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QUARTERLY INVESTOR LETTER

In the Second Quarter, stock market momentum accelerated as the NASDAQ Composite Index posted double-digit returns. The NASDAQ's year-to-date returns are reminiscent of the late 1990s. However, headline index performance masked a wide and growing divergence among constituents. A mere seven large-cap technology stocks account for more than 75% of the S&P 500's mid double-digit year-to-date gains. In particular, performance among companies with leverage to artificial intelligence was extraordinary. For the other 493 stocks in the index, performance has been modest. Meanwhile, the Dow Jones Industrial Average has lagged the other indices, with single digit year-to-date returns comparable to yields on short-term bonds. The lack of breadth in market leadership is worrisome. Concentrated stock market leadership is unsustainable, although narrow markets often persist for lengthy periods.

It is without question AI is transformative and disruptive. The world is in the early stages of AI adoption, and we agree with the view that AI-related projects will explode in growth. AI represents a breakthrough innovation with the potential to radically alter many industries. Applications with artificial intelligence ("AI") functionality will expand and improve over coming decades. Entrepreneurs will introduce new products and services that capture our imaginations. We expect corporations and governments will invest heavily to explore the capabilities of AI and LLM ("Large Language Models").

Yet, we are also cautious as valuations for technology stocks and AI, in particular, seem excessively optimistic. Many growth forecasts seem unsustainable and, perhaps, unrealistic. Nevertheless, high growth rate forecasts and valuations attract capital, competitors, and performance-chasing investors. As capital is re-allocated to such projects, there is high probability specious business models will emerge. In addition, excess capacity is generally the outcome of such developments. Thus, we prefer to tread carefully whenever the market seems inordinately enamored of new paradigms. At the same time, we acknowledge the fundamental appeal of new technology, particularly one with the transformative potential of AI. In our view, selectivity and patience will be rewarded.

The tone of the economy changed considerably during the Second Quarter. In February and March, there was fixation on a growing probability of recession, with some prognosticators suggesting economic contraction was imminent. The narrative was disproportionately negative. In fact, market participants, convinced the Fed had already tightened policy rates too far, extended fixed income duration in anticipation of Fed rate cuts during the Fourth Quarter. Economic data during the Second Quarter, appearing obstinate, confirmed a resilient US economy with moderating inflation. Because of moderating inflation, the Fed granted investors a reprieve from rate hikes with the so-called "pause" at its June meeting. Fed officials, however, reiterated their vigilance against inflation with the possibility of further rate increases. A pause, in other words, does not necessarily mark the terminal point of policy rates.

We acknowledge encouraging inflation trends, but the level remains well above the Fed's target. At a minimum, it seems clear from Fed rhetoric that rate cuts are unlikely. Thus, we remain both confused by and concerned with market positioning in certain sectors. There is a disconnect between the Fed and the market, in other words, implying a necessary adjustment at some point. Such adjustments are usually characterized by heightened volatility. As these dynamics eventually resolve, we continue to take advantage of attractive yields offered by short-term Treasuries.

We also note that China's post-COVID recovery seems to be faltering. In response, the Chinese government reverted to a stimulative monetary policy stance. China's economic uncertainties could weigh on global GDP growth, but their economic deceleration could also have a favorable impact on inflation. We look forward to meeting with you to review your accounts and further discuss our outlook.