

February 4, 2025

Dear Fellow Investor,

2024 followed a pattern we saw in 2023, only more so. By that I mean a strong market but a very narrow market. The Standard and Poor's 500 Index returned 23.3% (25% with dividends), but a short list of securities, seven to be precise, delivered by far most of the index's return. Indeed, 2024 was one of the narrowest markets in history, similar in many respects to the Dot.com bubble of 1999 or the "Nifty Fifty" craze of the 1970s.

The accounts for which we are responsible at Weybosset Research & Management LLC participated in 2024's gains, up high single digits, but trailed the S&P 500 by a wide margin. Obviously, we did not own "the Magnificent Seven"; excellent companies, all of them, but extremely expensive ("nosebleed" is a term often used to describe their valuation), and because of their high prices, extremely vulnerable, from the shareholder's point of view, to competition and other disruptions. (Competition is already showing up in the form of the Chinese company DeepSeek, knocking billions of dollars off the value of Nvidia, king of the latest mania, artificial intelligence. Expect more to come.)

Meanwhile, what about the 493 stocks in the S&P 500 *not* included in the Magnificent Seven? The 493 is where you'll find Weybosset. These also include excellent companies, but not concentrated in one or two sectors, and not selling at prices that require near-perfect circumstances to work out. When the "Nifty Fifty" went down in the mid-1970s, it was decades before share prices recovered. And all were excellent companies. When the tech bubble burst in 2000, again, it was more than ten years before prices recovered. And many, many of the darlings of 1999 never recovered at all because they were bankrupt.

We at Weybosset Research eschew speculative investments precisely because of the experience of the past. Herding is a normal and strong human instinct, but a bad idea in the world of investments. The investor thinks she has joined a pack of lions when in fact she has joined a mob of lemmings. Since the first rule of investing is, "Never lose money", and the second is, "Never forget Rule Number One" (Warren Buffett) we try hard to stay out of bubbles. It may cost some RELATIVE performance, as in 2023 and 2024, but preserving and growing your capital is our goal. To grow you must first preserve, and we take our goal seriously.

Thank you for the confidence you have placed in us, and Justin has comments and color to add.

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2023/2024 was the narrowest market since 1998/1999. The Nifty 50 period of the 1970s was the narrowest period before that. With only three such periods in the past 50 years, **narrow markets are the exception not the rule.**

In fact, according to MSCI World Indexes the Equal Weight S & P 500 index has outperformed the Market Cap weight index over the last 25 years.

The Equal Weight index is a stock market index that gives equal weight to each stock in the index, regardless of the company's size or market capitalization. This means that each stock has the same influence on the index's performance.

The Market Cap Weighted index is an index in which each component of the index is weighted relative to its total market capitalization. In a capitalization-weighted index, companies with larger market capitalization exert a greater impact on the index value.

Someone who invested in the Equal Weight index in 1999 would be one third richer today than the person who invested in the Market Cap weight index. This would not be the belief among market participants today.

I am pleased to report over the last three years (performance may vary for accounts based on when they started), though we have lagged the Market Cap index by just a few percentage points (roughly 3) we have outperformed the Equal Weight index by 5-6% in total.

Some market observers have suggested the US markets have started a new paradigm, but the facts are simple. Over the last two years the Magnificent 7 have increased their earnings by more than 25% a year, while the other 493 stocks have grown their earnings by only 2% (remember, earnings and interest rates are the main drivers of stock prices).

We have been in the midst of an industrial, transportation, and housing recession for the last two years, as earnings have declined in each of these sectors. The American economy is a strong and durable machine in which we normally have "rolling recessions"- one in which one sector a time goes down- as opposed to an entire economy in recession at once. Usually this only happens during financial shocks, such as 2008 and the 2020 pandemic.

Extremely narrow leadership implies a scarcity of growth opportunities. There are very few companies that can grow earnings. This has been the case for the last two years. Goldman Sachs commented that the 2024 stock market was the narrowest since the Great Depression. Implying that companies are trying to survive, let alone grow and that the only game in town is the Magnificent 7.

Investors have crowded into the Magnificent 7 pushing their percentage of the S& P 500 Market Cap index to roughly 40%, the highest on record for any group of stocks. 35% of the 2024 S & P500 return was Nvidia. We own **one** Magnificent 7 stock; acquired last summer, Alphabet (Google). One would have to own more than 45% of her portfolio in 7 stocks to beat the Market Cap weighted index. That would be insane!

Unlike the Great Depression, fundamentals haven't justified today's extraordinary narrow leadership. Throughout history it tends to be the case that the first mover in new technologies is NOT the long-term winner. It is the companies that learn to use such technologies to enhance and grow their earnings that prove to be the long-term winners, companies in which you use their goods or services in everyday life; in short, the Weybosset portfolio.

As the economy begins to recover, and earnings grow more rapidly in the other 493 stocks, investors will have to compare prices and values and decide where the risk/reward lies. As the late Charlie Munger said, *"to be a good investor, you have to fish where the fish are. To be a great investor, though, you have to fish where the fishing boats don't even go"*.

Because narrow markets are the exception not the rule, history shows that markets broaden for years after periods of extremely narrow market leadership.

The change in leadership can happen abruptly; however, most investors tend to wait for the narrow leadership to reassert itself rather than position themselves for a more "normal market".

By all accounts, 2025 has started off in the right direction, the market has appeared to broaden as evident by the outperformance of our accounts. According to the Wall Street Journal, **people are obsessed more than ever with mindlessly chasing whatever is popular.**

We, however, will wait patiently, knowing we own a diversified portfolio of the highest quality American companies, till the "normal market" returns and our company's true value is shown.

"No investment strategy works all the time. The trick is knowing the difference between a bad investment strategy and one temporarily out of favor." -- **Seth Klarman**

Thank you for your continued trust and support. We look forward to preserving and growing your hard-earned capital in 2025 and beyond. Please feel free to get in touch. We would love to hear what is going on in your world.

Sincerely,

Justin Edward Deutsch

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