The Crescent Group

(214) 775-6401
us.rbcwm.com/thecrescentgroup

Wealth Management
The Crescent Group

RBC Wealth Management

The Crescent Group

Carsten Frederiksen, CFP®
Senior Vice President
Financial Advisor
Senior Portfolio Manager
Portfolio Focus
Direct: 214-775-6401
NMLS#: 1321563 City National Bank

Paul Hendershot
Senior Vice President
Financial Advisor
Senior Portfolio Manager
Portfolio Focus
Direct: 214-775-6430
NMLS # 1370978 City National Bank

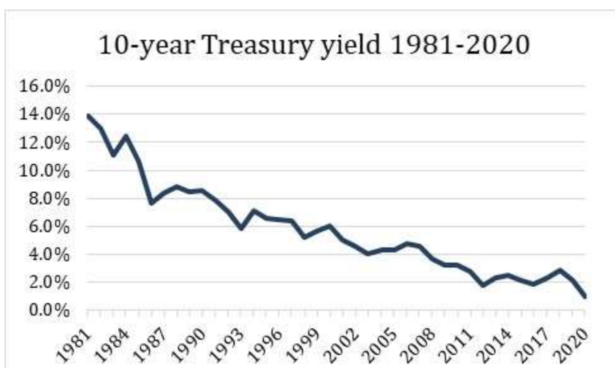
Lindsey Vickers, MBA
Senior Registered Client Associate
Direct: 214-775-6458

[The Crescent Group website]

Continued on page 2

November 2023 Crescent Commentary

In our October 2021 Commentary, we asked: what happens when the rules of the game change? Two years later, we wonder: have they changed? As the below charts show, one thing we've learned over the decades is to expect the unexpected.



Source: Board of Governors of the U.S. Federal Reserve

As the charts to the left show, interest rates increased for 20 years through 1981. As a result, investors thought rates would only move higher. But instead, interest rates fell for 40 years. Then after interest rates fell for 40 years, investors thought rates could only stay low. Instead, interest rates spiked over the next three years through October 2023 – even our Federal Reserve did not expect that to happen. While no one can predict the future, we can see one thing from these charts: our economy experienced a large stimulative tailwind over the 40 years through 2020 that simply can't repeat. Rates fell from 14% to 0%, and once you're at 0%, you obviously can't repeat that move.(1)

Why do we talk so much about interest rates? Interest rates act as gravity for the value of all financial assets: public and private equities, bonds, and real estate. And all of those asset classes – and our economy – received a boost from the 40 year decline in interest rates. Since we can no longer experience the stimulus benefit of interest rates falling by double digits, what does that imply for investment returns going forward? We expect that investment returns will be less exciting for everyone. The challenge is to square that reality with investor expectations. Individual investor expectations almost always reflect what has happened over the past 5 to 10 years. For example, in 1999, after a huge bubble formed, individual investors expected stocks to keep rising. Surveys show individual investors expected a positive return of more than 50% from stocks over the next year. Instead, stocks started falling and ended up declining more than 40% through 2002. You can see the exact opposite during times of despair: in 2009, individual investors expected stocks to decline more than 30% over the next twelve months. But instead, stocks soared, and we witnessed the longest bull market in history over the following 11 years.(2)(3)

And of course, now that we've experienced the longest bull market in the history of the U.S. stock market, investors once again have high expectations. Our own view at the Crescent Group is that the next several years have the potential to be less exciting for all investors compared to the past several years. We've already seen this happen, as U.S. stocks have been flat for nearly three years now. Bonds have had an even tougher time, with the bond market down 20% from high levels set in 2020. After the huge bull market we experienced from 2009 through 2021, it's only natural to expect more of the same. But historically, that's not what has happened.[(3)(4)]

This brings us back to our question at the beginning: have the rules of the game changed? Our answer is both yes and no. When we say yes, what we mean is that the days of everything going up indiscriminately purely on the basis of hype are likely coming to an end. Historically, time periods like that have lasted up to ten years, followed by equally long periods where speculative assets did poorly. While we have seen a return to speculation this year, most of the assets involved in last year's crash have not fully recovered. Our view is that those assets are still in the process of correcting, and the correction is likely to continue once the impact of higher interest rates fully filters through our economy (interest rate increases have historically had a lag of up to a few years in terms of their impact on the economy).[(5)]

When we say yes, the rules of the game have changed, we also mean that any investing involving borrowed money will be more difficult. As we mentioned at the beginning, interest rates fell for forty years. That provided a huge tailwind for private equity and real estate investing, which typically involve large amounts of borrowed funds. Again, with Treasury rates sitting around 5% today, rates cannot repeat the drop from 14% to 0% that they experienced over the past forty years. This will make investing with borrowed funds more difficult and possibly riskier.

When we say no – the rules of the game have not changed – what we mean is that what has worked best over the long term – decades and centuries – will continue to work. Sticking to a sound investment process that has produced consistent and repeatable results will continue to work. Over the long term, equities will generate higher returns than bonds, as they historically have. Trying to time investment markets will continue to fail. We expect the most consistent investments of the past sixty years to be the most consistent investments of the next sixty years, and those are branded consumer products and pharmaceutical companies. With potentially choppier investment markets in the future, investments that pay cash dividends and interest will become more important as they will allow investors to reinvest that cash through choppy markets, and reap the benefit of those additional investments when markets recover. We will continue to work with you to position your assets for success in an evolving financial landscape.[(6)]

The Crescent Group
Paul Hendershot | Carsten Frederiksen, CFP® | Lindsey Vickers, MBA

Sources:

(1) Board of Governors of the Federal Reserve System
(2) National Bureau of Economic Research
(3) Natixis
(4) Yahoo Finance
(5) Federal Reserve Bank of St. Louis
(6) Lindsell Train