



In uncertain times, investors tend to flock to safety. Such is the mantra, usually. We live in unusual times, however, and paradoxically, today's stock markets are driven by those few companies presumed to usher in the demise of the human race. There is Open AI and Anthropic of course (both of which are still private), but there is also Nvidia, Amazon, Alphabet with Gemini, Meta with Muse, SpaceX with Grok and Microsoft with Copilot (which is underpinned by Open AI), all of which have inseparable dependencies with one another. All advanced AI models are dependent on Nvidia chips while AMD and Intel are attempting to make inroads. Are we heedlessly investing our future in companies that will bring about the downfall of humanity? We are personally more optimistic about the resilience of homo-sapiens than pundits, politicians, and many experts, but the importance placed on AI's potential threats and impact should make us ponder the matter.

Geopolitically, cooperation among formerly friendly nations does not appear to be improving and alignments are constantly being re-drawn. Back in May, an important bit of news received less attention than merited. The United Arab Emirates, the third largest OPEC and seventh largest world oil producer, announced it would no longer abide by OPEC quotas, clearly a result of the war in the Middle East. One might expect this development to be positive for prices yet in the interim, it signals that oil-producing neighbors will have divergent, as opposed to unified, objectives going forward. What is the point of maintaining OPEC if the largest members no longer provide a safety damper to price volatility? For similar and additional reasons, Latin American nations are also splintering as a bloc, with some aligned with the U.S. agenda and others not. All the while Europe continually struggles to weigh a common cause over its separate priorities.

The increase in global disorder has served to generally benefit the U.S. dollar to many macro hedge funds' consternation. The crowded trade of being short the dollar has come back to bite funds which are now rushing to cover their failed bets. A more tangible effect of the strong dollar is that U.S. multi-nationals, particularly those with European exposure, will once again need to account for their products being less price competitive on the international stage. Perhaps that is no longer as significant an issue as it was due to on-and-off tariffs policies, but for those steeped in market economics, forecasting has become all the more difficult. A stronger dollar does not reduce our trade deficit, which was one of the current administration's primary objectives. All of these factors promote inflation due to increasing input costs hurting the competitiveness of companies domiciled in the U.S. Companies that benefited from economies of scale over the last few decades are now experiencing the reverse.

During the recently ended quarter the first interest rate hike since Federal Reserve chairman Warsh took the helm of the bank was announced. Just as unusual as the above-mentioned headwinds, the Fed opted to raise interest rates—less than two months before mid-term elections! The last time this happened was in 2018—during president

Trump's first mid-term. Prior to both Trump terms, one has to go back to the Reagan presidency in 1982 during which rates were raised ahead of mid-term election as then chairman Volcker tried to break inflation, which caused a recession.

Sticky inflation, a U.S. Treasury Secretary attempting to control the yield curve by issuing short-term debt while purchasing long-term treasuries and a new Fed rapidly changing course all point to reasons for the bond market to price in much higher prospective uncertainty. It is not often that the United States is compared to France yet we are now reading about contagion among developed country sovereign debt. Furthermore, the increasing cost of servicing the national debt continues to rise unabated. Perhaps the mid-term election outcomes will convince our elected officials to tackle our debt obligations but we place less than even odds on that occurring.

Amidst this volatility which spans across a number of different macro trends, investors flock, not towards preservation of capital, but to all things AI. A house of mirrors is all fun and games until one can't find the exit.

As for us, it just so happens that volatility across sectors and markets opens up our opportunity set. In equity markets, we always maintain a keen focus on preservation of capital. We are not averse to volatility as it expands our investment universe and prospective return equation. For stocks, downside volatility enables us to lock in elevated dividend yields from companies that have the wherewithal to continue rewarding their shareholders. These predictable payments tend to grow over time, providing a distinct advantage over fixed income instruments. Higher-than-historical dividend yields also connote that associated stock prices are already depressed. Those characteristics, among others, have proven to be desirable starting points over longer time periods while providing an additional stabilizing mechanism. In fixed income portfolios, we have maintained shorter durations than our benchmarks which has translated to less downside in this rising rate environment. Additionally, we focus our attention on investment-grade securities which tend to experience less downside.

In either our equity or fixed income investments, everything we seek is "investment grade." At times, companies deteriorate relative to our original hypothesis in which case we eliminate them from portfolios. More often, their market positions and attractive valuations become clear and their shares revert to more appropriate levels, rewarding us in more ways than one. Prices may not reflect these attributes in the short-term and that is precisely what we seek as it enables us to methodically add to our positions. Through cycle we end up being rewarded from some if not all of the following: earnings improvement, multiple re-valuation, and income throw-off. Those are the horizons we are interested in such that we enable our investments to flourish.

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