

October 12, 2026

Dear Fellow Investor,

Two overriding themes have come to dominate stock market behavior since we last wrote to you in July of this year, two themes that sometimes work against each other in the unending bull vs. bear back-and-forth of the stock market. First, there is the build-out of infrastructure necessary to make the next technological wonder, artificial intelligence, a reality.

The AI revolution is real and expressing itself financially in ways that simply cannot be ignored. Spending is astounding, spending for data centers, for all the equipment that goes in them, and for supporting electricity, water, and transportation.

So far, and we're just getting started, the amount of money spent or planned to be spent exceeds anything in American history. It exceeds, adjusted for inflation, the construction of canals in the early days of the Republic; the amount of money, again, adjusted for inflation, invested in connecting North America by railroad in the mid-and late-19th Century; and the cost of building the interstate highway system in the 1960s and 1970s. Hundreds of billions of dollars are already invested, and hundreds of billions more are planned. And it is happening *quickly*.

Obviously, all kinds of problems can and will arise. First, there is a real question—I say real because one of its most prominent advocates is Bill Gates, who presumably knows something about technology and its applications—of whether with AI we are creating some sort of Frankenstein monster that eventually destroys mankind. I have no worthwhile opinion on this question and prefer to defer to somebody who knows more about these things than I do (like Bill Gates) to institute regulations and guard rails to protect me and my fellow humans from computer-driven extinction.

Then we face a real problem as investors. The AI revolution is all about innovation and transformation; it is *dynamic*. But investors crave *continuity*, predictability, and the ability to confidently plan. There are already multiple players in the AI space, here and abroad, and there will certainly be many more coming. But only a few will succeed. Our job as (conservative) investors is to stay as far as possible away from the losers and hopefully have some stake in the winners. Remember, in the 19th century, railroad investing in general was a bad bet as most players went out of business. But fortunes were made and the country was transformed.

We at Weybosset Research & Management LLC (WRM) are deeply invested in AI, primarily via our holdings in companies like Alphabet (Google), Amazon and Keysight Technologies. We believe these companies have the experience, technical know-how and

financial might to negotiate whatever rough waters may lie ahead. You can be sure we will be watching closely.

But there are plenty of additional ways in which we, perhaps peripherally, participate. For instance, Cummins Inc., a manufacturer of diesel engines which we have owned for years, has a subsidiary that makes electrical generators. Given the insatiable demand by data centers for electricity, it is no surprise that Cummins is full out selling electrical generating equipment. Similarly, FTAL, which owns and leases jet engines to commercial operators while repairing those same operators' jet engines, has discovered that with some modifications jet engines can be used to generate electricity. Data centers cannot get enough of FTAL's engines given they are off any power grid and not subject to the kind of regulation usually afforded jet engines.

AI is, if nothing else, a boon for productivity. Our freight forwarders C.H. Robinson and Expeditors International along with Lab Corp Holdings, a medical laboratory, and Chubb, a large insurance company, benefit mightily.

And so on. The point is that we think we are well positioned to participate in the AI boom without violating any of the disciplines that have made WRM successful for more than 25 years. Again, we will be watching closely.

The second overriding theme in today's stock market has to do with the special military operation (sponsors are loathe to call it a war) initiated by the United States and Israel against Iran. The result so far has been to hand a sworn enemy of the United States and its allies veto power over the use of the Strait of Hormuz through which pass 20% of the world's oil. Oil prices, and the prices of oil-derived products such as diesel fuel, are through the roof as a result.

Some days the American president announces that peace is at hand, and the stock market roars; when it becomes apparent that the Iranians are yet again tapping their US interlocutors along, the market sags.

Much like the issue of whether mankind will survive the advent of artificial intelligence, I have no particular insight to offer. A return to the *status quo ante*, for which many years, strikes me as unlikely given it would require Iran to surrender certain existentially essential assets, such as control of Hormuz and its nuclear program.

And why should Iran do that? The US has been unable to accomplish its goals in the region by force, and it is difficult to see whether alternate means—economic pressure?—will work. This special military operation is profoundly unpopular at home and around the world, so it does not appear the U.S. has a lot of room to maneuver.

So, we are faced with some major uncertainties between the AI boom and the booming going on in the Middle East. But the future is always uncertain. The task of the investor is to proceed despite uncertainty, and we aim to have the odds on our side as we do so.

Thank you for your support and for the trust you have placed in WRM. We aim to be worthy of that trust,

-Fla

The Bear Market Within a Bull Market

For the first nine months of the year, the S&P 500 has posted a respectable 12% return, and the portfolios we manage here at Weybosset finished the third quarter right alongside it.

On the surface, with the broader market sitting just a few percentage points from its all-time highs, everything looks placid enough. But as Charlie Munger used to remind us, if you just water the grass, you don't see what's crawling underneath. What is happening beneath the surface to individual stocks tells an entirely different story.

For the first six months of the year, the market and the average stock were humming along nicely. Then July 1st arrived, and the weather changed.

In our estimation, the conflict in Iran re-escalated, and with it, the economic arithmetic shifted. As bombs began to drop once more, crude oil marched from \$67 to \$105 a barrel and Diesel prices surged from \$3.75 to \$7.00 per gallon.

The 10-year Treasury yield—the gravitational anchor upon which nearly every financial asset on the planet is priced—climbed from 4.15% to 5.30%, the 30-year fixed mortgage reached 7%, and the Federal Reserve embarked on a new hiking cycle. Hiking interest rates by 25bps and signaling there could be more to come.

Everything in the economy is tied to oil and diesel prices, from home heating to shipping costs, to the food on our tables and the clothing we wear. The list goes on. If and when the Iran conflict subsides, oil prices and interest rates will most likely retreat, acting as a powerful relief valve for multiple sectors of the economy and the stock market.

As I have commented before about rolling bear markets, one of the largest swaths of the economy outside of technology is housing. Housing starts, the construction of new homes are sitting at a 50-year low (!!). This has dramatic ripple effects across the broader economy, from contractors and real estate agents to construction materials, transportation, HVAC providers, home furnishings, retail stores, restaurants, and travel businesses.

As these pressures compounded, the average stock quietly entered a severe correction. The equal-weight S&P 500 declined for seven consecutive weeks (!!)—marking only the third time in history this has occurred—resulting in an 8% loss.

By the end of September, roughly 80% of all stocks were down at least 10% from their highs, more than 60% were negative on the year, and over half the market was sitting in a drawdown of 20% to 50% from yearly peaks. The internal correction of large parts of the stock market is statistically worse than the market decline of 18% in 2022 (!!)

Meanwhile, a handful of mega-cap technology stalwarts carried the headline indexes on their shoulders. That's because major technology companies' earnings are expanding at such an accelerated pace that macroeconomic factors like interest rates and oil prices have virtually no impact on them.

This is the bear market within a bull market, as investor sentiment has worsened alongside rising bond yields and oil prices.

The Rate of Change and Wall Street's Panic Button

Investors hate uncertainty, but more than that, they despise a rapid rate of change. When oil, diesel, and bond yields spike in a matter of weeks, human nature takes over, and Wall Street rushes to extrapolate the worst-case future. *Will rates go to 7%? Will crude hit \$150? Are we careening into a deep recession?* The markets discount the fears whether they become reality or not.

People spend an enormous amount of time worrying about things that never happen, like wearing suspenders and a belt at the same time. The wonderful thing about Wall Street, however, is its endless fascination with statistics.

History shows us that when internals wash out like this and fear takes the driver's seat, the forward returns over the next 12 months for common stocks bought in these windows average roughly 15% to 17%.

Let's put this into historical perspective. Bond yields rose much faster and further in 2022 than they did this year—and no recession materialized. Oil prices were at these exact levels back in February—and no recession followed. Furthermore, earnings growth for the S&P 500 has been phenomenal this year and is projected to strengthen further in the upcoming quarter.

Given that individual company earnings are projected to grow by roughly 15% this year, the broader economy appears well-positioned to absorb a 5% interest rate—effectively a return to historical, normalized interest rates over a 100-year horizon.

Sitting through a market correction is about as enjoyable as a root canal, but volatility is simply the admission fee you pay for the privilege of long-term compounding.

The Power of Holding Gems: Lessons from *The Investor's Odyssey*

I recently read a fantastic book called *The Investor's Odyssey*. The text dives deep into the philosophy of holding great businesses for the long haul.

Take core holdings in our portfolios like Keysight Technologies, Copart, and Deere & Company. Over the past decade, these businesses have compounded capital at 20% to 25% a year through multiple 20% market drawdowns, their individual shares declining 20% on more than one occasion, agricultural cycles, semiconductor slumps, geopolitical shocks, pandemics, and rate hikes.

As Christopher Mayer highlights in the book, the greatest investors often behave less like frantic stock traders and more like private business owners. Mayer recounts the lessons of investor Nicholas Sleep, who noted that the best returns belong to those who treat stocks as permanent ownership stakes in exceptional enterprises.

If you find a world-class business run by exceptional allocators, why on earth would you bother trying to trade around quarterly earnings reports, sell to take a tax hit, or jump out just because macroeconomic weather gets stormy?

To illustrate the point, consider what the headlines said about the agricultural sector during the recent three year ag recession. One would have thought farmers were facing the apocalypse. Yet Deere's management team steered right through the turbulence, guiding the business forward and delivering roughly 25% annualized returns over a decade. Our job is to find these rare companies and management teams, sit patiently, and let compounding do the heavy lifting.

As Albert Einstein famously noted, "*The measure of intelligence is the ability to change.*" For most investors, that requires a complete mindset shift. As Christopher Mayer and other long-term chroniclers point out, the power of holding onto these exceptional gems is the most potent lesson in finance.

Sitting through 30% to 50% drawdowns is excruciating, and holding on while commentators push a shiny new speculative toy is even harder. But as Martin Sosnoff's Law reminds us, the return you earn on an investment varies inversely with the thickness of your research file.

In real estate, the old adage is location, location, location. For long-term investors, it is price, price, price. Price is your ultimate offense and defense.

Why Price and Moats Matter

In the world of investing, price is everything because it dictates your margin of safety and your eventual return. But price alone is only half the equation; it must be paired with quality.

We look for wonderful businesses possessing durable economic moats—defensible market positions, superior pricing power, and high returns on capital that keep competitors at bay.

When you combine a wide-moat business capable of solid, predictable growth with an attractive purchase price during market dislocations, you create the bedrock of extraordinary long-term wealth compounding. You are buying a cash-generating engine at a discount, letting time and exceptional management do the heavy lifting while others panic over transient headlines.

What Do We Do Now?

Since earnings season ended in June, the market has turned its focus heavily on the macro. However, third-quarter earnings season is fast approaching, which will finally bring the micro—the underlying well-being and execution of individual companies—back into sharp focus, revealing how good or bad things in the real economy actually are.

So, what do we do in an environment like this? We wait patiently for the dust to settle, let the market's temporary tantrums exhaust themselves, and allow the relentless power of compounding to continue working in your favor. **Excessive pessimism in the markets has set the stage for the next rally.**

Looking Ahead

As we look toward the final stretch of the year, our commitment remains anchored in delivering for you, our clients. We write these letters to share how we think about the macroeconomic landscape while making rational, disciplined decisions for your hard-earned capital.

One value that never goes out of style is gratitude. We have enormous appreciation for you and the enduring trust you place in Weybosset Research & Management.

—Justin E. Deutsch

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