Quarterly Brief

Exclusive updates and insights for discerning investors.

Q4 2024

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General Commentary

The overall investment and economic landscape remain heavily influenced by two major trends: the daily news cycle from Washington and artificial intelligence (AI).

The flow of news from our nation's capital, along with frequent executive orders, is unrelenting. Not all news is relevant, so we spend most of our time separating signals from noise. We are in a unique moment in history where many investment professionals are struggling to digest the daily influx of news and information. Pass the Tums.

We're focused on anything that we believe will drive increased inflation (and, by effect, higher interest rates) and anything related to changes in tax policy. Both can and will impact our planning and investment thinking. It's early days, and thus, it's tough to conclude anything with much confidence. As always, we will continue to adopt a long-term mindset and not make any reflexive material adjustments.

Our orientation remains focused on capital preservation. In uncertain times marked by a lack of clarity, we will prioritize conservatism, even if it means forgoing some investment returns. Ensuring long-term investment sustainability and preserving capital during volatile periods and potential challenges will ultimately lead to long-term investment success.

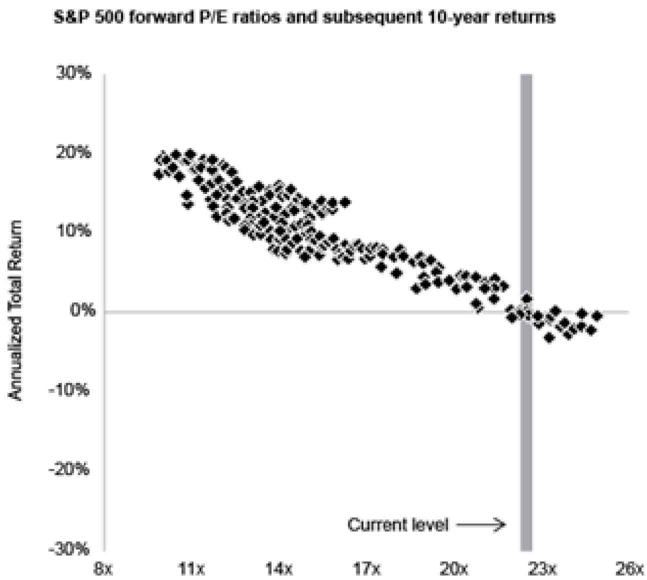
Equity Update

For the second consecutive year, stock market returns have been robust. Fixed income, real estate, and private equity have lagged. Essentially, any investment characterized by high leverage or reliance on interest rates for its fundamental economics underperformed. While stock market returns have been strong (the S&P 500 rose by 23.31% and NASDAQ increased by 28.64%), slightly over 50% of these gains can be attributed to just five stocks. Furthermore, all investors using the S&P 500 index for diversification should carefully review the fine print. The indexes no longer provide the same level of diversification they once did—a topic for another discussion.

While recent returns have been robust and exceed long-term trends, future returns are likely to be lower. The chart below illustrates that the entry multiple (the investment's valuation at the time of purchase) is negatively correlated with future returns.

In other words, your expected return will likely be lower if you overpay for an investment. The gray bar illustrates the current market multiple, indicating that the expected 10-year returns could be 0%. Relying on a single metric to forecast future returns is unwise; similarly, attempting to predict future market returns is imprudent. Fortunately, we do not invest in "the market" but instead hold a portfolio of stocks that are currently less expensive than the market, and we expect to produce positive future returns based on the underlying success of the companies.

Also contributing to the investment landscape is the surge of daily announcements from Washington, D.C. Given the rapid pace and constantly evolving nature of these decisions, forming consensus and conviction around most announcements is challenging. We know that one likely outcome of all these initiatives will be increased volatility. As a reminder, we do not equate volatility to risk. We believe that a high likelihood of permanent capital loss represents risk. A stock price that fluctuates rapidly in response to market events is simply volatile. This year, we anticipate increased volatility, which we will utilize opportunistically to make new investments and add to existing ones.



As the stock market rose throughout the year, particularly in the fourth quarter, we took advantage of the market strength to lower the weightings of certain holdings. Following the increased volatility after the election and into January, we reallocated a portion of these funds.

We are satisfied with our equity portfolio's performance overall and believe we possess an attractive mix of well-established companies alongside some new, emerging firms that are executing at a high level and performing exceptionally well.

Fixed Income Update

If the stock market valuation chart above is a reliable guide to future equity market returns, then fixed income yields today look attractive on a relative return basis. As interest rates remain high, we see attractive fixed income return opportunities. Our fixed-income portfolio combines high-quality corporate bonds, treasuries, and floating-rate private credit holdings.

Our changes to the fixed income portfolio early in 2024 resulted in strong performance. As we communicated last quarter, we did not believe the Federal Reserve Banks' ability to continue cutting rates was realistic. We maintain this position and believe interest will remain where they are or move higher.

If inflation resurfaces in the upcoming quarters, we anticipate fixed income returns will turn negative once more. We are closely monitoring the situation to determine if this scenario is likely and will adjust the portfolio as needed.

Real Estate Update

We did not make any new real estate investments in Q4 2024, but one new investment will close during Q1 2025.

Higher interest rates continue to be a headwind, reducing new opportunities significantly. However, the distress we expected due to the rapid increase in interest rates has not yet materialized, so we remain in the batter's box, bat on our shoulder, waiting for an attractive pitch.

If you live in California or Coastal Florida, the topic of insurance is increasingly appearing in conversations. With frequent hurricane-related destruction in Florida and the recent fire-related damage in California, insurance rates are surging. Moreover, availability has also become a significant concern. If insurance companies and state governments fail to find a workable solution, people and businesses may choose to leave these states, as the cost of real estate ownership will be too burdensome for some. We have limited exposure to California (two holdings) and Florida (two holdings) among our total of 29 real estate holdings. It seems likely that insurance, in terms of price and availability, will become a larger topic in 2025.

Our portfolio continues to perform well overall, and several properties will start making initial distributions in 2025. However, a few properties are still affected by higher rates and local issues, and they will continue to preserve cash flow and build reserves to ensure long-term viability.

Private Equity Update

The private equity sector continues to lurch forward. Financing is still a challenge, and we continue to see attractive opportunities that struggle to get financing. In contrast, the prospects of lower interest rates were expected to contribute to an improved lending environment - that has yet to materialize. There are alternatives available. Non-bank private lenders are disintermediating traditional bank lenders, and while this capital is available, it comes with higher rates and more restrictive terms.

We have purposely slowed our private equity investment cadence and are preserving cash.

Summary & Firm Updates

I am excited about the various initiatives we have in motion for 2025. In Q1, we plan to launch our tax optimization strategy and roll out enhanced reporting for our real estate and private equity investments. Several other firm-related enhancements are being worked on, and I look forward to sharing more information as the year progresses.

As a firm, we continue to focus on the road ahead and strive for long-term planning and preparation. We are grateful for your trust and relationship, and the team at Carmel works hard every day to deliver on its promise of Advice, Relationships, and Results.

We hope you found this brief valuable. 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 September 2024.