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Mid-Quarter Update

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The stock market rebounded in April. Much of the recovery can be attributed to an oversold condition that was reversed by some de-escalation in the Middle East and corporate earnings reports that were largely ahead of investor expectations. Energy prices remain high, and the downstream inflationary implications of supply disruptions are just beginning to appear. This is reverberating across currency, commodity, bond, and stock markets, as well as the broader economy. All of this comes against the backdrop of a less-than-vibrant economy being increasingly driven by the wealth effect and Artificial Intelligence (AI), including the associated business implications and capital spending. Nevertheless, the last month has been positive for stocks, and the portfolio has benefited. Market averages are now back in positive territory year to date.

The markets are encouraged by the current earnings reports that are being delivered. These results are largely ahead of expectations. Companies demonstrating strong business momentum are experiencing outsized moves in their share prices, and overall, corporate profits now represent a historically elevated share of GDP. We explore this topic in more depth in our recent Perspectives article titled *Update: The Corporate Juggernaut Powers On.*

It is worth pointing out that over the past several quarters, and particularly in the past month, the recovery in stocks has been somewhat uneven. There has been a divergence within the stock market, and today, many investors are highly focused on short-term business trends and quarterly earnings reports, as opposed to longer-term fundamentals. We are observing this in enthusiasm for companies that benefit or are expected to benefit from immediate business inflections or AI. We are also witnessing unprecedented levels of daily options activity, a measure of speculation in the market. This is partly due to strong fundamentals of certain companies, but it also reflects more of a “trading mentality” and prioritizes the very short-term and immediate business cadence over long-term fundamental durability.

There appears to be a growing disconnect between valuation and fundamentals for a number of businesses in the market. Part of this may be justified because AI does call into question many business models and the persistence of historical competitive advantages. This reassessment of long-term growth prospects on the part of the market is showing up in lower valuations for many stocks where the underlying business remains healthy and where there is limited or no evidence of AI-related disruption. In other words, what we are seeing is a market increasingly shaped by concerns about

AI-related displacement and a preference for economically sensitive businesses over companies that possess long-term business health and persistent competitive advantages.

Our investment process is intentionally aimed at compounding returns by focusing on the long term, owning high-quality, reasonably valued businesses, and letting fundamental improvements benefit shareholders over time through attractive total investment returns. We are pleased to report that the companies owned across our portfolios are operating in line with expectations, generating attractive earnings growth and returning capital to shareholders through share repurchases and dividend increases. Periods such as this can be frustrating over the short term, when the steady fundamental progress we expect from these companies is not being fully recognized by the market. However, as long-term investors, we look to use such periods to identify opportunities where the widening gap between current price and intrinsic value presents an attractive investment opportunity.

We note some potential clouds on the horizon: relatively high valuations for more cyclical stocks, the Iranian conflict and potential repercussions, budgetary issues, and an uneven economic picture. Rarely is there a period without unknowns. This is why we continue to focus on consistency and take solace in the quality of the businesses owned across our portfolios. Compounding is the most powerful force for an investment program, but it rarely is in a straight line. History shows that ultimately, the fundamentals win. Even the strongest businesses will not always be the most successful stocks over shorter periods of time. We remain focused and disciplined, knowing that chasing momentum late in the cycle can impair long-term returns, particularly when it results in buying near the peak of a trend. We continue to invest according to our long-held philosophy, believing it to be the best way to meet our clients' objectives.