FIVE MILE RIVER *Investment Management, LLC*

Five Mile River Investment Management, LLC
Client Quarterly Letter
2nd Quarter 2023

July 11, 2023

PERFORMANCE

	Dow Jones Industrial	**S&P 500 with Dividends***
2023 Q1	0.38%	7.50%
2023 Q2	3.41%	8.74%
2023 HY	3.80%	16.89%

In the Five Mile River (FMR) 2023 year-end Client Letter dated January 3rd we presented an outlook that called for a probable full year 20% rise in stock prices if a soft landing for the economy could be achieved. In the FMR March 21st client letter we explained why the demise of SVB would provide cover for Federal Reserve Chairman Jerome Powell to stop raising interest rates. In hindsight FMR made the correct macro forecasts, however….

What unfolded in the first half of 2023 was truly extraordinary. Through the first six months of 2023 the S&P 500 faced a number of headwinds that included: rising interest rates; an economy on the verge of recession; a debt ceiling legislation stalemate; and geo-political risks with China and Russia. Therefore, it is no surprise that 99% (493 stocks) of the S&P 500 stocks would be down or unchanged. What was extraordinary was the fact that SEVEN of the S&P 500 companies rose so sharply that they would dominate and drive performance for the entire S&P 500 index for the first six months of 2023. **Specifically, these seven companies accounted for the total 16.89% rise in the S&P 500.**

Investors have often had love affairs with particular groups over the past 50 years. In the late 70's there was a frenzy to own disc drive companies. Starting with just three companies in the 1960s (IBM, Fujitsu, and Hitachi), the industry grew to over 220 companies in the 70s and 80s. There are just three companies that remain today (Seagate, Toshiba, and Western Digital). The dot-com boom/bust of 1999-2000 was another example of a love affair with anything associated with the internet. Most of the dot-com companies did not have realistic business plans and almost all of those companies reached historic over-valuations and are no longer in business. A minority of dot-com firms did persist and merged or grew.

Today, we are witnessing a fascination with the transformative possibilities of Artificial Intelligence (AI), however, many beneficiaries of this trend are now being valued at prices associated with past peak euphoric levels. NVDIA is one of the early posterchildren of this mania. NVDIA rose 21% in 4Q22 and went from $146/share at year-end 2022 to $423 per share on June 30th, or an increase of 290%. Is this time different from past euphoric cycles?

In the recent 7.9.23 Wall Street Journal weekend addition is an article titled "Companies Are Being Swamped by Artificial-Intelligence Tools." A Garner Group analyst Arun Chandrasekaran was quoted saying "IT sellers are feeling pressure to move into the generative AI space or risk falling behind, meaning some half-baked features will

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be rushed out" . . . . and he further estimates that "a fifth of the independent software vendors have stepped into . . . . . AI space." Are there already too many players in the marketplace?

FMR's investment disciplines are imbedded in stock selection for client portfolios, and when boxes can be checked for recurring revenue, cash flows, etc., if the **valuation is too high and not compellingly attractive, those companies will not find their way into FMR portfolios.** FMR portfolios have only one of the seven stocks referenced above, Microsoft. Interestingly, Microsoft is among the best strategically well positioned companies to exploit AI. Nevertheless, the market was facing significant headwinds that argued against buying the other six companies because they were overpriced in almost any measure. History has a stark reminder of the downside following one of these peaks. On average, if one of the surviving dot-com stocks had been purchased four months prior to the Q1 '20 peak, it would have taken 14 years for that price to finally break even!

Technology opportunities will abound as robotics, robotics software, 3-D Printing, and various forms of new automation are likely to emerge as investible areas going forward. FMR has a number of new candidates for these and other areas of new technology investments. FMR continues to look at the Semiconductor Capital Equipment Industry as a recipient of the driving demand in the marketplace for chips, including AI.

The prolific writer and former McKinsey partner, Tom Peters, was once quoted saying, "If you're not confused, you're not paying attention." The CNBC Chief Economist, Steve Liesman, has used this quote several times during the first half of 2023.

Why is this quote so prescient now? Conflicting data abounds. One example is this: the Philadelphia Federal Reserve states the Pennsylvania economy has been in a recession since last year, while the Atlanta Federal Reserve states the greater Georgia economy is growing uninterrupted.

FMR forecasts a range-bound market until there is better economic and interest rate visibility. The S&P 500 is now at 4444, and a 10% drop suggests a bottom of 4000, and a "soft landing" bullish possibility of +10% to 4800. A positive market indicator emerged in June when all 11 S&P 500 sectors rose. This broadening market strength is certainly a positive development, however, it is important to remember that market corrections of 5% to 10% tend to be annual events, and 2023 has yet to have a meaningful correction. While the risk of a recession has diminished, it is a possibility that a mild recession may occur, however not until 2024. Interest rates are close to peaking, however, inflation will prove quite sticky at the 3% to 4% annual rate, which will argue for the Federal Reserve maintaining rates higher for longer. It is likely the Fed will raise interest rate in July by ¼ of 1% and hopefully this will be the last raise. Interest rates are likely to be flat to down through the balance of 2023, and possibly lower in 2024. Oil may be an inflation outlier as world energy inventories are sitting at historic LOWS. Inventories at this level have been associated with past upward spikes in oil prices. At the May OPEC+ meeting they announced production cuts and that action will likely add to this price movement.

In the FMR Q3 Client letter, October 3, 2022, FMR argued that the market was putting in a bottom to the rolling ten-month bear market. Now in hindsight, the S&P 500 did put in a cycle low last October, and since that time has risen over 20%, providing a narrative that the market may be starting a new Bull Market Cycle? FMR adds value to client portfolios by selecting unique leading companies, those that can demonstrate consistent earnings, cash flows, and dividends. Because of FMR's stock selection process, FMR seeks investments that can be held over long periods of time (ex., MSFT). This drives one of FMR's objectives which is tax efficient long-term performance.

FMR actively uses the opportunities that present themselves in these volatile markets to add to existing positions and to initiate new holdings. An exciting technology investment was added to FMR accounts and is explained in the separately attached article titled "Semiconductor Capital Investment Industry."

We look forward to the opportunity to discuss the information in this letter or to answer any questions regarding your portfolio and the investment strategy employed. We hope you are enjoying the summer and look forward to hearing about your summer experiences and/or travels.

Sincerely,

Lee Todd Martha

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**The S&P 500 Index is a market capitalized weighted index of 500 companies. It is a growth-biased index because the larger the capitalization of a company, the larger the weighting it contributes to the S&P 500 Index performance. The index referenced includes the dividends issued by these 500 companies. This index is used for a comparison for FMR accounts. The performance data included in this letter are not audited and have not been otherwise reviewed or verified by an outside party. While Five Mile River Investment Management, LLC endeavors to furnish accurate information, investors should not rely upon the accuracy or completeness of this information.*

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