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CAPITAL MANAGEMENT

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James P. Cullen
Chairman & CEO

Mid-Year Market Update

To the Moon, Alice!

We have already had 24 new highs this year, following 65 new highs last year, and 75 new highs the year before. **The most recent new high, powered by SpaceX, makes one wonder where this is going. Maybe to the moon. It made me recall the 1960s when Jackie Gleason in his TV show, *The Honeymooners*, annoyed by his wife, Alice, would say, "To the moon, Alice!"** Speaking of the 1960s, on the same day as the SpaceX offering, there was an article in *Barron's* pointing out that in the 60s the Dow Jones Index was at 1,000 but has now gone to 50,000. This was shocking to me because when I started in the business in 1964, with the Dow at 1,000, we went 14 years never making a new high. It seems unbelievable that with all that has happened in the market over this time we could have gone to 50,000. **Actually, there are similarities between today's market and the 1960s, but first let's discuss what's on everyone's mind today - AI.**

The AI Strategy

The main question we are asked today is about the impact of AI on our firm and on the stock market. We have been working with AI for a considerable time and this has made gathering information on stocks and markets much easier. Also, an advantage is that our two main portfolio managers, **Jennifer Chang in U.S. Equities and Rahul Sharma in International**, both came to the firm with strong technology backgrounds. Jennifer has an engineering degree from Rice and an MBA from Wharton and Rahul was a math whiz from William & Mary. **They both have been with our firm for 25 years, managing the U.S. and International portfolios and building robust research support teams.**

The trickier question is: "How will AI impact the stock market itself?" We believe the stock market will prove to be more difficult. **The main reason is that investing, and value investing in particular, have a very important contrarian bias - more later.**

The 1960s

During the gradual buildup in the '60s, the public became increasingly comfortable with stocks after the devastating correction of the 1930s. As the market went higher during the '60s, confidence built up, new brokerage firms were formed, and branch offices were being opened all over the country**. Trading in small cap stocks was popular in the '60s, but the most popular stocks were "conglomerates," (names like Gulf & Western, LTV, and Litton Industries,) which were highly leveraged companies.** These became the leading traded stocks on the market every single day, and like our Mag 7, all the financial news focused on these companies, almost to the exclusion of everything else.

The period came to an end when Charlie Bluedorn, CEO of Gulf & Western, walked into Chemical Bank and offered to buy them with money that was theoretically borrowed from Chemical itself and other banks. That got the government's attention and caused more scrutiny of their aggressive accounting practices, resulting in the end of the conglomerates, and with them, the bull market. **The devastation from that period is illustrated by the below tombstone which included almost a third of all brokerage firms on Wall Street. A few years later, 100% of these companies were gone, either through bankruptcy, merger, or sold at a major discount. Some of those firms were 50-100 years old.**

The New York Times

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June 16, 1960

Source: New York Times, 16 June 1960

Today's market is also similar to the '60s in that investors appear to be fearless of market risk. A 2026 Planning & Progress Study by Northwestern Mutual highlights that the current market is being dominated by the trading of younger investors and that 60% of American Gen Z and Millennials believe the only way to build wealth is through alternative methods like gambling, meme stocks, cryptocurrencies, prediction markets, and sports betting. Also, the leading options exchange, CBOE, measures risk and points out that presently investors have less concern for traditional market risks than they've seen in years.

With respect to risk, today's investors say they have hedged their risk with options. That may be the case, but history raises some questions. In the late '70s, institutions wanted to make sure they had downside protection strategies and Wall Street quantitative analysts came up with a supposedly foolproof way of using options and derivatives to give investors all the downside protection they wanted. It was called **"portfolio insurance."** But it turned out that the hedges were not foolproof. In 1987, there was a correction triggering the portfolio insurance, starting a run on the market which produced a 25% drop in one day. **This one-day sell-off remains the worst in market history.**

Our Strategy

Reflecting on the Dow going from 1,000 to 50,000 illustrates how effective companies have been in adjusting to changes in the economy over time. It certainly is a positive example of capitalism at work.

Below we include a study we have often referred to in the past, showing how focusing on a 5-year time horizon and the bottom 20% of stocks on a P/E basis historically has led to consistent strong returns over time. We have also highlighted the performance of the next 5 years following the few sluggish periods.

Annualized performance of low P/E stocks in five-year periods (1969-2025)

Period	S&P 500 Bottom 20% by P/E	Following 5-year Period
1969 –1973	-0.88%	+21.06%
1970 –1974	0.42%	+30.73%
1971 –1975	7.59%	
1972 –1976	14.06%	
1973 –1977	14.18%	
1974 –1978	21.06%	
1975 –1979	30.73%	
1976 –1980	26.06%	
1977 –1981	20.38%	
1978 –1982	24.39%	
1979 –1983	27.31%	
1980 –1984	24.53%	
1981 –1985	24.79%	
1982 –1986	27.74%	
1983 –1987	20.06%	
1984 –1988	20.04%	
1985 –1989	21.16%	
1986 –1990	10.52%	
1987 –1991	13.05%	
1988 –1992	18.11%	
1989 –1993	15.98%	
1990 –1994	11.85%	
1991 –1995	23.95%	
1992 -1996	18.65%	
1993 –1997	22.50%	
1994 –1998	18.66%	
1995 –1999	19.72%	
1996 –2000	16.63%	
1997 –2001	16.09%	
1998 –2002	7.01%	
1999 –2003	14.30%	
2000 –2004	17.38%	
2001 –2005	15.77%	
2002 –2006	16.16%	
2003 –2007	18.16%	
2004 –2008	0.23%	+25.27%
2005 –2009	4.81%	+17.68%
2006 –2010	5.61%	
2007 –2011	2.41%	+17.19%
2008 –2012	5.64%	
2009 –2013	25.27%	
2010 –2014	17.68%	
2011 –2015	13.69%	
2012 –2016	17.19%	
2013 –2017	17.57%	
2014 –2018	6.36%	
2015 –2019	8.98%	
2016 –2020	7.79%	
2017 –2021	9.82%	
2018 –2022	5.06%	
2019 –2023	10.91%	
2020 –2024	8.59%	
2024 –2025	13.38%	

Source: CapitalIQ, Standard&Poors, Bloomberg, & CCM Research

Past performance does not guarantee future results and there is no assurance any market trends will continue.

Investors may still be rattled by the prospect of a severe down market period. However, the downside has not been as bad for the low P/E strategy, as you can see in the table below. Here we show one of the worst periods for NASDAQ performance, from 2000-2002. In the table we compare NASDAQ to the S&P 500 and the bottom 20% by P/E.

	NASDAQ	S&P	Bottom 20% by P/E
2000:	-39.3%	-9.1%	+24.2%
2001:	-21.0%	-11.9%	+16.2%
2002:	-31.2%	-22.1%	-8.9%
Total:	**-67.0%**	**-37.6%**	**+31.5%**

Source: Bloomberg, SCCM Research

Dividends

An important aspect of the Value approach is dividends and dividend growth, which provide additional support for the strategy. In earlier reports we have shown studies pointing out that in the 13 recessions we've had since 1940, dividends have gone up for stocks as measured by the S&P 500 in every down year.*

Conclusion

Despite the explosive new highs, seemingly everyone being bullish, and having a President focused on a higher market, we are still witnessing significant weakness in some of the younger generations' favorite alternative strategies, such as private equity.

In summary, it's important to stay the course, focus on attractive valuations, and invest for the long-term.

Jim Cullen

***The only exception was the 2009–2010 recession when banks were forced by the government's TARP program to cut or eliminate their dividends.**

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The **S&P 500 Index** is a market capitalization-weighted index of 500 companies in leading industries of the US economy. The **Russell 1000 Value Index** measures the performance of the large-cap value segment of the US equity universe. The **Dow Jones Industrial Average (DJIA**) is a stock market index of 30 prominent companies listed on stock exchanges in the United States. The **NASDAQ Composite** is a stock market index that includes almost all stocks listed on the Nasdaq stock exchange. Investors cannot invest directly in an index.

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