CARMEL | CAPITAL PARTNERS

Quarterly Brief

Exclusive updates and insights for discerning investors.

March 2024

General Commentary

Surprise – this is the one word I would use to describe 2023. We faced rising interest rates, a Spring banking crisis, and a war in the Middle East. With this backdrop, it's hard to believe the stock market delivered the strong returns it did, and the economy continued its multi-year expansion.

We live in a world with many unknowns and surprises. Often, it's less about what happens and more about how prepared one is. A well-known bond investor, Howard Marks, recently wrote an article discussing investing in today's challenging world. He talks about how difficult it is to predict or forecast in such a volatile time. Instead, he observed that "you can't predict, but you can prepare." I like this sentence as it reflects our thinking and posture regarding investing and planning.

We continue to prepare for higher interest rates (relative to the past five years), continued global instability, and growing election uncertainty. Instead, we will avoid the prediction game and focus on preparing for a wide range of outcomes.

For Carmel Capital Partners, 2023 was also a busy year. We transitioned to a new portfolio management and planning platform as well as a new custodian, all with the goal of enhancing the level of service. I am incredibly proud of our team and of how we continued to serve the families we work with during so much change.

Financial Markets

The final quarter of 2023 ended with mixed news. We witnessed the sad events in Israel and are now seeing the turbulence spread further into the broader Middle East. Despite this development, the stock market has not suffered. In fact, the opposite occurred. We observed strength in the last quarter of 2023 in response to the Federal Reserve signaling the beginning of a rate reduction cycle beginning in 2024. Away from the stock market, we are seeing stress in the bank lending markets as many lenders are reducing their activities in preparation for the upcoming refinancing wave. The challenge is not only the amount of dollars in need of refinancing, but that prevailing interest rates are materially higher. We expected a coordinated effort between lenders, regulators, and the Federal Reserve as the only successful way through the refinance bubble. We believe the backstop and savior will again be the U.S. government, specifically the Federal Reserve balance sheet and the U.S. Treasury.

The government's generosity can only be funded from a few avenues, and increasing taxes is one of them—more on this topic below.

For the year, both our equity and fixed-income performances were strong due to improvements in our portfolios.

As a firm, we are preparing for a higher interest environment. Specifically, we have taken the following steps:

1. We moved our fixed-income portfolios towards higher-quality credit and shortened our maturity profile.
2. For public equities, we continue to own high-quality companies with low leverage, conservative balance sheets, little refinancing risk, highly generative cash flow, and leaders in their respective industries.
3. In our real estate portfolio, we have reviewed all our holdings' loans and understand where (if any) refinancing risks exist. We are not deploying new capital unless we know the investment will have positive carry (difference between cash flow generation and cost of debt) and can sustain itself in a higher for longer interest rate environment. Said differently, the path to success for the investment does not have to include lower interest rates.

As a reminder, our first objective is capital preservation, with the secondary objective being growth. With the growing uncertainty in financial markets and geopolitical events, we remain vigilant and focused on long-term wealth preservation.

Equity Update

During Q4 2023 we’ve continued to hold a portfolio of what we believe to be high-quality, well-run, durable, market-leading companies. Irrespective of how the economy performs in the coming months or quarters, we expect the companies we hold to perform well in the long term. If inflation returns or does not decline as rapidly as expected, the Federal Reserve will cut interest rates more slowly than expected. If this outcome materializes, we expect the market to weaken, and in response, we will be looking to add new holdings or increase existing holdings.

Fixed Income Update

We continue to see fixed income as an attractive investment destination. Despite the Federal Reserve’s shift towards cutting interest rates, we still believe rates will remain higher than in the previous five years. Our fixed-income portfolio continues to be a mix of high-quality corporate bonds, treasuries, and floating-rate private credit holdings.

Real Estate Update

We anticipate distress in the coming quarters and maintain cash to deploy should such opportunities arise. Our current real estate portfolio consists of four value-add holdings that we believe will reach stabilization in 2024. While the lending environment is challenging, we will evaluate refinancing options for all stabilized properties in 2024. There can be no guarantee that we will find loan options for these properties.

We have reviewed all existing loans for the remaining properties and believe we understand the refinancing risks and cash flow impacts from higher interest expense upon refinancing.

Private Equity Update

While we continue to review many opportunities, we are maintaining a very conservative posture, and any company that we do not believe will sustain itself in a higher rate or slower economic environment is an immediate "no."

We invite you to visit the Direct Investing page on our website to view some of our current Real Estate & Private Equity holdings.

Summary & Firm Updates

As a firm, Carmel Capital Partners engages with families as both financial planners and investment advisors. While these sound like the same area of expertise, they are quite different. However, one area of overlap is taxes.

Much of the capital we invest is domiciled in California and is taxable. We expect taxes at both the Federal and State levels to rise in the coming years; thus, we want to prepare for a more onerous environment.

To this end, we spent the past 12 months exploring various strategies designed to optimize and improve the tax profile of the capital we invest. In the coming months, we will begin to engage with you to discuss how these strategies may apply to you and help improve your tax profile.

We are grateful for your trust and relationship, and the team at Carmel is working hard each day to navigate the turbulent markets and ever-evolving geo/political climate.

We hope you found this brief valuable, and we encourage you to share it with your fellow investors. For further discussion or personalized advisory, please reach out to info@carmelcap.com, 858-457-7544, or visit our Contact Page.

About the Founder

Russell Silberstein

Prior to forming Carmel Capital Partners in 2002, Russell was a managing partner at Bedell Investment Counseling, LLC, a San Francisco Bay Area firm with $120 million in assets under management. He held the position of Director of Research & Portfolio Manager from 1996 to May 2001 at Bedell Investment Counseling, LLC. He was also the managing partner of the Harmony Fund, LP, a long/short investment fund. Russell graduated from San Diego State University.

About Carmel Capital Partners

Carmel Capital Partners was founded in 2002 by Russell Silberstein with the goal of delivering stable long-term returns to individuals, families, and entrepreneurs through opportunistic, value-oriented investments. The firm serves individuals, families, and entrepreneurs across California and manages approximately $370m in assets as of March 2023.

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