

Mweep, Mweep

Road Runner, 1948-

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Firm AUM *(9/30/26)*

$3.632 Billion

I just saw a great movie, *Coyote vs. Acme.* It is a joyous and expansive telling of a story first published in the New Yorker some 36 years ago, which postulated a lawsuit by Wile Ethelbert Coyote against the Acme Corporation for selling defective products. As I grew up on Looney Tunes, I found the premise engaging, and immediately of relevance to our work. Every quarter, somewhere, a Wile E. Coyote sets an elaborate trap, such as inflation that won't cooperate, oil prices lurching up on headlines, tariffs rewriting the rules mid-game, soaring long term interest rates, or the Fed tightening; one fully expects the market to go tumbling off the mesa. And so far this year, and indeed for the past several years, the market has simply gone "*mweep mweep*" and kept running. The S&P 500 is up roughly 2.3% for the third quarter and about 12.7% year to date, closing recently near 7651, just below its all-time high, having shrugged off just about every hazard the desert floor had to offer. Like Road Runner, it never seems to notice the anvil until it's already three canyons away.

What's doing the running, mostly, is one gadget: artificial intelligence, which has taken on the role of the Acme catalogue's star product, the one item this time that investors are certain will actually work as advertised, unlike the rocket sleds and spring-powered shoes of market cycles past. Maybe it will. AI-linked names have carried a disproportionate share of both the quarter's and the year's gains, and the enthusiasm is not without real earnings behind it. But every coyote believes, with total sincerity, that this purchase is the one that finally closes the gap between him and his prey. This letter takes the *optimism* seriously while keeping one eye on the catalogue's *fine print*; because the market's cheerful indifference to bad news is a wonderful thing to enjoy, and an even better thing not to take entirely for granted.

One does not have to look far to identify the rocket fuel powering this market. It is quite simply the remarkable advance in *earnings* estimates. We began 2026 with a forecast of $309, that has since jumped to $317 at the end of the March quarter, $338 by the end of June, and $360 at the end of September; this represents 34% growth year over year. 2027 estimates have moved from $369 at the start of the year to $414 today. You need to find a post-recession *recovery* year to see such a similar pattern of growth.

We have previously commented on the circularity of various *chipmakers* and *hyper-scalers* making cross *investments* in each other and the risks that this presents. We must further point out that the investments in yet-private companies are captured on public company balance sheets, with changes in private market valuation flowing through the income statement as "other income." This works well while things are trending upward, but it does pose some *risk* should these investment valuations turn lower.

The S&P 500 has never been this top-heavy; a small number of AI-adjacent mega-caps now account for a disproportionate share of index returns, meaning that an investor in a *passive portfolio* carries far more *exposure* to this single theme than they may realize. We have commented at length on the risk of having now close to 50% of the index concentrated in two sectors, dominated by fewer than ten names; that risk has only grown with each uptick.

When the market advances, it advances because those names advance; when they stumble, the index feels it immediately. Passivity, in this market, is not neutrality, it is a *concentrated bet* on a *concentrated theme*. Then there is volatility: AI-driven names move with an intensity that keeps your advisor awake at night. An earnings miss or an unexplained shift in sentiment can re-price a stock by twenty percent in a session, and that volatility does not stay contained. One day chips are dead and software is hot; the next day, the trade reverses. Add a Federal Reserve no longer playing to the accommodation camp, and the case for skepticism writes itself. We have long believed that the tone of the Federal Reserve actions provides an important backdrop for market sentiment, even as we have railed against chronic misinterpretation of those very actions by *traders*. The Fed has already signaled that it will maintain a tightening regime if that is what it takes to tame inflation.

Our last piece waxed poetic about the excitement of AI, from Waymo® to my ability to leverage my time by offloading certain tasks to my assistant, *Claude L'Escrivier.* We note that every generation of Americans has wagered heavily on *infrastructure,* but the size of the bet only makes sense measured against the economy that placed it. In raw dollars, the comparisons are almost comic: the Erie Canal cost less, even adjusted for inflation, than Microsoft now spends on data centers in half a day. Measured instead as a share of national output, the past regains its stature. The *canals* and *electrification* each absorbed roughly half a percent of GDP a year, the *Interstate highways* and the late-1990s *fiber boom* about one percent, and the *railroads*, the great obsession of the Gilded Age, more than two percent, sustained for two decades. Against that backdrop, the current AI buildout is projected to average more than three percent of GDP annually through 2032. If that holds, no single industry will have claimed nearly so large a slice of the American economy since the railroads.

Yet size is the least instructive part of the comparison. The canals, rails and highways were built to last a *century*; much of what AI investment buys is silicon that will be obsolete in *five years*, and so must be bought again. The public paid for the canals and the Interstates, while the railroads and the fiber networks were financed privately, largely on credit, and both ended in spectacular busts that ruined many investors, while paving the way for profits for future beneficiaries. AI's builders have so far paid largely from their own considerable *cash flow*, though that margin of safety is narrowing as the spending continues. AI leaders are *borrowing, issuing stock and investing heavily in their customers*. History suggests that the infrastructure will prove *useful*. It is less clear that it will prove *profitable* for those who built it, which is a distinction railroad bondholders learned in the nineteenth century and telecom shareholders relearned at the end of the twentieth. Our job is to identify the beneficiaries of all this spending. These companies may not be directly committed to the buildout but will be aggressively pursuing the opportunities that will arise from this investment.

We want to highlight a metric that has been useful in the past in assessing general levels of market risk. The earnings yield, defined as the S&P 500 earnings over the price, that is, the inverse of the P/E multiple, stands at 4.7% on current year's estimates. The ten-year Treasury yield stands at 5.27%. This comparison suggests, without prejudice, that *bonds are cheap* and *stocks are dear*. As we are hovering near an all-time high, and as it has been some time since our last gut-wrenching correction, we should keep a watchful eye. Our solution is to maintain diversified portfolios, hold adequate cash reserves, and rebalance asset allocation between stocks and bonds as appropriate.

The case for continued long-term *equity participation* is intact. Earnings are growing, the economy has demonstrated resilience, and the long-term record of equities as a wealth-building instrument is unimpeachable. But the risks deserve equal candor. *Concentration risk* remains perhaps the most underappreciated market vulnerability, in our opinion. *Valuation risk* compounds this; any earnings disappointment among the dominant technology names would carry disproportionate index consequences. *Geopolitical and energy risk* has been reintroduced by the Iran conflict in a manner not seen for some time, with direct implications for inflation, corporate margins, and the Fed's range of action. *Policy risk* persists in the form of tariff uncertainty and the ever-present possibility that the market mishears the Fed. And then there is the risk of *complacency* itself: the comfortable assumption that uncertainty will always resolve in the market's favor and that today's market leaders will always lead.

We close, as we are wont to do, with the observation that *risk tolerance is not a number on a questionnaire*. It is a lived experience, tested not in rising markets but in falling ones. We encourage each client to engage with us in a genuine, unhurried conversation about what risk tolerance means in practice: what level of decline would compel a change in behavior, what time horizon governs the funds in question, and what the cost of a *shortfall* is relative to the cost of lost *opportunity*. These questions have individual answers, and those answers should govern asset allocation decisions far more reliably than any market forecast, including our own.

Structuring portfolios to meet these objectives and tolerances is our principal mission. Staying *invested* remains our essential counsel. Staying *vigilant* is the discipline that makes it sustainable. The ability to filter out *noise* from *fundamentals* is most likely the most important factor leading to success.

Laurence R. Golding, Managing Director, October 15, 2026

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