Quarterly Brief

Exclusive updates and insights for discerning investors.

Q3 2023

General Commentary

A few months ago, I was on an evening flight home after a work trip. As I settled into my seat, the person beside me introduced himself and asked, "What do you do?" Now, I'll be candid with you – it had been a long day, and I was exhausted; all I wanted was to answer a few urgent emails and unwind by listening to a podcast. So, in an attempt to swiftly conclude the conversation, I replied, "I'm in the investment business." Perhaps not my finest moment, but fatigue had taken its toll. My neighbor looked at me quizzically and asked, "What does that actually mean?" I delivered a more detailed answer than he probably cared for, and quickly after that, he turned on his iPad and put on his headphones. It may have been a small victory for me, but his question got me thinking.

As I sat there climbing through the sky, I thought more about his question and would like to spend a paragraph or so providing a much better answer than "I'm in the investment business." While we spend no time forecasting the economy or the stock market, we pay close attention to what's happening worldwide and include this view in our investment process.

When Carmel Capital Partners was founded in 2002, we were "in the investment business." We were an investment-centric firm focused solely on stocks and bonds and saw everything through the lens of those outcomes. Over time, we evolved into offering families two distinct areas of engagement—wealth advisory and investment management. While not all families engage in both areas, our best work and outcomes occur when we are fully immersed in both. By seeing the complete picture and all the pieces on the board, we deliver the most value and the best results for families.

Our advisory offering includes guiding, assisting, planning, and advising families on estate, inheritance, cash flow, and tax planning. We answer questions such as "When can I retire," "How do I sell my business," "How much money do I need to maintain my lifestyle," "What's the most efficient way for me to be philanthropic," "How do I protect and grow my capital over the long term," and "I need to get organized and understand what I have." The Camel team is talented, hardworking, thoughtful, and caring. We have also invested in technology and systems to deliver an effective and high-quality solution set. I am proud of what we have built.

Our investment management offering is the financial expression and manifestation of our wealth advisory offering. Here, too, we have evolved and improved over the past 22 years. Today, we invest in public equities (stocks), fixed-income securities (bonds), real estate, and private equity. We use various strategies, partners, and technology to deliver a highly diversified and durable investment portfolio. Our first goal is to preserve each family's wealth and ensure we can accomplish the goals outlined in their financial plan. We achieve this by maintaining prudent diversification, utilizing various tax planning strategies, and thoughtfully researching our investments. Our capital preservation mandate means sometimes we will have excess cash due to our inability to find opportunities that meet our risk/reward requirements. It can also mean accepting a lower return if it means a more certain return. Finally, we will seek to avoid what is working now and avoid investment fads.

Our second goal is to grow the investment portfolio prudently and responsibly, and we measure our success over a rolling 5-year basis. Some years will be better than others, but we believe our portfolio of high-quality investments will deliver satisfactory returns in the long term. Despite our views about long-term returns, our primary mandate is goal #1 – capital preservation.

Now that I have summarized "what I do," I am unsure how to capture that in a one-sentence answer. The closest I have come is answering a different question: "How do I define success in our relationship with each family?" The answer might surprise you. I define success as "If a family does not think about me or Carmel Capital on a daily, weekly, or monthly basis." That may sound strange, but here is my rationale. If a family can live their life, enjoy their kids or grandkids, enjoy their hobbies, manage their business, spend time with their spouse, and not think about their wealth, we are doing our job correctly. The peace of mind comes from knowing that Carmel is on it, working on their behalf, executing their financial plan, and investing their wealth prudently, so there's no need to think about us. That's success.

In these uncertain and unsteady times, it always helps to revisit and reaffirm one's true North. The above represents my effort to reaffirm to each of the families we serve how seriously we take our responsibility in caring for their capital and how diligently we work each day to execute their financial life plan.

Financial Markets

As expressed in recent updates, the financial markets continue to be challenging. It's a tough environment when mortgages and car loans are at 8%, consumer debt is at an all-time high, and, more recently, the Middle East has once again become very unstable. Consumers and businesses are not set up for this kind of world. Despite the recent change in stance by the Federal Reserve to indicate an end to the rate hiking cycle, we still believe that difficult times are ahead.

We have maintained a defensive posture throughout 2023, especially regarding fixed income. Our actions to reflect this conservatism are that we have significantly reduced our real estate and private equity investing, generally held onto cash, and reduced our equity exposure. We believe this prudence has paid off. However, we slowly increased our fixed-income exposure as interest rates rose throughout the year.

The higher interest rate environment has resulted in some adverse outcomes as well. Some of those challenges exist inside our investment portfolio. Elevated interest rates are impacting global real estate and private equity investments. Any investment with leverage is ultimately exposed to some level of additional risk.

Today, we own several Real Estate and Private Equity investments that have generated strong returns over the past five years. However, we have two holdings where we believe a permanent capital loss could be the outcome. Receiving news of this nature is never easy; conveying it is equally challenging. Nevertheless, our clients must rely on us to be honest, transparent, and prompt in sharing all forms of news. As a firm, we are committed to being forthright and transparent in communicating our successes and stumbles. I believe this level of self-evaluation will allow us to refine and improve our process over time, be better investors and planners, improve our decision-making, and ultimately drive superior outcomes for the families we serve. For the most part, we believe our holdings are sound and performing as expected. Real estate and private equity will continue to play a meaningful role in our portfolios. We are mindful that we always take a long-term view remembering that the road to an attractive outcome is never a straight line, and we expect setbacks and detours along the way. Despite all this, we expect real estate and private equity to contribute attractive returns in the years ahead.

Please be mindful that we manage risk in a number of different ways. In the case of real estate or private equity, we use allocation size as a risk management tool. For each investment, we do not allocate more than a certain percentage of each portfolio value to a specific investment. We keep the allocation size small, which means that no single investment can severely impact the outcome of the whole portfolio. Diversification is essential when investing in non-liquid assets. While it's painful to experience any investment loss, and we consider every dollar of capital precious, we constantly manage the portfolio as a whole, and diversification in small allocation amounts allows for the long-term success of the portfolio as a whole.

Today, our working model is that interest rates remain elevated for longer and a period of extremely low rates is unlikely to be repeated. If the economy weakens, we expect the Federal Reserve to cut interest rates at the low end (3 months), but we expect interest rates to remain high at the longer end (10 years). We are analyzing and evaluating all future investments through this lens and where we can adjust. We are preparing for a changed world.

Equity Update

During Q3 2023, we added more holdings to the portfolio. The market volatility in 2023 allowed for more undervalued holdings additions. If the market weakens in the coming quarters, you should expect us to continue prudently adding to our equity exposure.

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 months or quarters, we expect the companies we hold to perform well over the long term.

Fixed Income Update

As interest rates have continued to rise, we have increased our allocation to fixed income where appropriate. We continue to see fixed income as an attractive investment destination. Early summer, we believed the Federal Reserve was close to the end of this rate increase cycle and thus extended the maturities of our fixed-income holdings. These actions will allow us to lock in elevated interest rates even if the Federal Reserve begins cutting interest rates in response to a weakening economy.

Real Estate Update

New opportunities are on the horizon and expected to close during Q4 2023. We foresee distress in the coming quarters and maintain cash to deploy should such opportunities arise. Our current real estate portfolio consists of value-add holdings expected to reach stabilization in 2024. Ordinarily, at that point, the asset would be ready for refinancing. However, given the distress the banking systems are experiencing due to a growing number of troubled loans, it is unclear whether that will happen, given the current lending environment.

Private Equity Update

We have one new opportunity, which will be shared in the coming weeks and is expected to close in Q4 2023. While we continue to review a large number of opportunities, maintaining a very conservative posture, any company that we don't believe can sustain itself in a higher rate environment or a slower economic environment is an immediate "no."

Summary & Firm Updates

New Wealth Advisor - Chelsey Frate

Please welcome Chelsey Frate. Chelsey joined Carmel Capital Partners in September after seven years at UBS. While at UBS, Chelsey worked with many high-net-worth clients on financial, estate, and tax planning. She brings all these same skills to Carmel. Please welcome her to the team.

We are grateful for your trust and relationship and are working hard 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.