CARMEL | CAPITAL PARTNERS

Quarterly Brief

Exclusive updates and insights for discerning investors.

Q1 2024

General Commentary

We continue to prepare and plan for a different environment than we've experienced in the past 15 years. It's not just about interest rates, elections, wars, and excessive debt influencing our thinking. It's about all these occurring together and the solutions and choices required to resolve these issues successfully. While we don't believe the world is ending, we think the era of low interest rates, free money, unchecked government spending, and globalization is slowly reversing. Like any good party with excess, the hangover does not feel good. The party itself will not kill you but will leave you regretting some choices and pledging reform for the next time.

We believe that investment strategies, portfolio composition, tax planning, and general investment thinking must be adjusted for what lies ahead. Not all change is bad; we see the shifting landscape holding the opportunity to invest in ways that will deliver attractive outcomes. 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.

As a firm, we have always worked hard to grow and evolve. In 2016, we added real estate and private equity to the investment offering, and in 2023, we added new technology solutions like our portal and the Orion reporting platform. As our next evolution, we will focus heavily on tax planning and tax optimization strategies. Some of these strategies include Private Placement Life Insurance (PPLI) and an active tax loss harvesting strategy. Both approaches will minimize taxable income in your investment portfolio. In addition, we have recently started utilizing a software platform that allows for tax/estate planning simulations and what-if scenarios. The ability to optimize capital gains tax and income tax planning will be increasingly valuable in what we believe will be an increasingly challenging tax environment. In addition, if the landscape investment landscape does indeed change, an optimized tax strategy will become even more valuable.

I look forward to sharing more details on these valuable tools and strategies in the coming months.

Financial Markets

The "will they, won't they" discussion about the Federal Reserve interest rate policy continued in the first five months of 2024.

At the end of 2023, investors expected the Fed would cut interest rates beginning with the March 2024 meeting and then continue cutting as the year progressed. As 2024 unfolded and economic data arrived, the forecast was placed in jeopardy, and the financial markets quickly adjusted. As a result, we have seen falling long-term interest rates reverse and head higher. As stated last quarter, we believe our time is best spent preparing rather than guessing. To that end, we are ready for rates to remain high, and thus, we continue to maintain the same level of conservatism across all our investments.

The era of free money and low interest rates is very much in the past. Many areas of the financial markets have not yet fully adjusted to this new reality but will eventually be forced to. We want to ensure that we're protected as reality settles in. Operating with financial fitness and prudence will be the key to long-term success for our investment portfolios. If this level of preparation is overly conservative or outright wrong, we'll all be pleasantly surprised.

Other concerns like election year uncertainty, runaway deficit spending, and two major wars add to the high interest rate puzzle. All these must be addressed and resolved in the near to medium term and most through a series of unattractive choices. Despite these problems, the equity markets continue to advance, exhibiting little concern for these broader geopolitical and macroeconomic issues. We will continue emphasizing quality, low leverage, and diversification across all our investments.

Equity Update

We continue 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 years, we expect the companies we hold to perform well in the long term. As markets have increased during the first five months of the year, we have trimmed and sold several positions, and our cash levels are now above average. We continue exploring new opportunities to deploy this cash while ensuring we adhere to the quality criteria that are so important to long-term investment success.

The recent hype cycle around Artificial Intelligence (AI) forced several tech companies' stock prices to advance meaningfully. We believe AI will transform how we work and live; however, the business model for AI is still undetermined. The amount of capital spending today is sizable. In 2024 alone, FAAMG companies will spend $200 billion on AI. Current forecasts indicate $1 Trillion of spending over the next five years. The significant level of spending is the fuel to the AI hype fire. We're unsure how this will all play out, but we will look for opportunities to invest in this growing ten and 20-year trend.

If the equity markets weaken in the coming quarters, you should expect us to add to existing holdings and add new positions to the equity portfolio.

Fixed Income Update

We continue to see fixed income as an attractive investment destination. With higher interest rates, we're seeing attractive fixed income return opportunities. Our fixed-income portfolio combines high-quality corporate bonds, treasuries, and floating-rate private credit holdings.

Real Estate Update

Today, we have three new opportunities we're evaluating, and we look forward to sharing more information in the coming weeks.

The Q4 2023 letter outlined the impact of rising interest rates on real estate in general and the expected impact on some of our holdings. During Q1 2024, we updated the year-end 2023 values for most of our real estate holdings. As expected, we have seen valuation declines in our three office holdings and, in one case, a substantial decline. We believe the valuation declines are temporary and do not represent the ultimate value of these investments. We expect values to increase as space is re-leased and cash flow recovers. Ultimately, we expect the returns on these investments to be adequate but most likely below our original expectations.

We continue to see an expanding opportunity for new real estate investments. Most of these are driven by the trends discussed above, specifically higher interest rates. As rates increased in 2022 and 2023, new construction fell in many real estate asset classes. Over time, the lack of supply will become problematic; we remain ready to invest in opportunities to earn outsized returns by building in underserved markets.

Private Equity Update

Today, we have one new investment opportunity in the modular home building sector, which we expect to close in the coming weeks.

Summary & Firm Updates

As a firm, we continue to focus on the road ahead and constantly watch for long-term planning and preparation. We are grateful for your trust and relationship, and the team at Carmel Capital is working hard each day to navigate the ever-evolving geo/political climate.

Lastly, in September we will be moving offices. As we get close to moving day, we will have more information available.

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 $333m in assets as of March 2024.