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Investment Institute

State of the Markets

From the desk of Darrell L. Cronk

January 8, 2025

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How shall we invest?

"The years teach much which the days never know." — Ralph Waldo Emerson

Ten years ago, we launched Wells Fargo Investment Institute with a goal of bringing together the best minds from across our business, learning from and challenging each other, and producing investment guidance that makes the complex simple and helps our clients become better investors.

A general principle of mine as a leader is this: Surround yourself with the smartest and best people you possibly can, give them the freedom to do what they think is right, and if they're smarter than you, all the better.

We've learned much from each other over this journey. Over the past decade and beyond, I have scribbled down my observations, some gleaning the wisdom of those around me, some the painful product of assumptions disproven, and some that piece together patterns that revealed themselves only after several decades of doing this kind of work. At various points in my career, I have kept this list on my office wall, and I revisit it regularly. Perhaps I'm a slow learner, or maybe I just need to orient myself to my own north star to keep the market's near-term twists and turns in proper perspective.

The beginning of a new year, coinciding with the beginning of our Institute's second decade, feels like the right time to pull that list down from the wall, examine the hard-earned lessons that have guided my thinking, and (with some trepidation and much humility) share these principles with investors for their consideration. Investors may not agree with every one of these observations, but if sharing what I've learned — often the hard way — shortens the distance between expensive mistakes and success as an investor, then I would consider it time well spent and ink well spilled.

I've come to believe one natural law that defies physics: If you give more than you get, you get more than you give. There is nothing intuitive about this law, despite ubiquitous evidence of its existence, which may be why it took decades for me to discover it for myself.

When I write these *State of the Markets* reflections, my favorite reactions are from veteran investors and advisors, sharing their own stories about similar lessons learned that hardened into the armor of wisdom after enough years passed. So, too, it's incumbent upon me to help others benefit from my own lessons learned.

So, think of this list, in no particular order, as advice I would give to my younger self:

1. Human beings are often emotional rather than objective investors. They tend to sell low and buy high, and at the time, they believe it to be for good reasons. It cannot be otherwise, or else they would not do it.
2. The single most important consideration when investing is your starting point. It's what drives your return, your risk, and the distance to your ultimate objective. Understand that, and half the battle is won.
3. Just because the market is efficient doesn't mean it's right.
4. Investing is not about returns, although many mistake it to be. It's about risk — understanding how much to take, how to calibrate it, how to manage it, and what is a good risk versus a bad risk to take. Returns are simply a byproduct of risks consumed.
5. The best investment strategy can turn into the worst if you don't have the resolve to see it through with discipline.
6. Greed, hubris, leverage, illiquidity, and lack of imagination all lead to the inevitable. Each possesses a gravitational pull for investors. Each, in excess, leads to demise.
7. Always believing the same rules apply is easy — and fraught with mistakes. Adapting to the conditions of today is what remains hard and yet rewarding.
8. Your level of confidence as an investor is inversely proportional to the amount of capital you have at risk in the market. Those who commit little are very confident. Those with much committed have the uneasiness to understand what can go wrong.
9. The illusion of certainty: Better to strive for conviction than certainty. Certainty lives in a world of absolutes. Conviction approaches markets with a high degree of humility. This requires asking questions, continuously testing our convictions, and recognizing that conditions and circumstances can and will change.
10. Stay attuned to unusual market divergences, prices that move in counter-intuitive ways. They don't always lead to great opportunities, but they are the places to start looking and asking: Why the divergence? What might it tell us?
11. Often investors are reminded that, as powerful as we think central bankers or politicians may be, markets, like the lion on land and orca in the sea, are the ultimate apex predator. When things get out of balance, markets will often restore this balance quickly, savagely, and without regard to stability.
12. The wisest investors dig to find out where growth resides and capital needs to go, and then they make sure they become relevant in that space.
13. We need to remind ourselves as investors that historically the two best phases of a secular bull market have been the first 25% of its life, and the final 25%. (The middle 50% has often been mush.) Get those right, history tells us, and you can put yourself in position to capture much of the return the market offers.
14. Don't fear strength. One of the enduring lessons of this business is that your best ideas often reach and then blow through your targets much faster than you thought possible, while the bad ideas languish and frustrate and fizzle.
15. Markets rarely trade at fair value. Most of the time, they trade at prices above or below their fair value fundamentals. Learn to understand this, get comfortable with it, and where possible use it to your advantage.

I hope at least a few of these principles will be useful for you, and useful for the generation of investors who follow. I'll continue to learn and continue to scribble additional items on my list. I think the late investor Charlie Munger had it right: "Knowing what you don't know is more useful than being brilliant."

I've learned that what got me into this business decades ago, and what keeps me engaged every day, competes aggressively with gravitational forces attempting to pull me away from it. In the same way, after we spend so many years as an investor riding through bull markets and battling through bear markets, there is a gravitational pull to settle into complacency, to believe you have it all figured out, to stop learning. As investors, we must fight against this; we must defy gravity, so to speak, and acknowledge that while there may be a terminal rate for the Federal Reserve to pursue, there is no terminal rate for wisdom.

I leave you with one more belief from my list, one that warrants frequent revisits: The market doesn't care how long you have been doing this or how much you know or don't know. It tests you, always.

And so onward we march into the great unknown of a new year, ready to be surprised, ready to learn new lessons, ready to adapt, and ultimately ready to modify our list. Investing with you has been and continues to be a privilege.

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