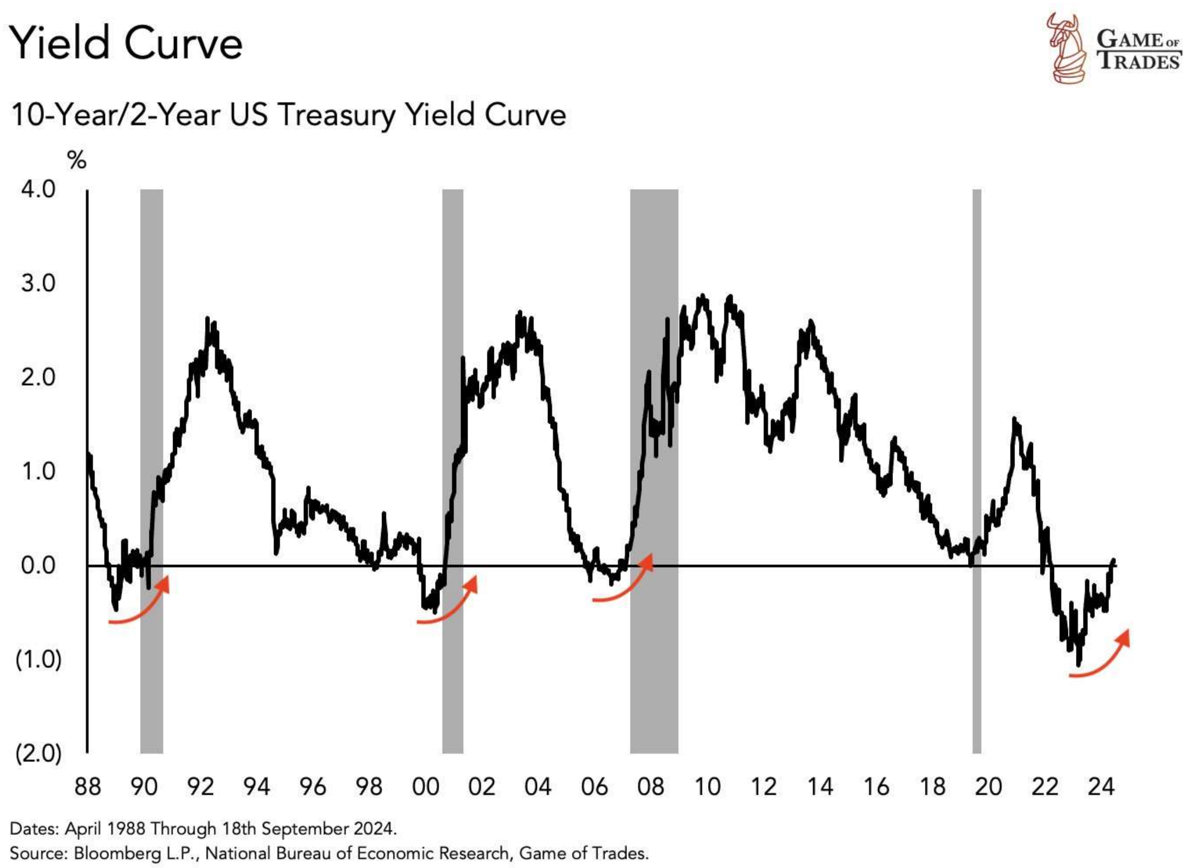
September 2024: I Was Inverted

"I was inverted." – *The Yield Curve AND Pete Mitchell, Call Sign: Maverick, in Top Gun*

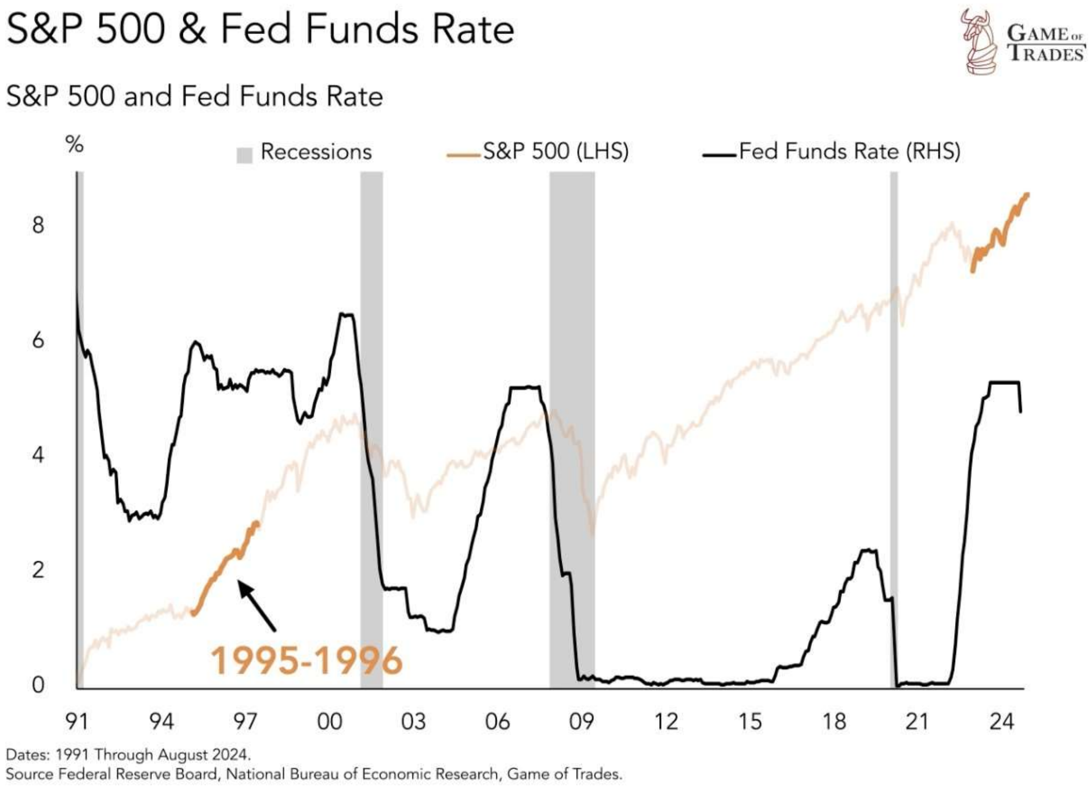
The key word in that quote is "was". As stated in my previous letter, the yield curve was set to normalize…, and it did. Historically, normalization of the yield curve starts the clock on recession. Efficient Growth, with its disciplined avoidance of overvalued, over indebted companies and equal-weighting is an excellent recession companion. For 35 years, it has provided significant value and downside protection when clients need it most.



Here's a quick review of yield curve terms:

- Normal – Longer term rates are higher than shorter term rates. The further out we go, the less certain the future is. Therefore, investors demand higher yields for that uncertainty.
- Inversion – Short term yields are higher than long term yields. That's not normal, like Ice Man doing his little fake bite thing, which is really weird.
- Normalization – When the yield curve moves from inverted to normal.

And we're back from that brief educational interlude. The yield curve just normalized. Since 1970, normalization of the yield curve has accurately predicted every recession. Please note that I'm not predicting a recession, personally. I'm simply directing attention to what the yield curve (and Federal Reserve) is stating.



"I feel the need - the need for speed." Several advisors have shared over the last few months that clients have asked why they didn't own more Nvidia, more Magnificent 7, more S&P 500. They're feeling the need. However, the last thing most investors *need* is more Magnificent 7 exposure, eg Large Cap Growth. Large Cap Growth managers occasionally pay lip service to risk, while the S&P 500 is entirely indifferent. In both, equity investors are effectively riding a wave – now a record-breaking 15-year tsunami of a wave, and - as is always the case years into a bull market - have forgotten that all waves come to an end.

"You don't have time to think up there. If you think, you're dead." We ain't flying Mach 2.5. In fact, I would argue the opposite; if you *don't* think, you're dead. Are you and your clients positioned for a recession? Again, I'm not saying a recession is imminent, only that the yield curve says one is. I'm also not advocating for evasive maneuvers, going to cash, shooting down wayward geese with missiles (as much as they clearly deserve it), or loading up on canned goods. I'm simply saying it might be worth considering the apparent likelihood of a recession and that "d" word that has been the bane of existence for many prudent advisors over the last decade, diversification. A recession may occur. It may not, but ignoring a signal that has accurately predicted every recession since 1970 seems a little foolhardy. This time could be the exception to the rule. 5'5" men in jeans might actually be able to spike a volleyball in sand while listening to Kenny Loggins. It's possible. But… what if this isn't the first time in 54 years that the yield curve is wrong?

Your Recession Parachute

Efficient Growth has a proven, time-tested track record of success. It has been managed – largely unchanged – since the early 1980s, and there is real-time data going back to 1989. Performance since the launch of Running Oak in 9/2013 is audited. Prior performance is unaudited but was generated real-time (not backtested), and I personally managed the portfolio through the Financial Crisis**. Since 1989, Efficient Growth has provided less than half of the downside risk of the S&P 500 (49% of the average drawdown of the S&P).*** 49% less downside is somewhat meaningless when the market goes straight up for a decade, but it's a life-saver in a recessionary environment.

And if the yield curve is wrong? Efficient Growth has delivered **top 1%** returns versus its peers and performed roughly in-line with the S&P 500 over the last decade. It did so with minimal exposure to the Magnificent 7, providing the diversification that clients need, particularly at this moment, AND rare performance.

While there are no guarantees, the current environment appears to be a win/win for Efficient Growth and our clients. If the market continues to go up, great. If it declines, as a client's portfolio parachute, that's precisely the environment for which Efficient Growth is built.

Efficient Growth - Your Portfolio Recession (and No Recession) Buddy

Efficient Growth is constructed to systematically and proactively address the risk of loss at all times. The portfolio will ALWAYS:

- Avoid over-valued companies - You don't want mean reversion working against you. The hottest companies very often become the coldest in a recession.
- Avoid over-leveraged companies - Debt is a double-edged sword that tends to turn on its wielder in a recession.
- Avoid over-concentration - Efficient Growth is equally-weighted, diversifying risk across companies and industries.

Efficient Growth's philosophy is simple, easy to understand, and common sense:

- Above Average Earnings Growth – Because owning a company that is making more and more money is obviously a good thing.
- Attractive Valuations – Because paying a dumb price is, well, dumb.
- Lower Downside Risk – Because losing money stinks. Lower drawdowns mean smaller bounces are required to get back to new highs.

With just the slightest bit of critical thinking, one would theorize that Efficient Growth is likely to outperform due to higher earnings growth and investment in under to fairly valued companies and do so with less downside risk, due to the avoidance of overvalued, unprofitable, and insolvent companies. Efficient Growth would also never have almost 30% of the portfolio invested in just 6 highly correlated companies. (Because that would be irresponsible, putting clients at risk...)

Running Oak's goal is to maximize the growth of clients' portfolios, while subjecting them to far less risk of loss. In other words, we aim to help your clients realize their dreams and avoid nightmares.

Risk vs. Return, Gross (Sep. 2013 –Aug 2024)*

If you appreciate critical thinking, math, common sense, and occasional sarcasm, we would love to speak with you. Please feel free to set up a time here: [Schedule a call.]

For additional data and context regarding the claims made within this letter, please refer to the Disclosures and Additional Data document located here.

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