THOUGHTS FOR THE WEEK

RANDOM RAMBLINGS ON MARKETS

August 16, 2024

Let's talk about last week's stock market volatility. Dramatic as the drop was early in the week, prices came storming back late in the week, and market prices finished the week about where they started. As we write Tuesday afternoon (8/13), the stock market continues to rise, recovering most of the "losses" that have accrued since the beginning of July.

There are myriad factors that affect stock prices, but two main themes – fundamentals and narrative. In our view, the most important is fundamentals. If a company is growing earnings and maintaining a Return on Equity (ROE) above its cost of capital, then the intrinsic value of said company should increase. It's a basic formula for building business value, which ultimately is based on how much cash you can expect to take out of the business in the future, discounted back to a value today. This occurs over the long-term. We invest on fundamentals.

But in the short-term, the narrative can overpower fundamentals. The narrative is the story behind, or astride, or ahead of, the numbers. Raw numbers are relatively meaningless without a narrative to shape the story. And last week, the broad narrative supporting the stock market seemed to shift. At least for a few days. A set of economic releases that fell below expectations ignited a new narrative – oh no, here comes a recession – and stock prices rapidly adjusted. Downward. The media, quick to join the fray, began to write of a possible emergency interest rate cut. The expectations for the total number of interest rate cuts rose. Threats of a massive Yen carry trade unwind (*Thoughts* is too short to fully explain that one) materialized. The optimists fled; the pessimists assumed the throne. Until a few days later, that is.

Long time readers know our view on these market machinations. "Not much you can do about them". They are unpredictable. And, to paraphrase the late Charlie Munger, "If you can't withstand an occasional terrifying drop in stock prices, don't invest in stocks." They happen. Frequently. You can expect stock price declines of -10% in any given year. You can also expect price drops of -30% or more roughly a few times per decade. That's not a prediction, just our experience. So, we don't tend to do much when stock prices get nasty, other than look for bargains. Instead, we combat market volatility employing a few basic principles of investing: i) make sure you have enough liquidity on hand to meet your near term needs; ii) carry an additional liquidity backstop in the form of high-quality bonds; iii) hold a diversified portfolio of assets that don't all respond to the same economic influences.

We can't predict when market prices will decline. Or when a recession or bear market will hit. But we *can* prepare. And we suggest ALL investors prepare. At all times.

So, how does last week's market ructions impact long-term investment strategies? "I don't know" is a good place to start. "I don't know" is not a cop-out; it's an acknowledgement of our inability to predict the future. And more importantly, a reminder that projecting an aura of certainty into a highly uncertain world can be dangerous. Outcomes are by definition highly uncertain…we don't find today's investment climate to be any more / less uncertain than other periods…it might just *seem* more uncertain.

Borrowing a page from Howard Marks, though, we can at least take stock (no pun intended) of where we are today. Starting with stocks, prices are higher than long-term averages. Justified? Perhaps, because today's leading companies are more profitable than those of decades' past. A high return, growing, less cyclical tech company is arguably worth more than a bank or oil company, on a PE (price to earnings) basis. But starting prices matter – a lot – when considering forward returns. So, it's reasonable to expect that stock returns in the US over the next decade will not match the prior decade, which has produced above average returns for US stock investors.

Conversely, we believe bonds probably offer a better return today than they have over the last decade. Why? Because interest rates are higher today then they've been at just about any time in the last 10 years. Could interest rates rise, hurting bond returns? Of course. Today's rates are still on the lower end of the spectrum of history. But starting prices, or starting yields in this case, matter, and today's yields are well above the 10 year average. The odds of a better return from bonds, relative to the rather dismal return of the last 10 years, have increased.

All of this, of course, ties back into our thinking on how to build an all weather portfolio that we referenced earlier: Indemnify your known liquidity needs for a few years; carry an additional liquidity backstop; and invest for long-term growth in a way that allows you to absorb unpredictable but frequent bouts of volatility. It's simple. But not easy. If you want to chat more, give us a call.

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Awards:
2024 Barron's Top 250 Private Wealth Management Teams
Source: barrons.com (Awarded May 2024) Data compiled by Barron's for the period Jan 2023-Dec 2023.

2024 Forbes Best-In-State Wealth Management Teams
Source: Forbes.com (Awarded Jan 2024) Data compiled by SHOOK Research LLC based on time period from 3/31/22-3/31/23.

Mike Burbank | **2019-2020 & 2022-2024 Forbes Best-In-State Wealth Advisors**
Source: Forbes.com (Awarded 2019-2020 & 2022-2024). Data compiled by SHOOK Research LLC based 12-month time period concluding in June of year prior to the issuance of the award.

Mike Burbank | **2017-2024 Barron's Top 1,200 Financial Advisors: State-by-State** (formerly referred to as Barron's Top 1,000 Financial Advisors: State-by-State)
Source: Barrons.com (Awarded 2017-2024). Data compiled by Barron's based on 12-month period concluding in Sept of the year prior to the issuance of the award.

Mike Burbank | **2013-2020 Financial Times 400 Top Financial Advisors**
Source: ft.com. Data compiled by the Financial Times based the following time periods:
Awarded 2013-2020; data 12/31/12 - 6/30/19
Awards Disclosures

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