July 8, 2025

It would be an understatement to say that the second quarter's stock market performance was a mirror image of the first. After the threat of imposing sky-high tariff rates that would have resulted in curtailing trade with China, the President's 90-day pause provided a parabolic boost to the stocks that had been hit hardest to start the year. The standoff and subsequent backing down with China was a preview for how trade negotiations have gone across the board, making it difficult for companies and the investment community to have a clear picture of how things will shake out in the long run.

Betting on the direction policy goes from here is neither a fruitful exercise nor one in which any reasonable market participant should expect to have good results. As a case in point, the average stock in the worst performing sector to start the year, Information Technology, was up roughly 20 percent for the 2nd quarter, outpacing the next best performing sector, Communication Services, by over 10 percent. This was a reversion back to the highly concentrated markets that have become commonplace since Covid as investors excitement about the prospects of Artificial Intelligence ("AI") remain high.

We see signs that the stock market is in the advanced stage of a Technology-led bull market where the risk to piling "all in" on the predominant theme of the day such as Artificial Intelligence well surpasses the risks of diversification. While money will be made in the near-term supplying the industry with machinery, chips and electricity needed to develop this technology, the long-term beneficiaries are still unknown, as is usually the case with infant industries. In comparison, during the Tech bubble of the 1990s, few had the vision to see what Amazon, Apple, Google, and others would become today, and more money was lost betting on finding the "internet winners" than in holding a diversified portfolio over the subsequent 20 plus year period. Similarly, even the management teams of the "Magnificent Seven" (Apple, Amazon, Microsoft, Alphabet, Nvidia, Meta Platforms, and Tesla) technology companies have yet to put out a firm path to operating profits on the hundreds of billions in capital expenditures they are currently undertaking.

In our view this bifurcation in the stock market provides an opportunity to those with a long-term investment horizon that extends well past the current cycle. As such, we are looking at the following to inform our decisions over the 6 to 12 months:

- Tariff risks remain and threaten to thwart consumer spending, hurt profit margins and slow down the economy.
- Last week's passage of the Tax Bill (a.k.a. - **One Big Beautiful Bill**) will expand deficits significantly and increase long-term borrowing costs, causing harm to mortgage and commercial lending.
- High geopolitical risks and tensions between Israel-Iran and Ukraine-Russia will continue to disrupt global markets, with no immediate solution at hand.
- The S&P 500 Market Cap-Weighted Index is edging close to all-time high valuations, while the median stock is more reasonably valued.
- The depreciation of the dollar relative to other currencies and the loss of the U.S. as a haven because of renegotiated trade arrangements will most likely lead to an increase in short-term inflation and longer-term deflation.
- AI capital investment likely continues to drive markets forward, but a path to profitability on the historically high level of investment will eventually be required by shareholders.
- The Federal Reserve remains stuck between a rock and a hard place with the threat of tariffs weighing heavily against a slowing economy.

We can summarize our recent activity in your portfolio as follows:

- Target cash reserves in stocks remain at 20 percent, as we remain modestly more defensive when compared to the start of the year.
- Selling has outpaced buying to start the year at a ratio of 1.6 to 1, and we remain vigilant in keeping turnover and capital gains low while positioning portfolios as optimally as possible.
- We will continue to utilize Treasury Bills as a supplement to cash with yields still well above zero.
- We have added three new companies to the stock portfolio that operate in the industrial gas, water treatment and telecommunication industries, respectively. All three add exposure to sectors where we were underweighted and have promising future growth and income prospects.

Though we recognize stock valuations are high, economic growth is slowing, and the Federal Reserve is stuck holding interest rates at 4 percent, we continue to believe growth in corporate earnings will remain strong over the next 12 months and maintain a positive bias for the stock market's potential gains going forward.

As always, feel free to call us with any questions, concerns, or updates to your circumstances that you may have.

Warmest Regards,

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In compliance with Rule 204-2(a) of the Investment Advisors Act of 1940, we hereby offer our current Form ADV Part II as filed with the Securities and Exchange Commission through notice of its public posting on our website (www.carderockcapital.com). The Securities Exchange Commission's Investment Adviser Public Disclosure database can be accessed at their website (www.adviserinfo.sec.gov/IAPD/Content/Search/iapd_Search.aspx). With reference to Rule 206(4)-2 Carderock urges you to compare the information on your statement with the statements received from your custodian. Please call if you have any questions.