



# MONTHLY INVESTMENT COMMENTARY

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In our recent quarterly letter, we outlined our forecast for a growing U.S. economy, supported by stable employment and continued moderation of inflation. We posited that these factors alone could lead to solid equity returns despite valuations remaining high by historical standards. At the same time, we acknowledged the inherent pitfalls of short-term forecasting, referencing a study by Avantix Investors that quantified how poorly professional market forecasters' track record has been in recent years.

What stands out to us is, while economic forecasts are generally not too far off from reality, the corresponding expectations for market returns often diverge significantly. This explains how an economist that accurately predicts key economic drivers—such as GDP, inflation, productivity, and tax policy—can still miss the mark in translating those insights into stock-price movements. Why is this the case?

First, markets are inherently forward-looking. This dynamic explains why select baskets of stocks, which may benefit from an administration's policies, often surge in anticipation of—but

falter following—an incoming president's inauguration. For example, stocks tied to the Trump 1.0 administration's campaign promises peaked shortly after his inauguration in 2017, and a similar trend occurred with stocks expected to benefit from the Democratic sweep in 2020. Recently, stocks most aligned with President Trump's platform have struggled. While regulatory changes and headline-driven enthusiasm can temporarily boost share prices, only policies that sustainably impact the trajectory of earnings drive long-term stock performance.

Second, while economic forecasts might offer insights into how the average or median stock might perform, concentrated indices dominated by a few large companies present additional complexities. According to the Avantix study, estimates for U.S. large-cap-stock returns in 2024 ranged from +13% to -12%, both significantly undershooting the S&P 500's 23% increase last year. However, it's worth noting that the average stock returned just 11%, and one-third of the index's constituents experienced share price declines. The rising tide of the "Magnificent 7" did not lift all boats.



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Finally, and perhaps most importantly, investors often find themselves in the “right church, wrong pew” when it comes to big themes. Currently, the greatest challenge is correctly identifying the winners and losers from the transformative potential of Artificial Intelligence (AI). We are confident that the AI revolution will be as groundbreaking as the advent of the internet. However, we remain skeptical that many of today’s leading companies possess the sustainable competitive advantages necessary to capture outsized profits from AI.

History provides a cautionary tale. At the turn of the 21st century, investors correctly anticipated the internet’s transformative power but often invested in the wrong companies: hardware providers like Cisco Systems, dial-up services like AOL, and browsers like Netscape. While the internet did change the world, the biggest winners were businesses that transformed industries—think booksellers, movie rentals, and advertising platforms. As the cost of delivering internet services declined, so too did the growth prospects of the initial “pick and shovel” companies that were developing the hardware and infrastructure to make the internet possible. Following the bubble burst, many of the early internet winners took a decade or more to recover their previous highs (while many never did.)

A recent development in AI underscores this point. In late January, Chinese startup DeepSeek announced a large language model seemingly competitive with OpenAI’s ChatGPT but at a reported 95% lower cost. While it seems unlikely that American companies will flock to a Chinese startup with their most precious data and skepticism over the reported cost of the model is warranted, this news highlighted the fragility of the assumptions underpinning many AI-related investments. If one startup can achieve such efficiencies, it’s likely others can too. This revelation rattled semiconductor companies, whose valuations are predicated on significant capital expenditures from AI-enabled companies, causing their stock prices to nosedive along with electricity producers, which were anticipating AI-driven energy demand. On the other hand, potential AI users, like healthcare firms and consumer-tech companies, emerged as unexpected beneficiaries due to the prospect of more affordable AI deployment.

Beyond AI, we see other areas where conventional wisdom may lead investors astray:

- **Traditional Energy:** The incoming administration’s plans to deregulate oil and gas could benefit existing operators. However, reduced regulatory barriers may attract new entrants, increasing supply and potentially lowering prices. While we believe the energy sector is undervalued, overextending based on political tailwinds carries risks.
- **Environmental Social Governance (ESG) Investing:** ESG has become politically charged. Nevertheless, our view remains balanced. Historically, companies employing multi-stakeholder approach generate superior returns on equity and stronger earnings growth, all else being equal. As ESG investing gains in popularity, distinguishing genuinely sustainable businesses has become challenging. The current “culling of the herd” may ultimately benefit the stock prices of truly durable and diverse businesses.
- **Private Market Investing:** The proliferation of products democratizing access to private investments presents both opportunities and risks. While we earnestly believe our clients’ greatest advantage is their longer time horizon, we’re also aware of the dispersion within private markets. Indeed, mediocre private market managers can quickly erase the advantages of the private markets versus the public markets. That’s why we put so much effort and rigor into identifying top-tier private equity and credit managers who we believe have the potential to deliver exceptional client outcomes.

Forecasting is fraught with uncertainty, and even accurate economic predictions don’t always translate into success. The key for investors is to remain discerning, question conventional wisdom, and focus on fundamentals rather than fleeting headlines. By maintaining a disciplined, research-driven approach, we aim to navigate these complexities and uncover opportunities that deliver sustainable, long-term value for our clients.



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