Return on Equity	16.8%	11.5%	9.8%
% Losing Money	4.0%	2.5%	39.7%

Source: FactSet as of 3/2/2025. 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



"The Egg" by Odilon Redon (1885). Source: WikiArt.org.

Income Investing

Interest Rates	
1yr Treasuries	4.2%
10yr Treasuries	4.4%
10yr TIPS	2.0%
Municipal Bonds (5yr AAA)	2.7%
Corporate Bonds (5yr A)	4.8%
30yr Fixed Rate Mortgages	7.0%

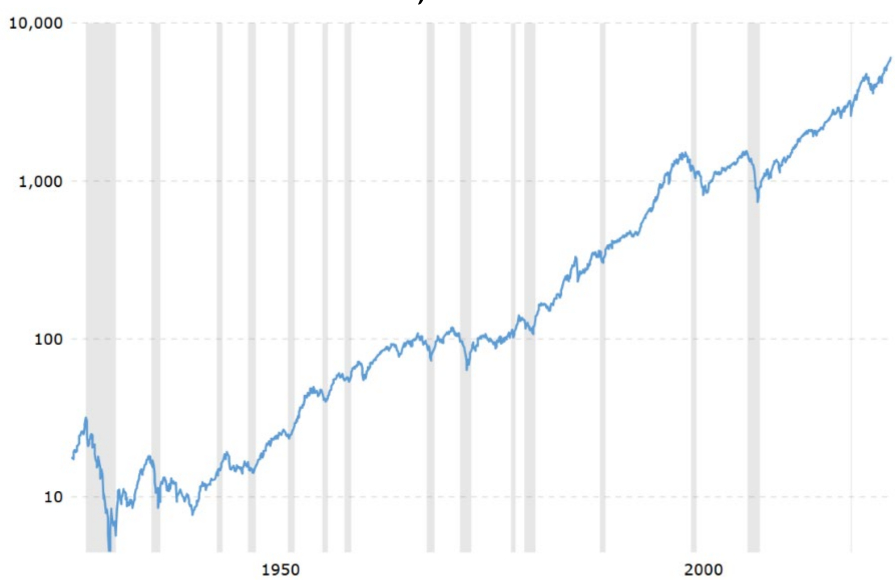
Dividend Yields	
Common Stocks	1.2%
—Top 25%	4.2%
—Next 25%	2.5%
Preferred Stocks	6.2%
Utilities	3.2%
Real Estate (REITs)	3.6%

Source: Interest rates from Raymond James' Weekly Interest Rate Monitor as of 2/24/2025 and The Wall Street Journal as of 3/2/2025. Source for the Dividend Yields is from FactSet as of 3/2/2025. 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.

Long-term interest rates fell primarily on concerns about economic weakness and a resulting softening of inflation expectations. While that may or may not be the case short-term, I don't see anything warranting a change in long-term inflation risks.

The Long View

S&P 500, 1928 to 2024



Source: MacroTrends.net

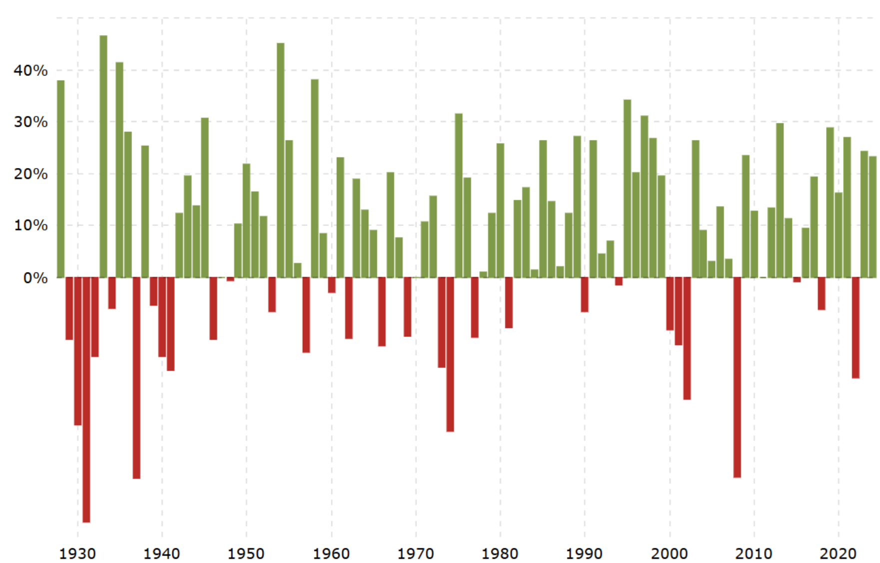
For the last 20, 30, and 100 years, stocks have averaged around an 8-10% annual return, driven by dividend yield, reinvestment of earnings, and earnings growth. Long-term bonds have yielded about 5% on average over the last century while inflation has been about 3%.

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 6-10% 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 12/31/24, has been profitable for 148 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.

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

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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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