PARK AVENUE CAPITAL | NORTHWESTERN MUTUAL PRIVATE CLIENT GROUP

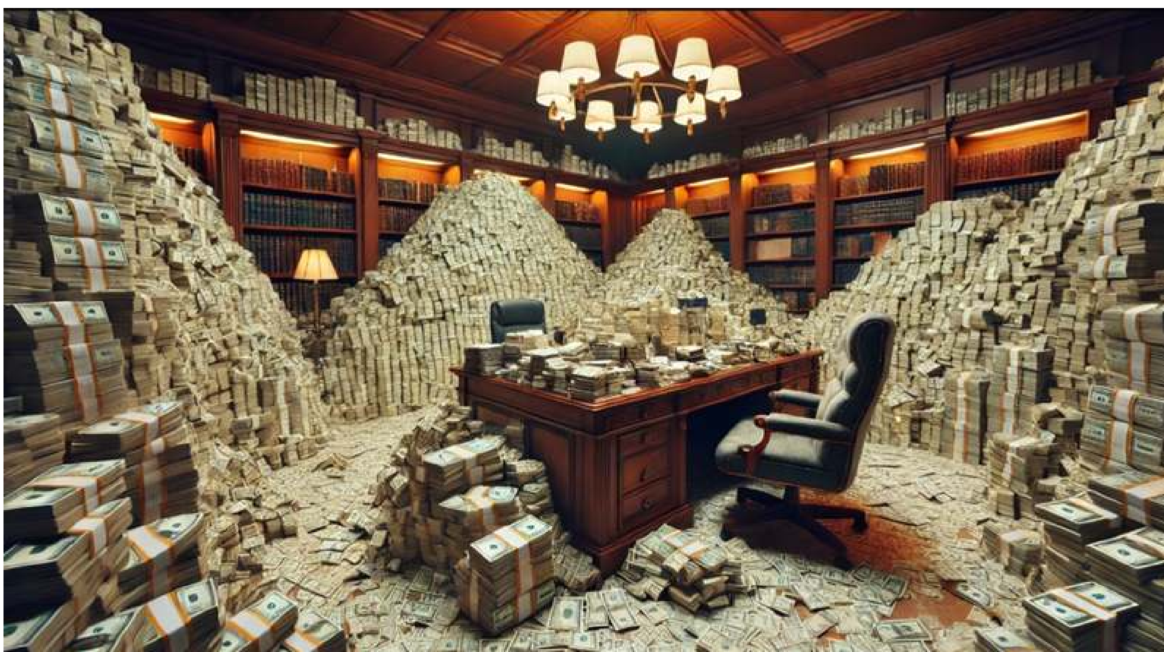
PAC INSIGHTS

Welcome to December 2024 PAC Insights – our exclusive market commentary. We hope you all are having a wonderful holiday season. A few reminders before we jump into an exhilarating edition about 'Dispelling Market Narratives'.

1. Follow us on LinkedIn! Click here to follow Park Avenue Capital on LinkedIn.
2. Our upcoming Quarterly Briefing webinar is December 11th at 11am CST / 12 PM PST. This call is led by our Chief Investment Officer, Chris Breme, who covers topics as it relates to investments and financial planning. If you missed the invite, reply to this email and we will send it to you again.

Now, let's talk about:

Dispelling Market Narratives



ChatGPT/Dall-E version of what an office like Warren Buffett's could look like based on common market narratives.

"Pessimism holds a special place in our hearts. Pessimism isn't just more common than optimism. It also sounds smarter. It's intellectually captivating, and it's paid more attention than optimism, which is often views as being oblivious to risk."

– Morgan Housel

QUICK HITS

- **Common market narratives** often lead investors to stray from their long-term plans.
- **Election-driven portfolio changes have historically led to missed opportunities or regret,** as markets have shown resilience through Administrations of both political parties.
- **Recent market strength should be views in context of longer period returns**, like 3-years, which are currently at historical average levels.
- **Warren Buffett's current positioning** likely reflects risk management and succession planning rather than bearish market views.
- **Portfolio decisions should be driven by financial planning and probability analysis** rather than market narratives that encourage market timing.

Narratives are everywhere in the markets, helping us interpret movements and offering a sense of control in a chaotic world. While some narratives inform, many mislead, and can tempt investors to act in ways that are satisfying in the moment but detrimental to their plan.

The exercise of dispelling myths can be both entertaining and valuable, allowing us the opportunity to reinforce our planning framework, and more clearly articulate our

investment approach. After-all, successful investing is about avoiding mistakes, not predicting what comes next.

With that, let's discuss a few market narratives:

Narrative 1: Adjusting portfolios to capitalize on election results.

This presidential election has caused heightened anxiety compared with past election cycles. Psychologically, anxiety is a secondary and forward-looking emotion often fueled by fear of imagined scenarios. This can cause investors to want to make short-term decisions with their portfolios.

Historical data shows, however, that the markets perform well over time under both parties. Reacting to short-term political events introduces significant risk without increasing the probability of better outcomes. Changing allocations based on emotional responses is not a sustainable investment approach.

Our investment committee monitors and reports weekly on asset allocation models and monitors that inform our asset allocation views. The most impactful portfolio adjustment any investor can make is the allocation decision between U.S. and global stocks relative to the strategic investment plan.

If some or all of President elect Trump's campaign promises get enacted, in our view our current overweight posture on U.S. stocks is warranted. Said differently, making no portfolio adjustments is still an active decision: we are always assessing the highest probability outcomes.

In 2016 and 2020, many investors who made election-based portfolio changes missed significant market gains. The S&P 500, and the individual company management teams, have demonstrated remarkable resilience through dozens of presidential terms.

Narrative 2: The stock market is strong, and we should cut back equity exposure.

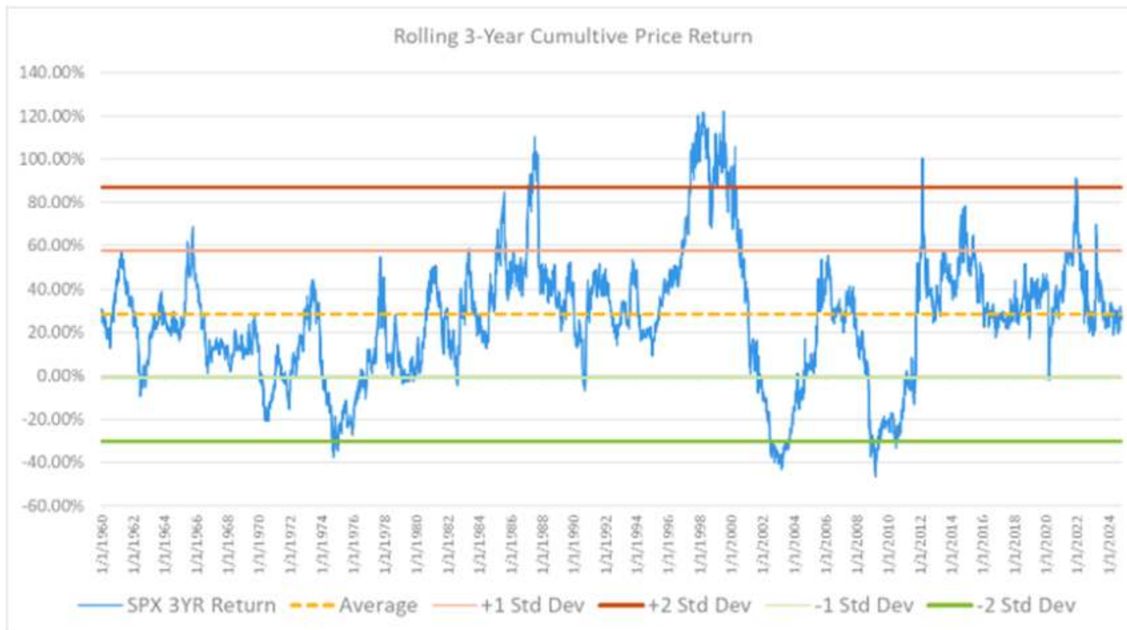
The stock markets over the long-term have rewarded investors who have stayed the course. Yet market strength, rationally, often leads to investors questioning the sustainability of stock market returns.

Unfortunately, there is no reliable process or indicator, including Warren Buffett (see

below), that consistently informs market timing decisions.

Your financial plan, including scenario analysis, accounts for all the good and bad times together. While we cannot predict when corrections or bear markets will occur, our planning analysis accounts for the fact that they will inevitably and frequently occur.

While the stock market has very strong one-year returns, the 3-year total returns are almost exactly the same as the long-term average, suggesting that the market returns are more modest than many investment commentators suggest.



Source: Bloomberg and Park Avenue Capital

Narrative 3: Warren Buffett is bearish.

According to this narrative, Warren Buffett is bearish due to actions such as selling Apple stock, holding high cash reserves, and avoiding aggressive share buybacks.

We are fans of Buffett and agree that he has not expressed bullishness. However, we do not think this translates to bearishness.

Apple sales. While Berkshire reduced Apple, it remains its largest holding, at over 30% of the portfolio. Reductions likely reflect risk management rather than pessimism.

High cash. At 28%, cash as a percent of Berkshire's assets is indeed at the highest level in 20 years. However, Buffett has always maintained high cash reserves for risk management and opportunity, as highlighted in the most recent annual report, "Your company also holds a cash and U.S. Treasury bill position far in excess of what

conventional wisdom deems necessary…Extreme fiscal conservatism is a corporate pledge…in most years – indeed in most decades – our caution will likely prove to be unneeded behavior..."

Age and Transition. At 94 Buffett may have more of a focus on risk management and succession than finding the next great opportunities, which are increasingly challenging due to size. Consider also that Buffett's vice chairman and business partner of 45 years, Charlie Munger, passed away last year. It's pretty clear that the two of them relied extensively on one another's guidance and counsel.

In summary, we think the value of using Buffett as a signal has diminished, mostly due to age, circumstances, and size.

CONCLUSION

Market narratives are enticing, offering logical explanations for complex market action. However, history shows that following market narratives leads to poor investment outcomes. Your financial plan is specifically designed to withstand market volatility and accounts for all market conditions, the good ones and bad ones.

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your personal needs and objectives.

[1] We are referring to private equity investments. There are many other types of private investments that come with similar risks. For example, "private credit" is a popular offering today with promises of 9% to 13% yields in most cases. For reference, the 10-year U.S. Treasury yield is about 4.1% at the time of this writing. In other words, these investments are much riskier than public fixed income "credit" counterparts .