The Crescent Group

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Wealth Management
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June 2024 Crescent Commentary

In our recent Commentaries, we've talked about the exuberance we've seen in financial markets this year, and how this exuberance has pushed risky assets to levels that seem unsustainable. One byproduct of the exuberance is that we haven't seen large swings in financial markets in a couple years. Over the past 44 years, U.S. stocks have seen an average annual intra-year correction of 14%. This doesn't mean that stocks fell 14% per year. Stocks have increased in 3 out of 4 years over that time period. The 14% intra-year correction means that stocks fell an average of 14% at some point during the year, and recovered for a positive return for the year in 3 out of 4 years.(1)

Because of the recent financial market exuberance, we've experienced below-average corrections over the past two years. Instead of a 14% intra-year correction, we experienced a 10% correction last year and only a 5% correction through the first part of the current year. We bring up this information as a reminder that at some point, financial markets will again become more volatile with larger swings. The present time – while things are quiet – is the time to mentally prepare for more volatile times ahead. Doing so will help you stay the course with your investments when markets become erratic. And this will help ensure you remain on track with your financial planning.(1)

Something else that happens during times of financial market exuberance is that investors tend to want to become more aggressive with their investments. It's natural to see things going up – often in an unsustainable way – and to want to get in on it. There are pitfalls with this mindset, however. The first is that it leads to a very high risk of overpaying for investments. If you buy an investment after it's gone up rapidly, there's a good chance you're buying before a correction. History is full of examples of investments that rose rapidly and then crashed or did nothing for decades. Then what typically happens after the correction is that investors tend to want to sell after it's fallen. And again, we understand why. The decision is a reaction to the fear of seeing one's investments fall in value. The problem is that this results in buying high and selling low, which hurts your investment results. Warren Buffett tells investors to be greedy when others are fearful, and be fearful when others are greedy. Buffett's mindset leads to buying low, rather than buying high. And that's helpful to remember during times of exuberance like the present.(2)

One thing we do know is that economies and financial markets move in cycles. We know this from looking at the past several hundred years of human history. With the U.S. stock market, we can see it over the past couple hundred years. The question today is do we ignore those lessons of the past just because investors are excited and something has gone up rapidly? Or do we learn from the mistakes of the past and try not to repeat them? We believe it's critical to learn from the past and not repeat mistakes. This is a crucial part of protecting your wealth over the long term and helping ensure success with your financial planning. This is why we currently advocate for a strong weighting towards boring, dividend-paying investments in conjunction with adequately diversified amounts of so-called "growth investments".

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Beneath the surface of exuberance in some segments of public financial markets, lesser followed private markets are showing signs of strain. For example, take these recent Wall Street Journal headlines: "Pensions Piled Into Private Equity. Now They Can't Get Out." And "A Real-Estate Fund Industry Is Bleeding Billions". Pension funds must make regular benefit payments to retirees. The private equity investments they own had previously made cash distributions which covered the pension's benefit payments. But those cash distributions have dried up, and private equity funds are now resorting to selling assets at a discount and borrowing in order to continue to make distributions to pension funds. This type of activity can only go on for so long. Only time will tell if the situation stabilizes or continues to worsen and lead to a bigger problem.(3)

With private real estate funds, or REITs, we mentioned in our previous commentary that one of the largest private REITs, the Starwood REIT, recently made the decision to restrict investor withdrawals. The restricted withdrawals is a sign of underlying strain in the commercial real estate market. REITs paid top dollar for properties when interest rates were low. The increase in interest rates has caused a decline in property values, and the REITs are reluctant to sell properties at lower prices in order to meet investor withdrawals. As with the private equity situation described above, this dynamic can only go on for so long. Either the situation will stabilize, or it will lead to a bigger problem. Only time will tell.(3)

Both the private equity and REITs situations highlight some of the risks of private investments. Some Wall Street firms have aggressively pushed private investments for individual investors over the past several years. It serves as a reminder that it's important to know what you own, and know the risks. It doesn't do an investor much good to own a lot of investments where they can't access their own money at a time when they need it. And the fact that an investment is popular and touted as safe doesn't mean it's true. Mortgage bonds paid attractive yields and were touted as safe in the early and mid 2000s. Then the market fell out and many bonds defaulted or were worth only a fraction of the amount originally invested. And these were bonds sold to conservative investors and touted as "safe money". Once again, it's important to learn lessons from the past and try not to repeat the same mistakes. This is something we will continue to focus on for you.(4)(5)

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Forbes Best-In-State Wealth Management Team 2024

Sources:

(1) JP Morgan
(2) The New York Times
(3) The Wall Street Journal
(4) Morningstar
(5) University of Chicago

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The 2024 Forbes Best-In-State Wealth Management Teams award was announced January 2024. Data as of 3/31/23. The award was developed by SHOOK Research and is based on in-person, virtual and telephone due diligence meetings and a ranking algorithm that includes: a measure of each team's best practices, client retention, industry experience, review of compliance records, firm nominations; and quantitative criteria, including: assets under management and revenue generated for their firms. Investment performance is not a criterion because client objectives and risk tolerances vary, and advisors rarely have audited performance reports. SHOOK's research and rankings provide opinions intended to help investors choose the right financial advisor and team, and are not indicative of future performance or representative of any one client's experience. Past performance is not an indication of future results. Neither Forbes nor SHOOK Research receive compensation in exchange for placement on the ranking. The financial advisor does not pay a fee to be considered for or to receive this award. This award does not evaluate the quality of services provided to clients. This is not indicative of this financial advisor's future performance.

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