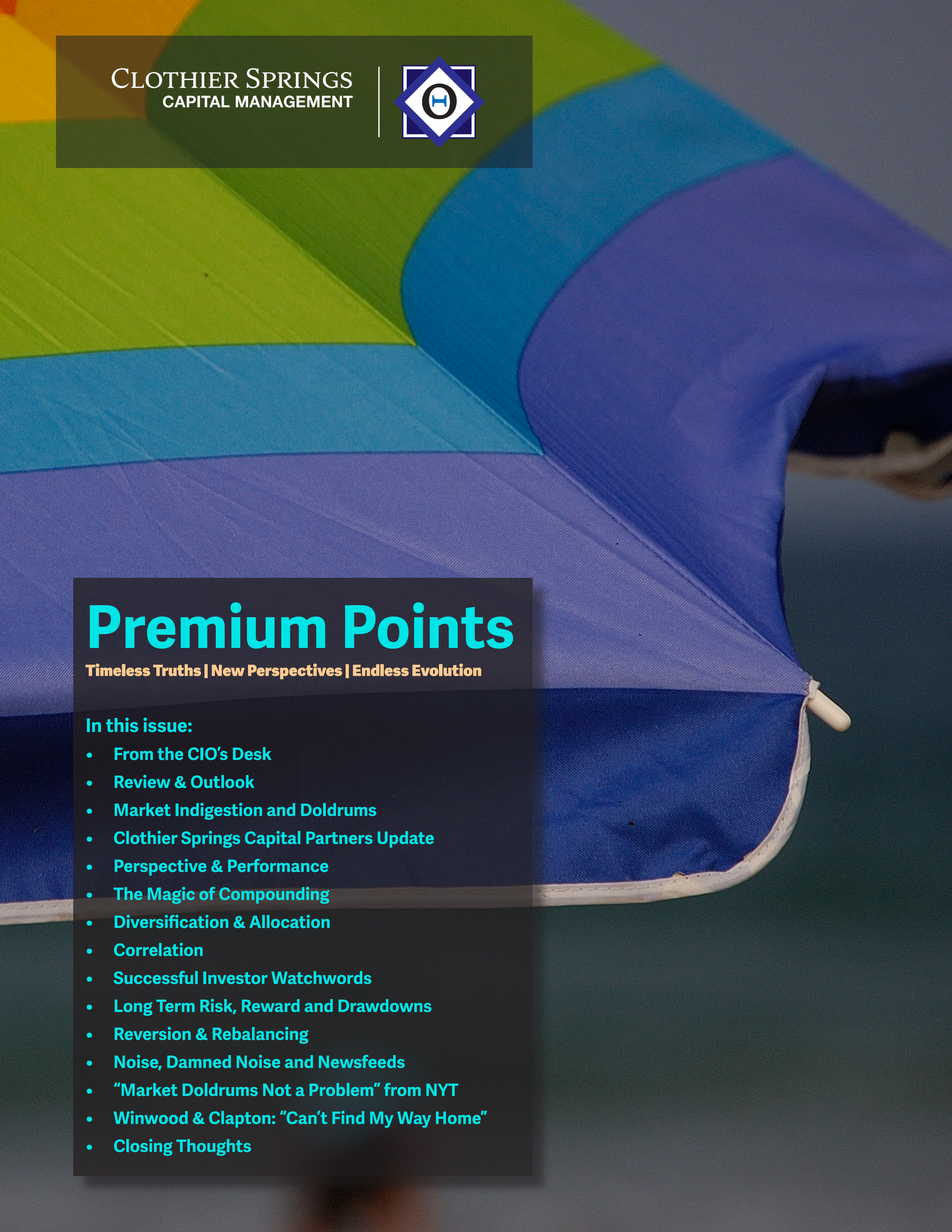

Clothier Springs
Capital Management

Premium Points

Timeless Truths | New Perspectives | Endless Evolution

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From the CIO's Desk

Our registration with the Pennsylvania Department of Banking and Securities was approved and effective as of June 30th, 2010. That means we just had our 13th birthday. We hope to have many more.

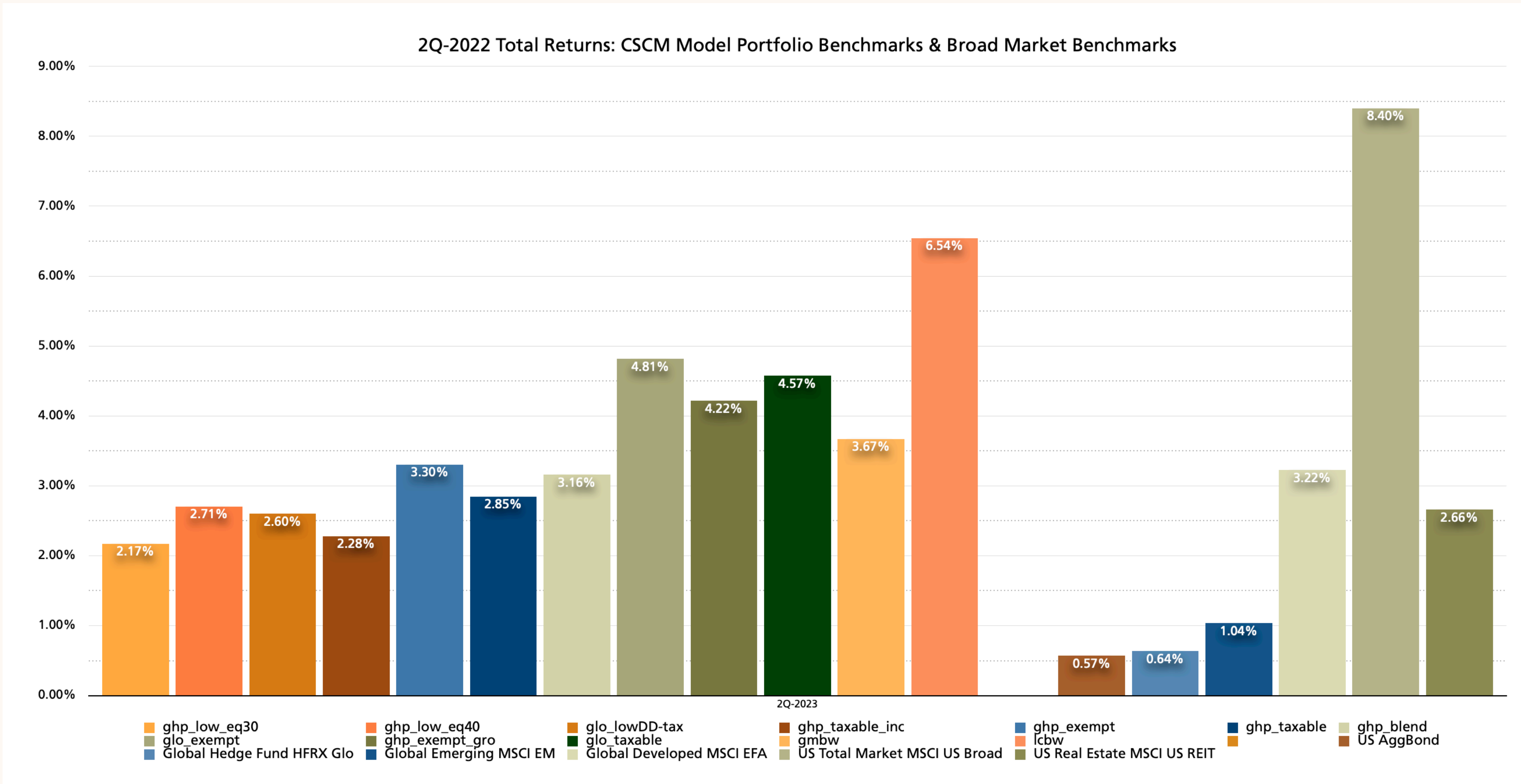
Perspective is everything in the pursuit of successful investing. Investors recently endured a 23.8% decline in the equity markets in 1Q-2022 through 3Q-2022 and a near 20% decline in 1Q-2020 as the Covid precautions and lockdowns rattled the markets.

Now, after three positive quarters, we can look back and see how in the fullness of a prudent equity investors' time horizon, these unpleasant down-markets did not really matter to the long term returns. They were in fact buying opportunities. Data and charts to follow within.

Inflation—the metric of the moment—is showing further signs of abating and we can chalk up the equity market rally to the expectation that further rate hikes will be minimal or unneeded.

Is it just me or is anyone else tired of the "billionaire" cliché? We monitor any number of financial news feeds and the term billionaire is now used as evidence of competence. "Billionaire" so-and-so says "do this" or "do that" or whatever. That billionaires are now a dime-a-dozen is certainly evidence, but of something else entirely.

Thomas F. McKeon, CFA
August 31, 2023



Review & Outlook 2Q-2023

The equity market just posted a third consecutive positive quarter and equity markets in the U.S. are now within shouting distance of their all-time highs. The rally has continued through July as inflation shows further signs of abating and the Fed's effort to stem inflation with interest rates hikes nears an end.

Fixed income (bonds) and preferred stock markets have not rebounded as quickly as the higher interest rate regime keeps a lid on prices. The yields (current income) on these investments are however much more attractive and collecting a 5% to 8% income while you wait is fine compensation.

The Federal Reserve recently reported that they no longer think an economic recession is likely. If that is the case it appears that they have engineered the proverbial "soft landing" for the economy, reducing inflation without causing a recession. We'll take it.

Indigestion and Doldrums

The markets are digesting numerous moving data points, inflation, interest rates, economic growth (perhaps recession) low unemployment and more. With so many uncertain variables, it is no wonder that the equity markets are taking a breather (written in late August).

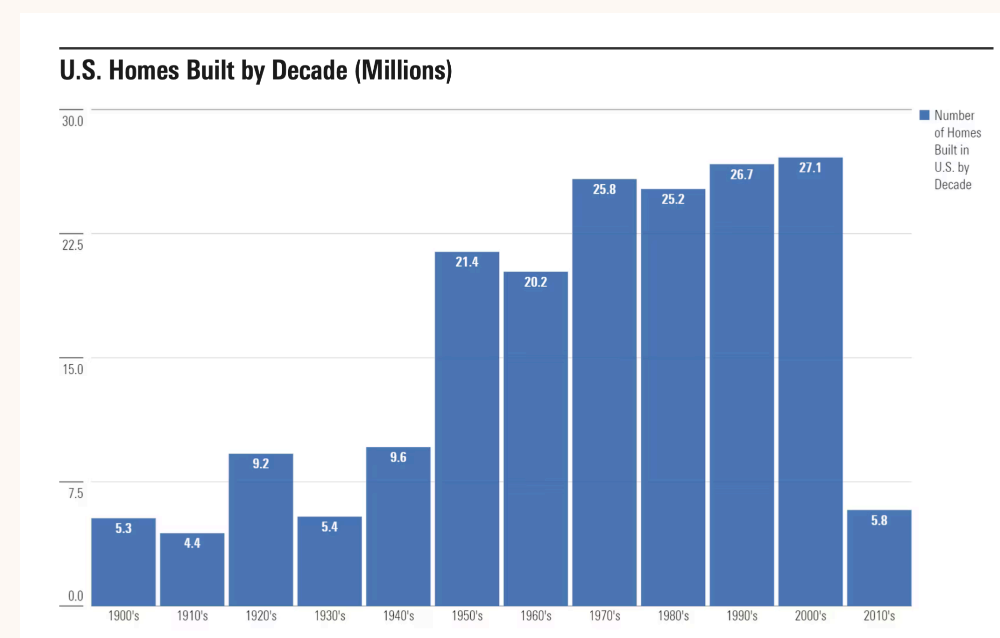
These are however opportunities to do some portfolio re-balancing, planting and pruning. The markets are still below their end of 2021 peaks and there is good money to be made being fully invested as the markets ultimately digest the data and move to new highs. We believe the 4th quarter of 2023 would be a good time to launch the rally.

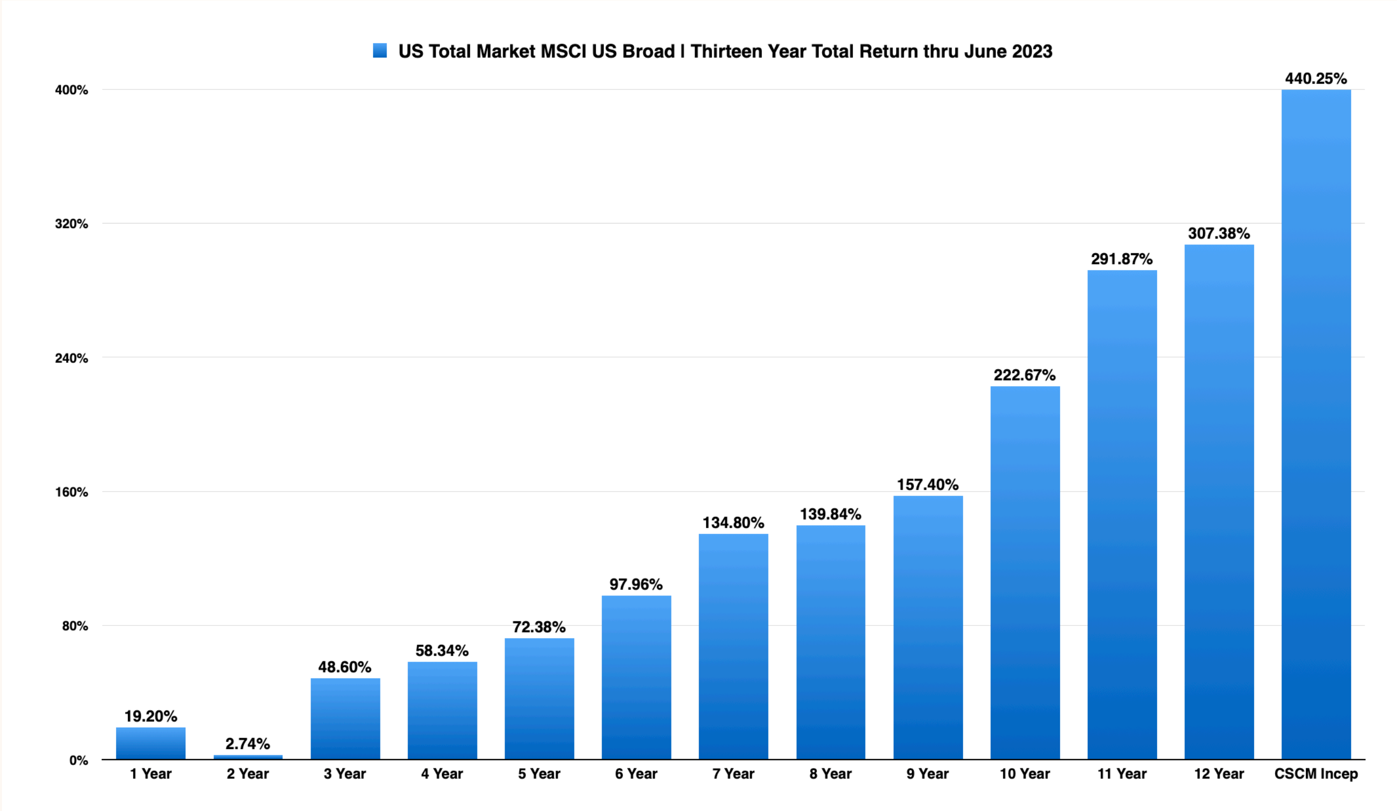
Clothier Springs Capital Partners Update

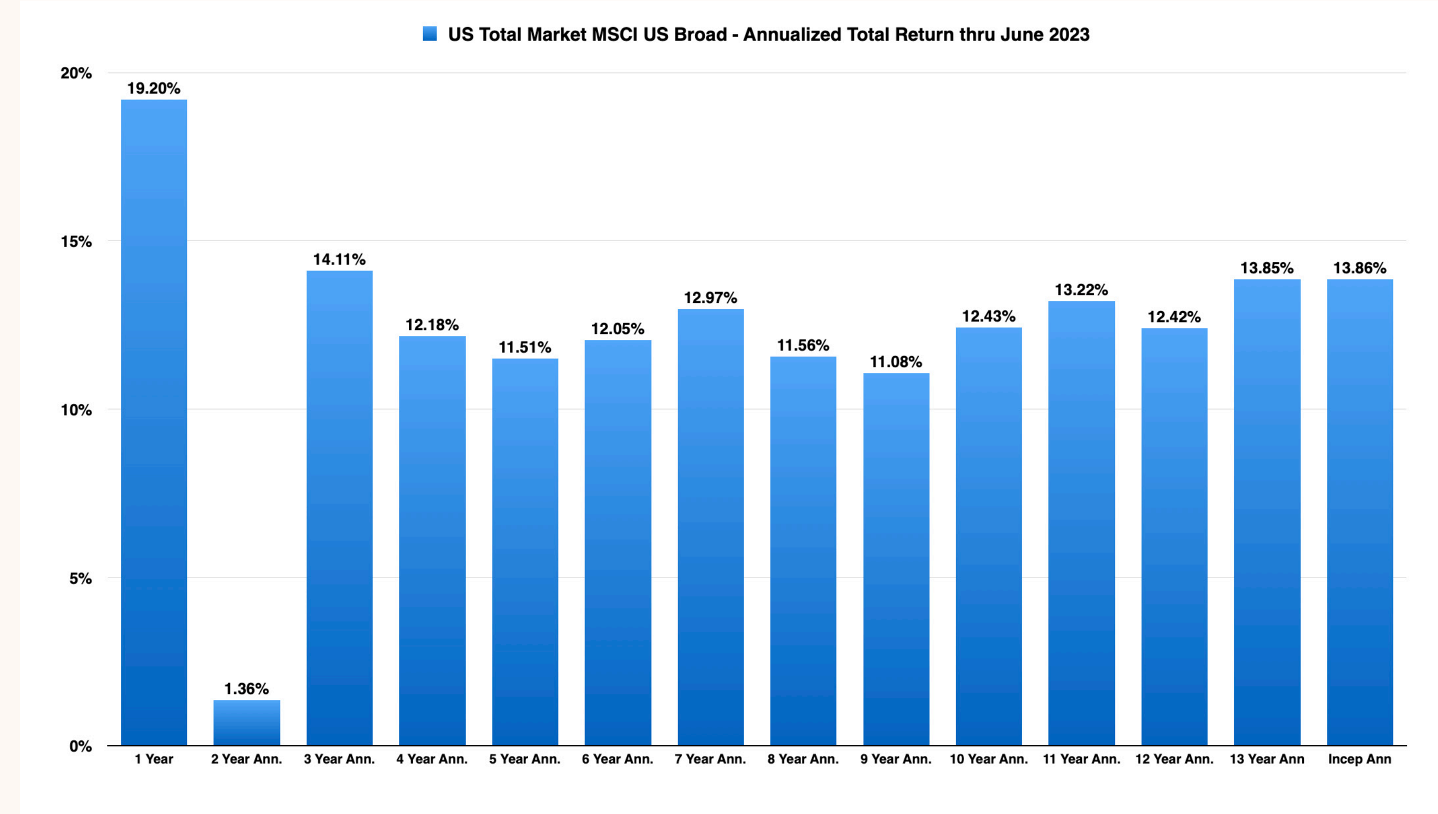
We are in the final phase of our audit for 2022. The new auditor took extra time as they got acquainted with our operations and accounting conventions. All the cash flows reconcile and the last piece is the Fair Market Value estimates. This is the subjective part of the audit and they wanted additional personnel to review our FMV estimates. We appreciate their thoroughness. The FMV revisions for 2022 should provide a healthy uptick in our Net Asset Value (NAV). The upward revisions are a function of our investments operating their businesses, improving properties, raising rents and increasing their Net Operating Incomes (NOI). With the lack of capital events resulting from interest rate uncertainty, this is the best way to realize the growing value of our investments. We will let you know when the audit is published.

We are waiting on one final K-1 to produce our own K-1 for our members. The tax return is effectively finished save for that last K-1 so our turnaround will be quick once we receive it. One of our investments began making cash distributions this month--Cross Properties-The Dane--and this adds to our monthly/quarterly partnership income. We made one new investment recently--a small apartment deal in Conshohocken, PA--a robust suburb of Philadelphia.

Evidence continues to show that the housing shortage in the U.S. remains acute. From Morningstar: *In the four decades leading up to the global financial crisis, nearly 26 million new homes were built in each decade. In the most recent decade, only 5.8 million new homes were built.* This bodes well for the long-term demand for multi-family housing.







Perspective and Performance

The chart above shows the cumulative total return (gains + income) of the MSCI US Broad Equity Market Index over the thirteen year life-span of Clothier Springs Capital Management, LLC.

The equity markets suffered three down quarters (-23.8%) in 2022 before rallying in 4Q-2022. In 1Q-2020, the equity markets had a sharp tumble of over 21% before rallying for the next 21 months through year-end 2021. Those were the two worst down periods in the broad US equity markets in our history.

Enduring them in real time is unpleasant for both investors and advisors alike. Clients engage us to advise and deliver returns.

The Magic of Compounding

However, as the investor's time horizon lengthens, the occasional negative market returns have a smaller and smaller impact.

Over the thirteen-year lifespan of CSCM, the MSCI US Broad Equity Market has delivered a 440% total return. A $100,000 portfolio would have grown to $539,000. A $1 million portfolio would have grown to $5.39 million. These are very robust returns and are in fact slightly above long-term average equity market returns.

Of course these are hypothetical's and precious few investors have the nerve to be 100% invested in equities, precisely because short-term declines can trigger bad behaviors.

Diversification & Allocation

A one-asset class portfolio would be imprudent in today's world, knowing what we know about the benefits of broad diversification and global asset allocation.

The chart above annualizes the cumulative annual total return from the chart on the left. It is remarkably consistent beyond a mere two-year horizon.

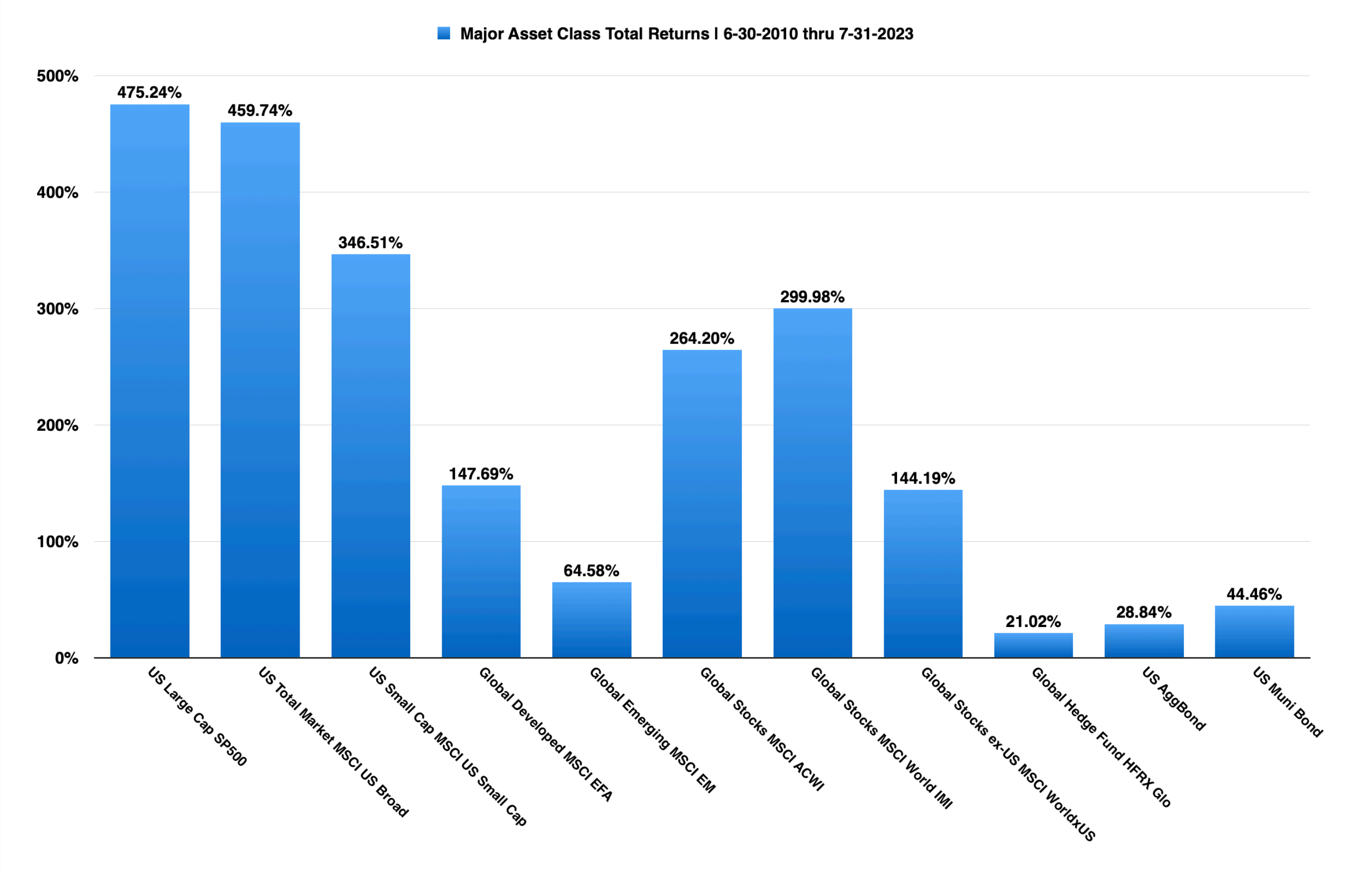
So prudence indicates that portfolios should be balanced across asset classes (stocks, bonds, preferreds, real estate, cash) and broadly diversified to achieve the best risk management. The asset mix should reflect each investor's risk tolerance and return requirements and ideally arrive at a mix that achieves the investor's required return and minimizes portfolio volatility and the occasional urge to abandon a well-constructed portfolio during periods of market volatility.

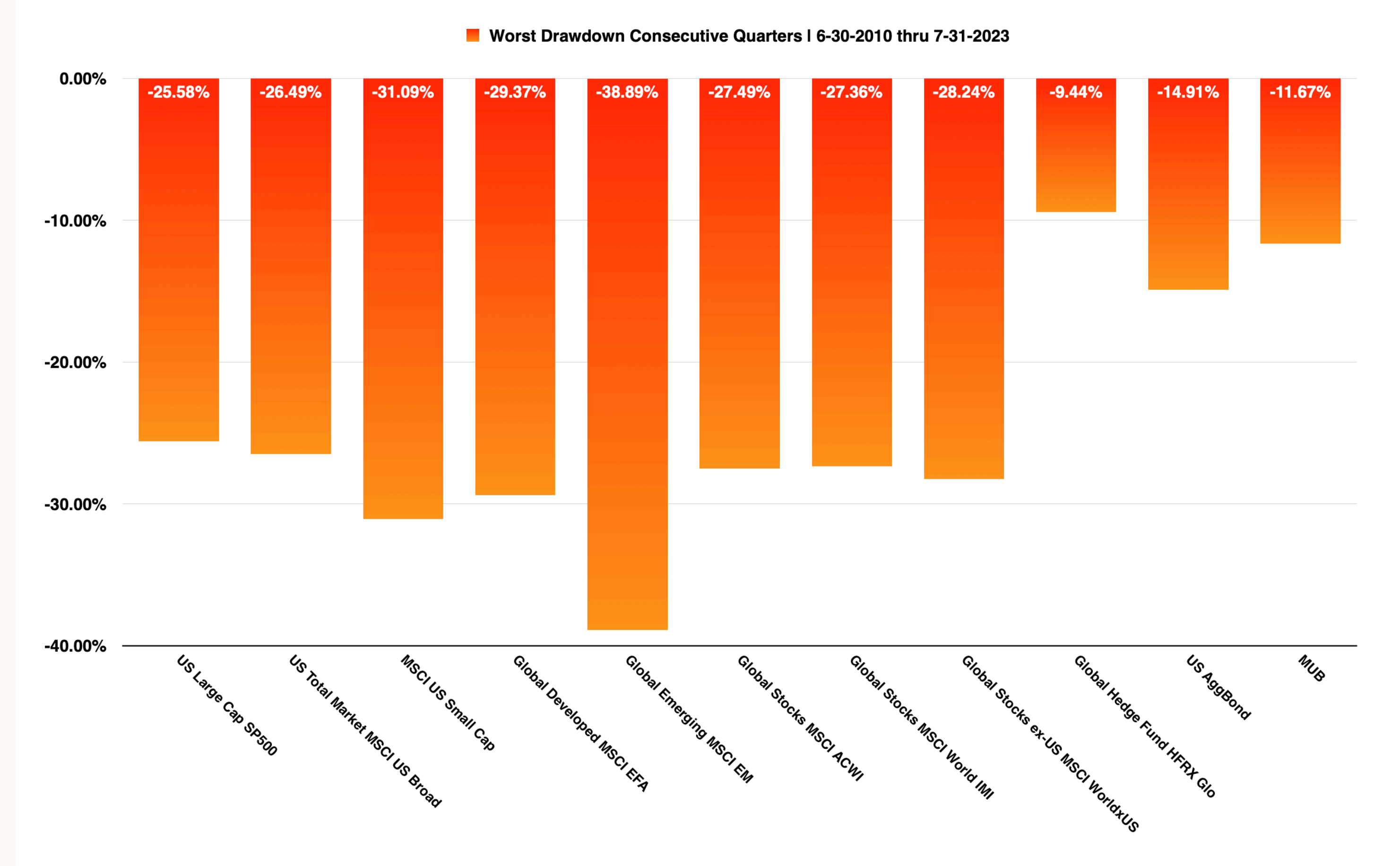
Correlations

More magic and risk management arises from the reality that asset classes are not perfectly correlated. To the extent that they do not move in lockstep, risk is further reduced. This assumes that average annual returns for said asset classes do in fact materialize, even as they took slightly different paths (annual returns) to get there.

Successful Investor Watchwords

Perspective, diversify, allocate, keep costs down, re-balance, endure, reap the rewards.





Risk and Return

The chart above shows the total returns of the indicated asset class benchmarks for the period 6-30-2010 (CSCM Inception) through 7-31-2023.

US Large Cap Equities led the way with near 500% total return for the period. US Small Cap delivered almost 350% total return. Global Developed Markets lagged significantly with a total return of 147% and Global Emerging Market barely outpaced a US Municipal Bond.

The other side of the return coin is risk. The chart above right shows the worst quarterly peak to trough drawdown of the same asset class benchmarks. The drawdown periods for each benchmark are not identical. Global Emerging Markets had the worst at a 38.89% drawdown.

US Small Cap was next with a 31.09% decline. Overall the equity markets had drawdowns of anywhere from 25.5% to 38.9%.

To be sure, these are unpleasant negative returns to endure. However, there is not a single benchmark examined here that did not provide a positive return over the 13+ years examined.

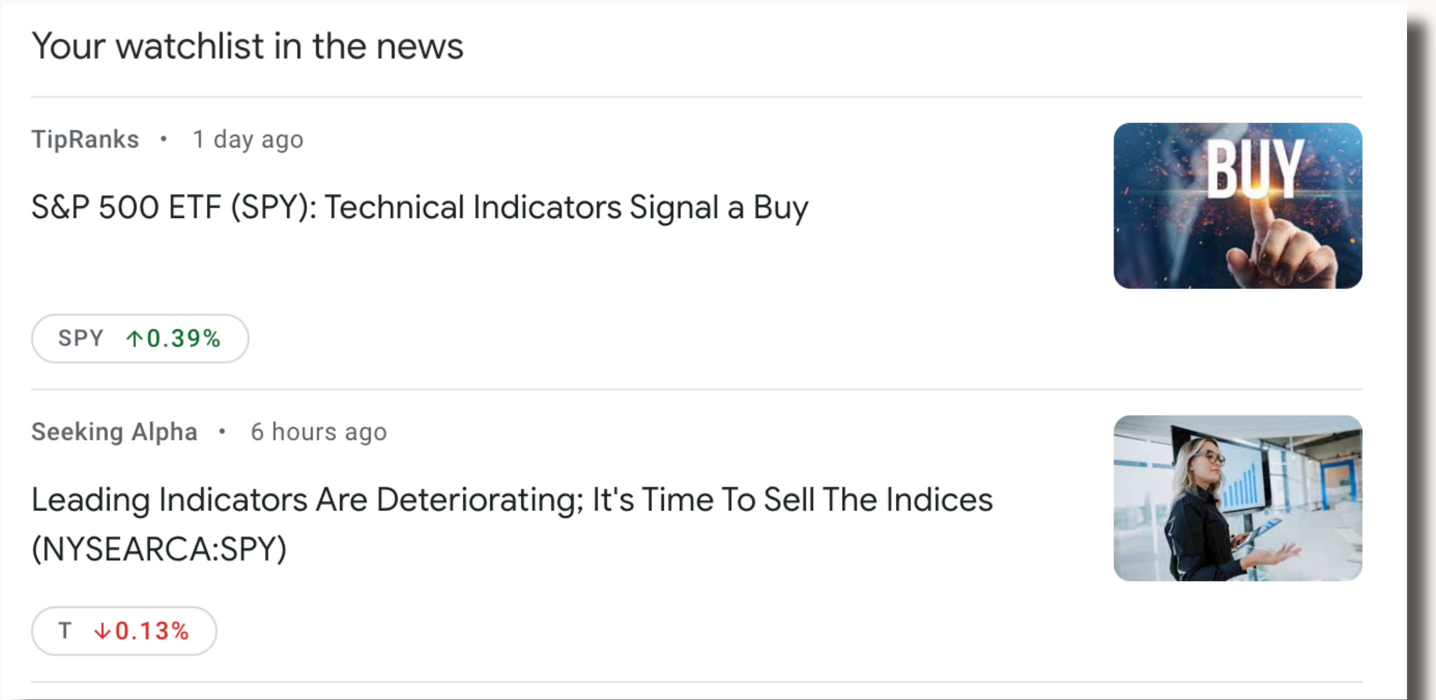
Some of the equity benchmark returns were inadequate for sure (looking at you Emerging Markets) especially given the nerve-rattling drawdown(s) they delivered from time to time.

The real mystery for us is why any investor would choose to invest in Global Hedge funds and their ilk. The Global Hedge Fund index had by far the worst total performance at a scant 21.02% over the 13+ years—barely more than 1.0% annually. Bear in mind that hedge fund management fees are the highest in the industry. Investing in hedge funds does not appear to be rational...for the investors.

Reversion to the Mean & Rebalancing

All of this data is backward-looking. Aside from the abysmal returns of the Global Hedge Fund index, there is an argument to be made for including the rest in a broadly diversified, globally allocated portfolio. Generally, lower returns come with smaller drawdowns. And mixing these assets in a portfolio should provide for the required return at an acceptable level of risk.

In addition, when asset classes have deviated substantially from their long-term averages, rebalancing into (or out of) them makes good sense and prudent management. Again, the Emerging Markets would be an obvious candidate for additional investment. It appears that they have underperformed relative to other equity markets and to its own historic averages.


Your watchlist in the news

TipRanks • 1 day ago

S&P 500 ETF (SPY): Technical Indicators Signal a Buy

SPY ↑0.39%

Seeking Alpha • 6 hours ago

Leading Indicators Are Deteriorating; It's Time To Sell The Indices (NYSEARCA:SPY)

T ↓0.13%

Noise, Damned Noise and News Feeds

The screenshot above is from one of the financial news feeds we follow. The two adjacent items say exactly the opposite things: time to buy, time to sell. Only one of them can be correct.

Needless to say, we pay no attention to the endless river of conflicting and conflicted "news" streaming from numerous sources. We seek our own information, make sure it reconciles to current market realities, investment theory and historical returns and form our own opinions about valuations, expected returns, etc.

One has to wonder what the various agendas are of the entities creating the headlines. What behaviors are they trying to get readers and investors to pursue? What conflicts of interest might be behind the news feed item? It is not possible to know. This is a virtual daily occurrence out there in the river of noise.

It might not surprise you to know that millions of people have money at risk in the markets and pursue any number of long and short-term strategies. It seems that a great many of them are poorly informed or misinformed. If the so-called "smart money" can influence some people to make and act on a bad decision in the markets, clearly someone stands to gain.

Don't Play the (Fool's) Game

In last quarter's newsletter we wrote about Morgan Housel's "The Psychology of Money", a best-selling down to earth look at how to best maximize your investment outcomes. One of the important maxim's was: ***What Game Are You Playing?"*** We ask you: do you know what game we are playing for you?

What He Said

We read a lot to stay abreast of all the moving parts that impact the capital markets. Sometimes someone else says what we are thinking a little better and more clearly. Below is a spot on column from Jeff Sommer, who writes a weekly column for the New York Times: Strategies.

Why the Stock Market's Summer Doldrums Are Not a Problem

After a fierce rally largely propelled by a handful of tech stocks, the market's rapid climb stalled in August. That setback could ultimately be a good thing, our columnist says.

NYT Columnist Jeff Sommer | 8-25-2023

The stock market's months-long rally stumbled this month. The thrill of seeing investment gains, with metronomic regularity, is gone.

I miss that feeling: scanning my investments and knowing in advance that the numbers will be larger than they were the last time I looked. But, in an important way, the market's summer setbacks have been long awaited, and they come as something of a relief.

Don't misunderstand. It's not that I want to see the rising stock market stop in its tracks. I'd prefer an endless move upward, making me, and everyone else, richer.

But that's a fantasy. In the real world, upward stock market thrusts are always temporary. When stocks rise too quickly, they inevitably fall and sometimes crash. The stock market is essentially volatile, and for every big winner, dozens of casualties occur.

That's why, as a second-best alternative, I hope for something more modest: a choppy market that experiences periodic downturns, but one that trends upward for very long periods.

The Stock Market's Movements

That is, in fact, a rough description of what the stock market has been like for the past 25 years, according to statistics provided by Howard Silverblatt, senior index analyst for S&P Dow Jones Indices. In that period, the S&P 500 has returned 552.31 percent, or 7.8 percent, annualized, but to garner those handsome returns, an investor would have had to sit tight through countless downturns.

While August has so far been a negative month for the stock market, there have been no major downturns this year. Through July, the S&P 500 rose for five consecutive months. Just seven big tech stocks — Apple, Nvidia, Microsoft, Amazon, Meta (Facebook), Tesla and Alphabet (Google) — accounted for more than two-thirds of the S&P 500's gains.

This year, through July, the S&P 500 rose 19.5 percent, for a total return, including dividends, of 20.7 percent. Those were splendid numbers, but the market had been rising so rapidly on such a narrow base that it seemed to me that it was setting itself up for a fall.

What's more, from a market bottom on Oct. 11, 2022, through July, the S&P 500 gained 27.9 percent, for a total return of 29.6 percent including dividends. In June, when the market had gained 20 percent from its October low, many commentators declared that the bear market that started on Jan. 3, 2022, was over, and that a new bull market had begun.

Mr. Silverblatt did not agree, because the market had not returned to its peak of Jan. 3, 2022, when the S&P 500 stood at 4,796.56, almost 9 percent above its current level. By his definition, it won't be clear that the S&P 500 is in a bull market until it climbs back to that level. Categorizing the market this way, as either bull or bear, is a straightforward retrospective judgment, not an assertion of the market's future direction, which no one can forecast accurately.

This cautious way of thinking about the market is one I favor.

I'm not sure what the rally that started in October will amount to, but based on history, the summer swoon could be a good thing.

The stock market's problems in August stem, at least partly, from shifts in the fixed-income markets: a sharp rise in short-term interest rates underway since the start of 2022, and a surge in long-term rates since June.

The Lure of Fixed Income

Thanks to the rise in short-term rates, it's possible to get a great return on cash. Money market funds provide yields well above 5 percent.

Bond yields have risen this summer, and they are now high enough to make bonds, with their safer profiles, an attractive alternative to stocks. And many factors driving up yields are negative for stocks, too.

Briefly put, short-term rates — those embodied in money-market funds as well as credit cards — are a direct consequence of the Federal Reserve's campaign to reduce inflation. The Fed has been tightening monetary policy, mainly by raising the short-term rates it controls, the best known being the federal funds rate.

On Friday, Jerome H. Powell, the Fed chairman, said that until there is conclusive evidence that inflation has been tamed, the central bank will maintain these rate levels or take them higher.

Longer-term interest rates — those for bonds and mortgages — have been rising, too. But these rates are complicated. They are set in the vast bond market.

By bidding down bond prices and raising yields (prices and yields move in opposite directions, as a matter of basic bond-market math), traders have indicated that they consider the economy to be stronger and inflation to be more persistent than had been expected a few months ago. The downgrade of U.S. Treasury debt by the Fitch Ratings agency also contributed to the run-up in rates on Treasury securities. And because Treasuries serve as benchmarks for virtually every other bond and, indeed, for every other investment in the global economy, higher rates have made stocks less appealing in comparison.

In addition, the balance of supply and demand in the bond market has been tilting in a way that is contributing to higher rates. The Treasury has been auctioning an unusually large amount of debt, bulking up its resources after the brinkmanship of the debt ceiling crisis this spring. That increase in the supply of Treasuries coincides with a reduction in demand from several important sources: The Federal Reserve is no longer purchasing bonds, while the appetite for Treasuries from Japan and China has begun to flag, too.

All these factors have contributed to the run-up in yields, and they are weighing on stocks.

Reading the Economy

Furthermore, one core issue assessed by bond buyers — the prospects for economic growth or recession in the United States and elsewhere around the world — has obsessed stock traders, too. But, at the moment, the U.S. economy is extraordinarily difficult to decipher.

Higher interest rates might have been expected to slow down the economy by now, or throw it into recession. A waning of economic growth in China might also be expected to be a drag on the U.S. economy.

But the U.S. economy and the job market, in particular, have been remarkably resilient, and consumer spending remains strong. As a consequence, corporate earnings in many sectors have exceeded Wall Street's muted expectations. If a recession were to develop, however, the outlook would be much worse.

All that said, there are many reasons for optimism. In July, the market rally broadened substantially, with the stocks of smaller companies outperforming the giants, and every domestic sector posting gains. It was just what a stock investor would want to see in a market with sustainable upward momentum.

Even the surge in interest rates could turn out to be innocuous. After all, it has returned rates to a level deemed healthy in previous economic cycles. Since January 1962, 10-year Treasury yields have averaged 4.2 percent — not far from where they are now. The appropriate level for interest rates for the rest of this decade is being debated at the Fed and among a broad range of economists.

In short, uncertainty about inflation and the Fed's response to it are well-founded. The paths of the markets and the economy may meander inconclusively for a while, thwarting anyone who wants to place a decisive bet one way or another.

But it's a complicated world. Binary distinctions like bull market and bear market reduce complexity to simple notions that investors can grab onto. But I think these, in particular, are the wrong notions.

The bull and bear market labels imply future action.

In a bull market, stocks, for the most part, rise. In a bear market, more often than not, they fall. You might assume that you should avoid bear markets and welcome bull markets. But that's not a wise course for long-term investors, who are better off buying when prices are low and selling only at moments of their own choosing.

I'm bullish about the stock market for the long haul. But that's very different from believing that we are in a bull market or a bear right now. I just don't know and don't really care.

Instead, I'm investing for the long run, without trying to time market movements or pick individual stocks or bonds. I hold a piece of the world's entire stock and bond markets — not just the S&P 500 — through low-cost, broadly diversified index funds, and have been hanging in for decades.

Market rallies are fun, and it's a letdown when they take a breather. But an August pause could be just the thing the stock market needs. I worry about lots of things, but not that. Enjoy the rest of the summer.

Steve Winwood and Eric Clapton performing "[Can't Find My Way Home](#)." This performance sparkles and the two rock 'n roll veterans know it. From the 2007 Crossroads Guitar Festival.

Closing Thoughts

After a strong start to 2023, the equity markets have become directionless, rallying and fading. We found a well-written article (which we include here) to explain and totally agree with.

I remember a discussion with a client many moons ago. I cautioned that the markets do not go up in a straight line. He countered with "they sure seem to go down in a straight line." He was not wrong.

Markets gain ground little by little and occasionally they give back much of the gains, as the concern of the moment weighs on market values and investor sentiment. I think we now have to add that many actors in the markets nowadays benefit from fomenting anxiety and exit stampedes. This again speaks to the question: "what game are you playing?"

The article from the New York Times columnist accurately states:

"(Over the past 25 years) the S&P 500 has returned 552.31 percent, or 7.8 percent, annualized, but to garner those handsome returns, an investor would have had to sit tight through countless downturns."

And there lies the game and the formula for winning: endure the inevitable periodic downturns and thus capture the also inevitable rallies and moves to new highs. That is the game we organize, implement and manage for our clients.

Tune out the noise, understand the game we are playing and reap the rewards. Enjoy the rest of the summer

Thomas F. McKeon, CFA | August 31, 2023