

Plus ça change... plus c'est pareil

October, 2025



Continuing a bit on the theme of our last quarterly letter, which talked about how the market “climbs a wall of worry,” and the closing quote from Charlie Munger: “It is not supposed to be easy. Anyone who finds it easy is stupid,” we will discuss distractions, aggressive “promotions,” and a cautionary tale about accounting disclosures and packaging illiquid securities and investments to make them appear, with a little sleight of hand, to be “too good to be true” fully liquid high-yielding investments with less risk and lots of diversification.

You have all no doubt read about how private equity and credit will now be eligible investments in 401(k) retirement accounts in the US, and that banking institutions will be promoting private equity and credit to retail investors. What could go wrong?

Let’s start by trying to understand the motivation: private equity funds are designed to have a liquidity event, or sale, after a certain investment period, say 7 years. However, as they have become so popular over the last 20 years, too many are seeking exits for their very varied and sometimes less successful positions – all at the same time. The market within the institutional sector is saturated with product and light on buying interest – cue the siren song to the retail marketplace where they can repackage or sell off various illiquid and less interesting investments to less sophisticated investors who can’t wait to get in on what’s been a very lucrative market as assets in general have soared in value over the same 20 years. Unfortunately, the opaqueness of the financial reporting, and lack of a good secondary market to create liquidity for the retail

buyer, will lead to the creation of “stranded,” or illiquid, assets that the client will not be able to monetize, or sell, but on which fees for the packaging and “management” will continue to be charged against a “value” that has been, and will likely continue to be, established by the sellers. In other words, the sophisticated seller will transfer the risk and illiquidity to the optimistic and unsuspecting retail buyer. Cue the tears...



As always in long-lived bull markets, there are financial wizards who try to package illiquid product into a different wrapping that will magically “defy gravity” and become fully liquid on preset occasions. This has occurred many times at the frothy highs in markets and often involves real estate, which by nature doesn’t have the same liquidity characteristics as securities listed on an equities or stock market.

Recently, the Globe and Mail has discussed some Canadian real estate funds and investment trusts, that have “gated” redemptions – in other words what was sold as redeemable on regularly scheduled dates such as monthly or quarterly, becomes redeemable for greatly restricted amounts, less frequently, and only if funds are available. Thus stranding the investors’ capital which remains in the funds and inaccessible, but who still must pay management fees to the fund manager based on a value that the manager sets... the funds are many including Centurion Apartments REIT, Trez Capital, Kingsett, more locally, Fiera Capital and most recently Nicola Wealth Management whose CEO apparently said in an interview “Quite frankly, we’ve never seen this before” – which is very disingenuous as it occurs in every real estate market cycle – cue the tears...

Real estate investors often need liquidity, particularly in their retirement years – they need to consider these types of products particularly carefully and in many cases, avoid them altogether. It reminds us of the old Eagles hit song Hotel California: You can check out any time you like, but you can never leave...



And, of course, this cautionary tale would not be complete without warning against financial deception, practised by some companies to enhance returns, and con investors into believing that they are in good financial shape when, of course, they are not.

Everyone remembers Enron with their “off balance sheet debt.” In the 2000s, companies masking their poor credit quality, weak collateral, double pledging of assets, difficult market conditions, all sorts of circumstances where a company may try to fudge the numbers to make it to their next opportunity... It almost always ends badly... Cue the tears...

Our message in this is that you must always be vigilant. We are always vigilant in selecting appropriate investments for our clients – We focus on the industry, the management, the quality of the business, the quality of the financial reporting, the transparency in their public statements, the limited leverage and the consistency of the company’s performance over time. We avoid businesses we find to be opaque, inconsistent, with too much debt and that are illiquid by nature. We study the market history and try to avoid past mistakes.

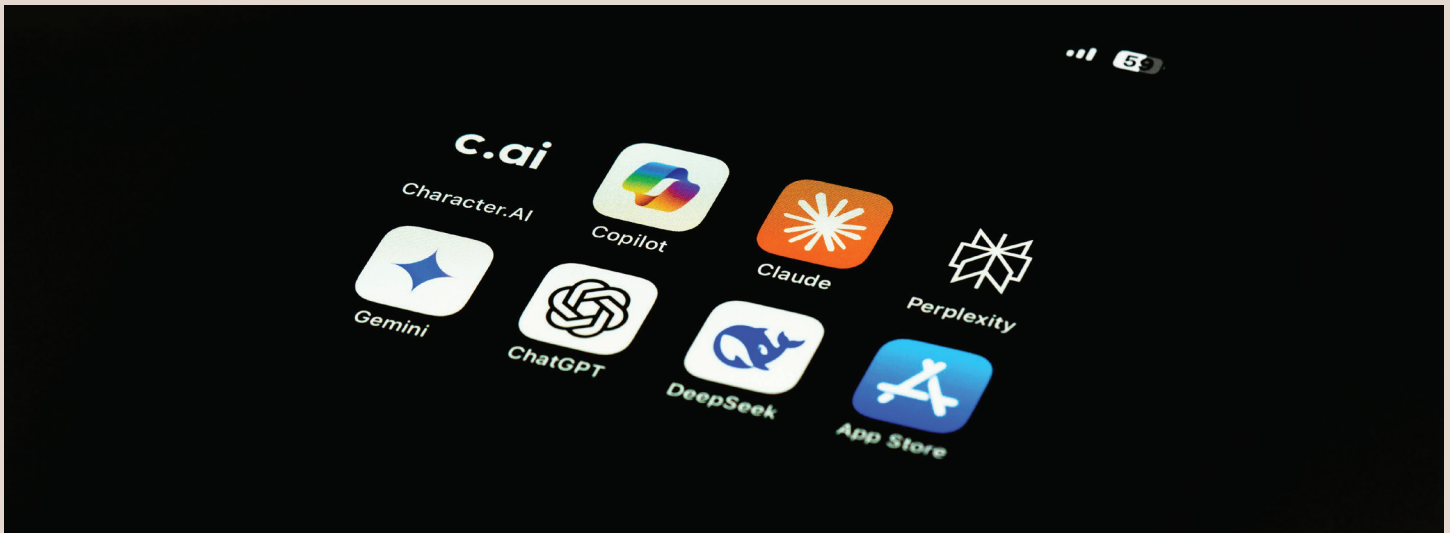
While no one will be immune to a market downturn, the best companies will outperform come rain or shine, and as the markets continue their ascent, we remain focused and continue to avoid investments that are “too good to be true.”



Since the release of ChatGPT in 2022, any investment that contains the word “Artificial Intelligence (AI)” has gone up over 100%. While one exchange-traded Fund (ETF) is up more than 160%, some stocks have more than tripled, even quadrupled: NVIDIA is up 1500%. Investors are drawn to this latest technology that will not only revolutionize everyday life, but also corporate America’s business models, workforce, and even supply chains.

The 64 million \$ question is: AI bubble?

It is impossible to know the top of a secular growth cycle like AI and/or the Internet, and it is equally hard to know with 100% certainty whether we are actually in a bubble or not.



We can, however, compare market valuations for the 2 periods and try to assess the level of risks based on investors optimism, assuming extreme valuations reached in 2000 are the danger zone.

Flashing caution in valuations:

- In 2000, the S&P 500 was trading at 27x earnings. Today, it is trading at 27x...
- In 2000, the price/revenues ratio was around 2x. Today, it is at 3.35x...
- In 2000, the price to Book was 4.80x. Today, it is 5.5x...
- In 2000, the tech sector made up approximately 33% of the S&P 500. Today, it is just below 35%...

With differences today versus 2000s:

- Valuations of top tech names today are a lot more reasonable than in the 2000s. As an example, Microsoft, being the top name back then and today, traded at over 80x earnings whereas today, it is 38 times;
- The superior profitability and asset-light business models of corporate America today warrant higher valuations on sales and book value.
- The Internet, or dotcom, bubble happened during a rising interest rate cycle whereas today, it seems that interest rates are now tending to head lower.

Taking action...

Instead of paraphrasing one of the best minds in the investment industry, we decided to reprint what Howard Marks wrote in his last memo regarding how he quantifies risks:

“The existence of overvaluation can never be proved, and there’s no reason to think the conditions discussed above imply there’ll be a correction anytime soon. But, taken together, they tell me the stock market has moved from “elevated” to “worrisome.”

What should you do about it? I consider tactical actions in terms of the spectrum that runs from aggressiveness to defensiveness, and when valuations are high, I consider becoming more defensive. In the “action shows” my wife, Nancy, and I like to watch, the Pentagon sometimes announces a Defense Readiness Condition, starting at DEFCON 5 and escalating as the danger grows to DEFCON 1, which indicates a nuclear attack is underway or imminent.

In a similar vein, I think of progressively applying the following Investment Readiness Conditions, or INVESTCONs, in the face of above average market valuations and optimistic investor behavior:

6. Stop buying
5. Reduce aggressive holdings and increase defensive holdings
4. Sell off the remaining aggressive holdings
3. Trim defensive holdings as well
2. Eliminate all holdings
1. Go short



*In my view, it's essentially impossible to reasonably reach the degree of certainty needed to implement INVESTCON 3, 2, or 1. Because "overvaluation" is never synonymous with "sure to go down soon," it's rarely wise to go to those extremes. I know I never have. **But I have no problem thinking it's time for INVESTCON 5.** And if you lighten up on things that appear historically expensive and switch into things that appear safer, there may be relatively little to lose from the market continuing to grind higher for a while . . . or anyway not enough to lose sleep over.*

*I hasten to note, of course, that credit investments are generally more secure than stocks, and thus well suited to serve as defensive holdings in the climate I describe. **The narrow yield spreads mean today's prospective returns on credit aren't generous relative to those on "risk-free" assets in the context of history, but the returns are significant in absolute terms, competitive with the historical returns on equities, and supported by the issuers' contractual promise to pay interest and return principal, something that can't be said for stocks.*** " - Howard Marks, August 13th, 2025



We hope that you and your families had a wonderful Thanksgiving, and as always, we are extremely grateful for your ongoing support.

- Alain Chung, CFA, Chairman and CIO, on behalf of the Claret team.