FORTHRIGHT PARTNERS, LLC

INVESTMENT LETTER, 2ND QUARTER 2023

EXECUTIVE SUMMARY

Risk on or Risk off when macro-economic and geopolitical uncertainties persist?

Artificial Intelligence: short-term hype versus long-term impact.

Valuations matter even more after a narrow market rally in the past six months.

Adding more to intermediate bonds as 10-year yields approach 4%.

A short ode to legendary investor Sam Zell.

RISK ON, RISK OFF, RISK…

After the confidence crisis triggered by the collapse of Silicon Valley Bank in mid-March, the fear of a 2008 replay drove the S&P 500 below 3,900 and the NASDAQ Composite close to 11,000. While concern over the structural soundness of our financial system may have been overblown, the more practical implications such as access to capital for businesses warrant continued vigilance.

But the real news has been on the inflationary front and in Artificial Intelligence. Now that individual economies around the world are more or less open for business post-pandemic, global supply chains have improved, helping to drive down the prices of many basic goods and bring down 40-year high inflation numbers. The hot-off-the-press consumer price index data rose slightly less than expected in June, at a year-over-year clip of 3.0%. As consumer and producer inflation numbers have gradually come down, expectations for an economic soft landing and excitement over Artificial Intelligence have provided the tailwind for the equity markets' strong rebound in the first 6 months of 2023. Thus, the S&P 500 just recorded its best first half since 2019 and the NASDAQ Composite its best first half in 40 years.

However, whether the coast is clear remains to be seen. The Federal Reserve has hinted at another rate increase in July due to the continued strength in the economy and the labor market. The current market consensus is that inflation will decline to 2% next year and the Federal Reserve has, against all odds, engineered a soft-landing. Nine months ago, the consensus was for a looming recession. It is notoriously hard to read economic tea leaves. We are essentially faced with the same uncertainties (inflation, recession, ongoing geopolitical tensions) now as we were nine months ago, so, risk on or risk off?

"Taking risks today for tomorrow's reward is both the most challenging and difficult of tasks. Unbridled optimism must be tempered with reality."

Sam Zell

HUMAN vs. MACHINE

The Artificial Intelligence (AI) "arms race" is upon us. What exactly is AI, one might ask? From our Google Nest device: "According to Wikipedia, artificial intelligence is intelligence demonstrated by computers, as opposed to human or animal intelligence…" Amazon's Alexa offers this definition: "Artificial intelligence is the ability of the computer program or machine to think and learn; it is also a field of study which tries to make computers smart…" In our opinion, AI is an all-encompassing term that defines the new frontier of man-made adaptive learning machines. As with other impactful inventions throughout human history, the results will be a mixed blessing. There will be winners and losers both in the long-term and the short-term. On the positive side, AI can help mitigate labor shortages in aging societies and potentially improve the speed of drug discoveries. On the other hand, in the drive to improve efficiencies, it will cause disruptions in certain industries and lead to a potential excess supply of labor. In a bit of supreme irony, AI is already wreaking havoc in its birth industry, technology. An Indian startup recently announced laying off 90% of their support staff after developing an AI-powered chatbot that could manage customer inquiries instantly, as compared to their human staff's average response time of 1 minute 44 seconds! Closer to home, Dropbox announced that it was cutting its workforce by 15% as it harnesses the power of AI.

There is no doubt that Generative AI is a transformative technology. However, it's important to remember that we are in the midst of what a CNBC guest labeled a "hype cycle." The true impact, adoptability as well as risks of Generative AI will likely take years to unfold. Given the dramatic performance of the Big Techs over the past 10 weeks on the back of excitement over AI, we will continue to look for opportunities to invest in reasonably-priced companies that will benefit from AI's growth, from technology to finance to industrial automation. FYI, for better or for worse, we did not write this newsletter with the assistance of AI.

"Technology is the ultimate definition of human capital."

Sam Zell

A SHORT ODE TO SAM ZELL AND INVESTING IN BUSINESS

The 2008 Great Financial Crisis is but a distant memory to even those of us raised in the age before TikTok and Instagram. We want to share with you a story about Sam Zell, who passed away in May this year. Sam Zell is considered a legend in the real-estate investment world for both how he built his businesses and his prescient timing. Mr. Zell's most-successful deal was selling Equity Office Properties to Blackstone Group for $39 billion in 2007, shortly before the real estate-induced financial implosion. In addition to being known for his colorful language, taking the proverbial road less-traveled and his philanthropic endeavors, Mr. Zell was known for seeing value where others did not as well as building businesses to create value for shareholders. In the midst of the mini-banking crisis that engulfed us earlier this year, we feel more strongly than ever that his example of investing in businesses run by good people will endure longer than a Snapchat photo.

"I am somebody who has been very fortunate to have had the opportunity to test my limits."

Sam Zell

WHAT IS IN STORE FOR THE SECOND HALF OF 2023?

As Yogi Berra would say, "It's tough to make predictions, especially about the future." But valuations matter even more after the spectacular AI-fueled market rally over the past three months. The degree of investor complacency worries us. In our humble opinion, a healthy stock market will only be sustainable if the investment performance broadens into sectors other than just technology.

PORTFOLIO POSITIONING

While our focus on high-quality dividend-paying companies served us well last year, it has proved challenging in 2023 due to the dominance of expensively-priced technology stocks. We have a healthy exposure to the technology sector, but we do have a slight underweight because of valuation concerns. On the bright side, the extreme narrowness of the market gains this year (please see Market Highlights for details) means that we have been able to add to positions in solid companies in the financial, heath care and industrial sectors at reasonable prices. In this risk on / risk off volatile market, we remain convinced that our investment discipline will pay off.

As 10-year interest rates moved back up to the 4% area, we have increased our exposure to intermediate bonds (3 – 5 years) but continue to hold a considerable amount of short-term Treasury bills and money market funds.

As always, please do not hesitate to contact us if you have any questions.

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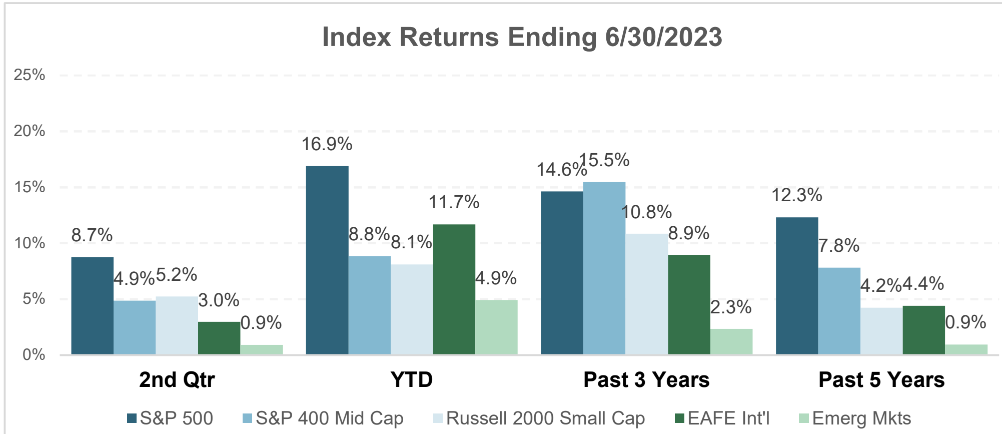
SECOND QUARTER 2023 MARKET HIGHLIGHTS

Stocks – Déjà Vu or Saved by Chat GPT?

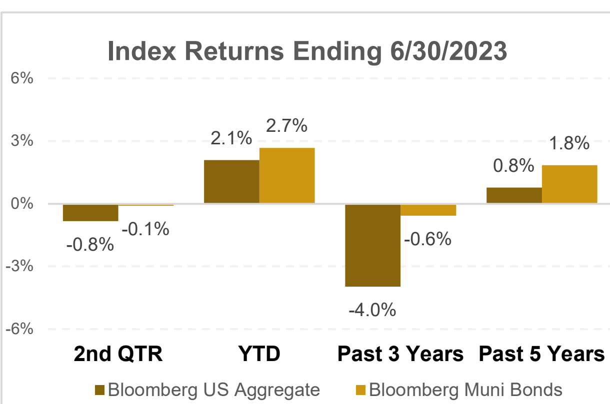


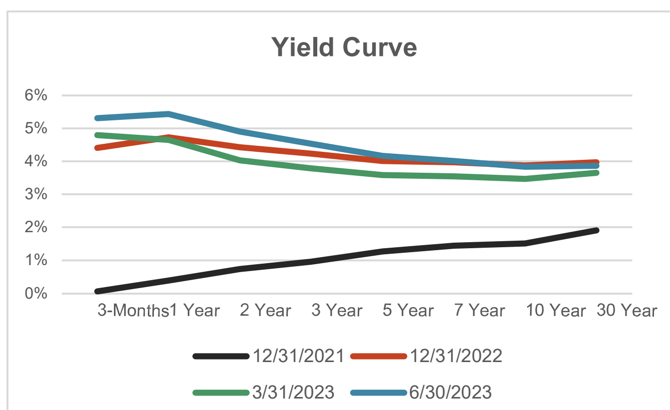
- Despite rising interest rates and economic uncertainties, global stock markets have all posted solid gains this year.
- US large cap stocks continue to lead the pack, as AI excitement led to a strong rally in technology stocks.
- While the S&P 500 Index gained 17% in the past six months, the <u>average</u> stock rose only 7%.
- Continuing the first quarter's trend, market gains were extremely narrow, dominated by seven stocks, all 2020 darlings (Alphabet, Amazon, Apple, Meta, Microsoft, Nvidia and Tesla).
- The Russell 1000 Growth Index rose 29% in the first half of the year, versus 5% for the Russell 1000 Value Index.
- Is diversification dead? Over the past five years, investors have not been rewarded by straying from US large cap stocks. The S&P 500 Index is now trading at 19 price/earnings ratio versus 13 for overseas stocks. Does valuation matter?

Bonds – Higher for Longer?

- After leaving the Federal Fund Rate at 5.25% in June, the Federal Reserve has strongly hinted at a 0.25% rate hike in July. As a result, bond prices have declined, pushing longer-term bond yields up to year-end 2022 levels. The yield curve remains inverted – that is, short-term rates continue to be meaningfully higher than long-term rates.
- While taxable and municipal bonds posted a slight loss in the second quarter, year-to-date returns remained solid.

	2 Year Bond Yield
12/30/2022	4.4%
2/1/2023	4.1%
3/8/2023	5.1%
3/31/2023	4.1%
6/30/2023	4.9%





- While rising interest rates have been painful, bond investors are now actually receiving income, vastly different from the 0-2% environment that has reigned most of the post Financial Crisis period. With inflation gradually coming down, bond investors may even get to enjoy real return after inflation!