

State of the Markets

From the desk of Darrell L. Cronk



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The discipline of investing in the age of dominance

"Investment success accrues not so much to the brilliant as to the disciplined." — William Bernstein

Every market cycle has tended to elevate a handful of companies to almost iconic status.

Today, a select group of companies seem to dominate nearly every investment conversation. They power our devices, shape how we consume information, and increasingly influence how businesses operate. They've become so large and successful that, in many ways, the stock market has begun to resemble a concert where a few headliners receive all the attention while everyone else fights for a spot on the poster. To be fair, these companies have earned much of that attention.

Many are extraordinary businesses with strong balance sheets, impressive profitability, durable competitive advantages, and growth prospects that would make most chief executive officers (CEOs) blush. They sit at the center of some of the most important innovations of our time, particularly artificial intelligence, which may ultimately prove as transformative as the internet itself. The challenge isn't that investors are overly exuberant about these companies. The challenge is that exuberance and concentration often arrive at the same party.

Investing is ultimately about guiding capital toward meaningful outcomes. Families, institutions, and beneficiaries place their faith in markets to transform today's resources into tomorrow's security, opportunity, and legacy. Successful investing requires more than market participation. It demands the pursuit of long-term value while remaining vigilant of the risks that arise when leadership narrows and sentiment becomes overly enthusiastic.

When success becomes concentrated

One of the more remarkable features of today's market is how much influence a relatively small group of companies has had over S&P 500 Index returns. Imagine attending a family Thanksgiving where one cousin insists on doing all the talking. Eventually, the conversation stops being a group discussion and starts becoming a monologue. Markets can behave similarly.

When a small number of companies drive a disproportionate share of returns, portfolios can become dependent on a more narrow set of outcomes than investors realize. That doesn't necessarily spell trouble. But it does deserve attention.

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While markets tend to reward success, they also have a habit of reminding investors that even the most admired companies are subject to competition, regulation, disruption, changing consumer preferences, and the occasional failure of expectations to keep pace with optimism.

One of the most expensive mistakes investors make is confusing a great company with a great investment. The two are related, but they are not identical. The best restaurant in town may make a wonderful burger, but that doesn't mean you'd pay \$1,000 for one. Likewise, a company can be wildly successful while still being priced for perfection.

Investing isn't solely about identifying a fundamentally strong business. It's also about determining what is already expected of that business, as reflected by its price. The market doesn't reward investors for knowing something everyone already knows. It rewards them for properly assessing whether future reality will be better or worse than current expectations. And expectations, particularly during periods of enthusiasm, have a tendency to become ambitious.

Avoiding volatility is not the objective

Most investors think risk is volatility. Quite simply, it isn't.

Investors frequently think of volatility as something to avoid. Yet volatility is not inherently good or bad. It is the source of both the market's greatest dangers and its most compelling opportunities. The discipline in investing is not to eliminate volatility altogether, but to distinguish between destructive volatility and productive volatility — avoiding the former while preserving exposure to the latter. In mathematical terms, getting the skew, or lean, toward the latter over the former is what we call high-convexity opportunities.

Equity markets have historically displayed this characteristic. A relatively small minority of companies has generated a substantial share of long-term wealth creation. Many businesses have disappointed, stagnated, or failed to outperform lower-risk alternatives, while a select group of exceptional companies have compounded value at extraordinary rates.

The power of equities comes from their asymmetry. The downside of any individual position is finite, while the upside can be substantial. Over time, a relatively small number of exceptional companies often generate enough value to more than offset a much larger number of mediocre results. The challenge is that the market has a habit of testing your conviction before rewarding it. Great businesses often come with uncomfortable volatility attached.

That's why successful investing is often less about finding the next winner and more about avoiding the knockout punch. A 50% loss demands a 100% recovery just to break even. More importantly, every major drawdown puts compounding on pause. Money can recover. Time cannot. And compounding is a terrible thing to interrupt.

The real tragedy of any market downturn is not only experiencing loss. It is being absent when the recovery begins. Market drawdowns and recoveries never send invitations. The market does not ring a bell at the bottom. There is no email subject line that reads: "Congratulations. Fear has peaked. The recovery begins tomorrow."

Humility and liquidity: Often the most underrated asset classes

One of the more humbling lessons in investing is that the future rarely unfolds exactly as expected. History is filled with transformative innovations that changed the world. Railroads changed transportation, automobiles changed mobility, the internet changed communication, and smartphones changed daily life. Artificial intelligence may very well join that list. Yet while these technologies transformed society, the companies that ultimately generated the greatest investment returns were not always the obvious winners at the beginning.

The salient point is not to avoid innovation. Rather, the lesson is to remain humble about our ability to know precisely how the story ends. The importance of balance within your portfolio is to prevent your future from becoming overly dependent on a single forecast, theme, company, or outcome. In a concentrated market, diversification can feel like a tax on performance. In hindsight, it often looks more like an insurance policy.

Transformative technologies often exceed expectations in their impact on society while simultaneously disappointing many investors along the way. Progress and profits do not always arrive on the same schedule. That's why humility remains such an important investing virtue. Whenever investors become convinced they know exactly how the future will unfold, markets generally find a creative way to introduce some humility.

Concurrently, portfolio risk management is often misunderstood as a defensive exercise. In our view, it can be one of the most powerful forms of offense. Liquidity, diversification, and disciplined portfolio construction historically have done more than protect capital; they've preserved optionality. When markets become stressed, capital becomes scarce, prices disconnect from fundamentals, and forced sellers emerge. Investors with patience and flexibility are no longer reacting to events; they are writing the next chapter. The ability to deploy capital when others are compelled to retreat has often been where extraordinary returns are born.

Market dislocations have a way of transferring assets from the impatient to the patient, and from the leveraged to the liquid. The paradox is that the best offense in investing often begins with a strong defense.

Lessons from the tails

All of this points to a simple historical pattern: Investment success has been determined less by what's happened in the middle outcomes of consensus and more by what's happened at the edges or tails of market volatility, both good and bad. The consensus is heavily studied, endlessly debated, and increasingly priced efficiently. The real challenge, and opportunity, lies in periods of market enthusiasm and strain.

For most investors, this understanding does not come from textbooks. It comes from experience, usually acquired at a cost. Markets have a remarkable ability to educate those willing to listen, and a painful ability to punish those who are not. Over time, patterns begin to emerge. Leverage builds quietly until it doesn't. Liquidity seems abundant until it disappears. Returns are easy and plentiful until they aren't. Confidence slowly becomes complacency, and complacency eventually becomes fear.

Perhaps the most valuable lesson is that the market is not merely a test of intelligence. It is a test of temperament. The longer one invests, the more important self-awareness becomes. Fear, greed, impatience, and overconfidence never disappear; they simply find more sophisticated disguises.

Capital compounds, but so does judgment

Over time, money compounds quietly but judgement compounds relentlessly. Experience does not eliminate mistakes, but for those willing to learn from them, it can improve the quality of decisions. Even the most successful investors carry a collection of scars, each serving as a reminder that humility remains one of the most underrated assets in finance.

In the end, investing is not about eliminating uncertainty. It is about arranging your portfolio so that uncertainty can work in your favor. It is about remaining resilient when conditions are difficult, liquid when opportunities arise, and humble enough to recognize that nobody knows exactly what comes next.

The irony is that great investing can feel boring for long stretches of time. Yet beneath that apparent calm is a continuous exercise in judgment, discipline, and resilience. Our view is that you should stay invested, stay patient, and keep exposure and concentration disciplined. In investing, you do not need to be right all the time. You simply need to be in the game when it matters most. The market has spent centuries humbling people who were certain and rewarding those who were prepared. There is little reason to expect it to change now.

Risk considerations

Each asset class has its own risk and return characteristics. The level of risk associated with a particular investment or asset class generally correlates with the level of return the investment or asset class might achieve. Equity securities are subject to market risk which means their value may fluctuate in response to general economic and market conditions and the perception of individual issuers. Investments in equity securities are generally more volatile than other types of securities.

Diversification cannot eliminate the risk of fluctuating prices and uncertain returns and does not guarantee profit or protect against loss in declining markets.

Definitions

S&P 500 Index is a market capitalization-weighted index composed of 500 widely held common stocks that is generally considered representative of the U.S. stock market. An index is unmanaged and not available for direct investment.

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