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
[The Crescent Group website]

Paul Hendershot
Senior Vice President
Financial Advisor
Senior Portfolio Manager
Portfolio Focus
NMLS # 1370978 City National Bank

Nick Weege, CPFA
Financial Advisor
214-775-6408

Lindsey Vickers, MBA
Client Service Associate
214-775-6458

Andrew Ielmini
Investment Associate
214-775-6448

June 2021 Crescent Commentary

Vaccination, social reopening, and economic recovery. Those are the themes that drove U.S. investment markets higher in the first half of 2021. As one would expect, assets hit hard by covid-19 have staged a strong recovery this year. Our Group anticipated this time would come, and we positioned clients for this recovery last year when we rotated client assets into those investments hit hard by the virus lockdowns. While we have the benefit of living in a country winning the battle against covid-19, many developing countries lack adequate vaccine access, and the pandemic continues to present problems in those areas. Despite the challenge this poses for human health, it does present investment opportunity – those large markets will experience a strong recovery as the virus abates, similar to what happened in the U.S. While the current investment climate does present risks – just as it always has and always will – we see multiple favorable opportunities for our investors, and remain strongly optimistic about the good results those opportunities will provide[1].

There's no question that the world went through a frightening period last year when most nations entered lockdowns and financial markets crashed. Despite the great uncertainty of this time period, our Group looked to the future, to a time when "this too shall pass". We heavily invested client assets in selected companies and industries hit hard by the pandemic – such as those tied to bars, restaurants, gatherings of people, and the general economy. Those investments drove strong gains for our clients in the first half of 2021. Many investors feel more comfortable about their investments today than they did a year ago, as the world now has a much more certain path to recovery from covid.

The interesting thing about risk is that it always has been and will be present. While covid has abated, new risks have emerged, which we discussed in commentaries during the first half of this year. Those risks include the potential for higher tax rates, increasing inflation, and increased speculation in financial markets. The Wall Street Journal recently highlighted the plight of three friends who tried to get rich quickly by gambling in the stock of AMC, GameStop, and SPACs. While they initially made quick money, texting each other about expensive cars they would buy, two of the three friends ended up losing about a third of their initial investment. The third friend made an insignificant amount of money. Even the super rich can give in to the emotions of

investment frenzy. A recent CNBC article mentioned that none other than Tom Brady lost 40% on his Bitcoin "investment". Obviously, Brady has access to professional financial advice. We don't know if his advisors encouraged the Bitcoin gamble, or if Brady didn't listen to their warnings. Our job as financial advisors involves both encouraging our clients to remain invested (or even to invest more) when markets fall, and conversely encouraging restraint during times of speculation. Both are equally important and difficult, and there can be no better example of this yin-yang approach to advice than what's happened over the past year with a great crash followed by areas of speculation[2][3].

In terms of the risks to your financial plan posed by potentially higher tax rates and inflation, in commentaries earlier this year, we discussed the need to maintain a higher allocation to stocks rather than bonds in order to offset the wealth hurdles these two factors potentially pose for the future. We also discussed how our Group carefully selects investments that have a demonstrated track record of overcoming inflation and tax rate changes over the past decades and centuries.

Despite the varied risks financial markets presented last year and this year, our Group remains strongly optimistic about our client investments moving forward. The first factor underpinning this optimism is the early stages of the global economic recovery. While the U.S. has moved pretty far along with social reopening, other developed countries are in much earlier stages, which leaves a lot of room for improvement. With developing markets, we mentioned earlier how many of them lack adequate vaccine access and the pandemic remains mostly uncontained. While this poses misfortune for humanity, it does mean that recovery and reopening in developing countries leaves a long runway for economic growth. Many of our investments earn a substantial portion or even majority of their earnings from developing markets. The combination of later stage recovery in developed markets and early stage recovery in developing markets provides a significant driver of growth for our investments going forward[1].

Another strong driver of future investment earnings growth will come from new technology in combination with its accelerated adoption as a result of the pandemic. When the world entered lock down, it forced corporations to rapidly adopt new technology to work and meet remotely, and it reduced their reliance on expensive travel and office locations. While a certain amount of baseline travel and office space is needed, it made corporate management teams aware of the opportunity to cut costs by eliminating unnecessary travel and office space. Some of these cost cuts will provide a permanent boost to profits going forward[4].

Direct-to-consumer sales is another capability corporations accelerated their adoption of during the pandemic. Although this was in development prior to the pandemic, it took off during lockdowns as consumers looked to purchase online rather than in person. Direct / digital sales have become a much larger portion of the sales of many of the investments we own, and they carry higher profit margins than sales through distributors. This trend will continue into the future.

Along with direct / digital sales comes digital advertising, which also accelerated during the pandemic as a result of fewer opportunities for in-person advertising. Unlike traditional mass advertising channels of the past, digital advertising allows companies to target specific people with specific products and services based on a person's specific interests. Corporations have reported that digital advertising costs less than past advertising channels and more effectively drives revenue growth, again providing a boost to future profits and sales[1].

Finally, corporations learned to manufacture more efficiently during the pandemic. They implemented new "smart" manufacturing technologies as a result of the need for social distancing in factories, which have increased their efficiency and profitability. And as with the above technologies, the lessons learned are here to stay, along with the increased profitability that results from them[5].

While there's enough to get excited about from the technologies discussed above, perhaps most exciting of all is the unknown future technologies that will once again increase the efficiency and profit margins of corporations as time goes by. Over time, the opportunities provided by new technologies and improving economies will far outweigh the short-term noise caused by risks and crises. Over the past 120 years, stocks have returned an average of 7% a year, despite a continuous stream of unprecedented crises. We expect that trajectory to continue into the future. Our Group looks forward to guiding you through the future challenges and opportunities that financial markets provide, in order to realize the success of your financial plan.

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Carsten Frederiksen, CFP® | Paul Hendershot | Nick Weege, CPFA | Andrew Ielmini | Lindsey Vickers, MBA

Sources:

(1) Company reports
(2) The Wall Street Journal
(3) CNBC
(4) Reuters
(5) Forbes

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