CORE Comments

ON PLANNING AND INVESTING FOR THE TWENTY-FIRST CENTURY

June 10, 2024

Favorable Returns

The continued excitement around artificial intelligence has been driving stock prices higher, particularly in those companies active in AI. The primary beneficiary has been Nvidia.

Core's holding in Nvidia has contributed to the favorable returns we have enjoyed.

In my last letter, I suggested that stock markets had become overvalued and that risk of economic downturn and stock market decline had increased. In the last month, the bond market has sent us a telegram to the effect that the US economy is slowing: bond prices have risen. (And many economic reports are discouraging.) The stock market seems not to have received the telegram. The general excitement around artificial intelligence (AI) has continued to drive higher the stock prices of the big companies deeply engaged in AI. These include Microsoft, Alphabet (Google's parent company), Amazon, Apple and, especially, Nvidia, the maker of the semiconductors ('chips') and the software that power AI. As a result, the major stock market averages have made new all-time highs.

Core's investment in Nvidia made early in the year has served us well. In last Wednesday's stock market session, Nvidia reached a valuation of three trillion dollars and slipped past Apple to become the world's second most valuable company. Microsoft remains ahead of Nvidia—for now. Last month, Nvidia released its quarterly earnings, demonstrating that its quarterly revenues had risen 262 percent from the previous year; its profit was more 600 percent greater than a year ago. Those companies mentioned above active in AI are spending billions of dollars to build their AI systems. Much of their spending goes to directly to Nvidia. Nvidia's position is not unassailable—those other big companies are seeking to meet their needs in house—but its position is formidable. Apart from its chips, Nvidia makes the software that facilitates the use of its chips. This functional integration binds its customers to it as they seek to develop their own AI activity. It is likely that Nvidia's stock price will rise in the coming months.

Despite my view that Nvidia will continue to appreciate, I have just reduced our position by about one third. I have done this for purposes of managing risk. Because of its appreciation since our purchase, Nvidia had come to constitute about 20 percent of portfolios that hold it. That is too much for one stock. Although I think it will likely appreciate further, if I am wrong, losses in portfolios holding a 20 percent position could be considerable.

By

Jack Mayberry

Core's other equity investments, in Japan, India and US oil pipelines have all performed very well this year and their prospects remain favorable. India just had a national election in which, to the surprise of pollsters, Narendra Modi's BJP party did not win a majority and the opposition Congress Party (the party of the Nehru and Ghandi family) gained a large number of seats in the parliament. Modi has made a deal with another party and will continue to lead India. As I read this, the unexpected weakness of the Modi and the BJP is unlikely to derail the extremely favorable economic growth of India nor does it disturb the likelihood of further gains for our India holding. I have used some of the proceeds of our Nvidia sale to increase our investment in India.

As I have written in previous *Core Comments,* Japan has made significant changes in corporate governance, begun during the tenure of Shinzo Abe, changes that have produced very favorable returns in its stock market. While we cannot assume that the rate of Japanese stock market appreciation will continue at the high level of the recent year and more, the prospects for Japan remain solid and favorable.

Our investment in the pipeline ETF (symbol AMLP), held now for about two years, continues to do perfectly well. Its dividend exceeds seven percent and it has enjoyed reasonable price appreciation. I expect that AMLP will continue to provide good returns.

In April we put on a short position in US small company stocks. This investment is a hedge against the risk of recession and stock market selling. To date this hedge has been unnecessary, but the business cycle has not been repealed. A recession will come. As it comes, our hedge will be valuable for us.

Central banks are beginning the process of easing monetary policy.

The Fed stands pat while other major central banks have begun to reduce interest rates.

The Fed and other central banks. The spike in inflation in 2021 and 2022 afflicted all developed countries except Japan. And the central banks of all developed countries—again excepting Japan—raised interest rates sharply to lower inflation. The rate of inflation has fallen in the US and elsewhere, partly because of monetary tightness imposed by the Fed and other central banks. The Fed's Open Market Committee meets this week; it raised rates from essentially zero to the range of 5.25% to 5.50% in its monetary tightening exercise. Its last rate increase was in July of last year. It will certainly leave rates unchanged at this week's meeting. However, Canada's central bank and the European Central Bank each reduced rates last week. The current view is that the Fed will begin to cut rates later this year. All the banks say they are 'data dependent,' meaning that beginning or continuing to lower rates will depend upon the strength or weakness of economic reports.

So, for now, we wait and watch and enjoy the appreciation of our investment capital.

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