



AMWHAM Portfolios

In the third quarter, the Global Equity portfolio (GES) returned 7.4%, and the Energy Transition portfolio (ET) returned 7.2%. In the first three quarters, GES returned 18.6% and ET returned 26.7%. Please see our fact sheets for more details (pages 8-11).

Market Overview

The strong upward trajectory of US equity markets continued through the third quarter. AI excitement and a relatively calm time on the tariff front, coupled with decent economic growth, an interest rate cut, and the possibility of lower interest rates, were supporting factors. The US administration may assume that quiescent financial markets are a sign that its policy mix is working and accepted, but by the end of the quarter there were signs that professional investors (perhaps not retail investors) are becoming stressed. It is an unusual and contradictory combination for equity markets to be rising (risk on) while long term interest rates and the gold price are rising (risk off) at the same time.

A small cohort of big tech stocks still drove market returns. AI excitement was fueled by the announcement of a succession of multi-billion dollar deals to build data centers, supply chips, and source energy as the biggest companies seek to strengthen their positions. Since the big tech companies are financially successful and strong, the headline capital spending frenzy glossed over questions about physical world shortages (electricity, water), capital requirements for the utilities that will have to develop the grid, the time to do all of this, the timeline for new nuclear energy, and the ultimate utility of and financial model for AI. Big figures in business and finance (Jamie Dimon, Ray Dalio, Ken Griffin et al) have begun to talk openly about a bubble, which would most probably leave useful new, even transforming technology behind it, but which will also destroy a lot of capital on the way. Railways in the 19th century, or the internet at the end of the 20th century are the analogies. The circular, vendor financing nature of many of the latest big tech deals are very redolent of the TMT bubble more than 25 years ago. Questioning the financial consequences of the AI investment wave is probably reasonable. This is not to question the technology itself. In our opinion it is too soon to tell. But if the AI investment boom is a bubble, it is well telegraphed.

Leaving aside AI, other investment issues are increasingly apparent. Inflation is very sticky, and even rising slowly. Services inflation is important here. Government finances are deteriorating, with fiscal crises emerging in the UK and France. The US fiscal position is caught between the spending and tax implications of the BBB, the promise of significant tariff revenues, and the possibility that successful import substitution would undermine the



case for tariffs as a solution. All of these are possible explanations for higher long interest rates and a higher gold price. It's also worth noting that excluding AI investment spending, US economic growth is not strong. Challenges to central bank independence, pressure to lower interest rates despite sticky inflation, the lack of reliable government provided economic data, domestic political stresses resulting from fiscal problems (the shut down in the US, constitutional impasse in France, the rapidly deteriorating fiscal position in the UK) and diminishing international trust didn't help. Credit spreads and financial market volatility measures stayed low, but signs of stress, such as the First Brands default, are beginning to emerge. These are only some of the anomalies of the moment.

Investors are in the uncomfortable position of either having to have a foot in both camps, as the distance between them widens, or having to choose between the two.

Q3 Investment Returns

S&P 500 returns were again largely attributable to the Information Technology sector. 6 companies: Apple, Nvdia, Alphabet, Tesla, Broadcom account for nearly 65% of the index's aggregate return¹.

Global Equity (GES)

- Industrials was the largest sector contributor to performance (Mitsubishi, Prysmian, Chart were top drivers)
- Gold was the top individual contributor adding over 1% of attribution
- Software and related companies were the primary detractors (Verisk, SAP, Accenture)
- Stock selection effect of nearly 4% offset the relative underweight to information technology

Energy Transition (ET)

- Performance was driven by industrial holdings (Prysmian, Chart, Bilfinger, Quanta)
- No holding detracted more than 10bps of performance

Investment Outlook

It seems to us that this is not a time when financial metrics are the most significant elements to consider in an investment outlook. That is not to say that US monetary policy or company earnings aren't important. They are, but there is little that we can add to the debate about inflation and monetary policy, or to the observation that profits are at all time high

¹ Apple 1.4%, Nvdia 1.3%, Alphabet 1.35% (both share classes) , Telsa 0.7%, and Broadcom 0.5% Source: Bloomberg



proportions of GDP. Rather it is structural and secular change and the political forces that drive them as well as monetary policy and the distribution of economic rents that matter most now. Here are some of the points that interest us.

Big Tech and Competition.

It's broadly true that the big tech companies grew up in separate silos (operating system, social media, device ecosystem, search, online retail), each defined by the concept of network effect and essentially distinct from the point of view of competition. The more purely digital businesses are cash flow machines with relatively low capex needs. The more capital intensive ones such as online retailing and device ecosystems still benefit from the winner takes all advantages they have in their respective silos. The results of the last 30 years are trillion dollar market capitalizations and extremely strong financial positions. It's not surprising that, given their monopoly like domination of their respective silos, they have grown to dominate the equity market as well.

Our observation is that with the advent of AI they are all now in direct, capital intensive competition with each other. AI challenges the separation of their silos. For example, the best AI will have a strong advantage in search, and therefore digital advertising and retail. The best AI can challenge Apple's ecosystem by encouraging users to go outside it. Obviously the big tech companies have encroached little by little on each other's territory without AI, but AI has greatly accelerated the process and increased the costs. It's reasonable to think of big tech now as direct, highly capital intensive (data centers, LLMs, power) competitors with new pure AI competitors such as OpenAI.

Whether the arms race is driven by the need to defend market position, or by the belief that AI is another winner takes all technology, the scale of capital investment and the competition implications lead one to think differently about the group. Questions about how the scale of datacenter build will be financed are beginning to be asked, and concerns are growing about the use of vendor financing (Nvidia is a prime example) to keep the capex cycle growing. Questions are being raised about the availability of power and water and how these affect the general population. Questions are increasingly being asked about the effectiveness of AI as a productivity tool (it's early days for an answer), and, based on current metrics, whether the business models can be profitable. Amazon was able to keep on investing without profits for many years by delivering growth, but it was a unique proposition. Will multiple AI competitors be able to pull off the same trick? It's a small step from this to wonder whether big tech companies are still the impregnable financial



fortresses of the last twenty years. Should they now be judged by more conventional criteria?

US/China

In our note² after Liberation Day in April we wrote that China will not lose face, will be prepared to absorb a lot of pain internally, and will play a long game on the trade front. China believes it has a strong hand. The elements are rare earths, agricultural product demand, and most importantly domestic political strength that allows it to wait longer than the US political cycle even in the face of economic and financial pressures. In addition recent trade data from China shows that since April overall exports have grown, even though exports to the US have shrunk. In other words, China is confident that it has been able to make alternative arrangements at the cost of price cutting that might last for the life of this US administration.

The rising temperature of trade discussions between the US and China show this. China is confident enough to restrict formally the export of rare earths, which the US cannot easily replace. China has stopped buying soya beans from US farmers and has sourced beans from Argentina instead. Both these put pressure on the US, which is tightening further restrictions on chip exports and talking of imposing higher tariffs again.

We cannot know how this will resolve, but we think that China's position is analyzable. China will be resolute in holding its position. Its real estate debt problems while large are for the time being contained and internalized, so it appears that China is not immediately politically concerned by financial market pressure or deflationary pressures for at least as long as the US political cycle. These would be problems for another day. The question is how the US will react now that China has revealed its hand. Will the Trump administration concede to settle financial markets? Or what will be the financial market disruption if neither side backs down? There is no favorable investment asymmetry here.

Geopolitics

The recently announced US \$20 billion rescue package for Argentina confirms the shape of the new multi polar world. The Trump administration has made claims on Greenland, Canada, and the Panama Canal. Military force is being used in the Caribbean. The Arctic is of strategic importance. Now direct financial support is being given to Argentina. The common theme is access to raw materials, especially rare earths and hydrocarbons, and control of the trade routes within the sphere of influence. There will be interesting investment

² Please let us know if you would like a copy



consequences both where US influence and interests are waning in the rest of the world, and where they are growing in the Americas.

It will also be interesting to watch developments as the US flexes its muscles internationally, both in the Middle East and Ukraine. The constantly changing policy backdrop of shifting priorities and short-term deals is fragile and challenging for investors.

Financial System Contagion

We believe that the whole financial system will be affected by problems in private credit and other private assets, should they emerge. Banks lend to the intermediaries in private credit. Insurance companies take on illiquidity in return for small increases in yield. Private credit has increased the leverage supported by the economy as a whole. Obscurity in private assets, especially private credit, creates a strong negative asymmetry. Private credit is only as strong as the weakest hands holding the asset. Continuation funds and NAV lending are not healthy developments. The First Brands failure is an early example of unknown credit concentrations and poor unappreciated credit standards.

Fiscal challenges around the world

Deteriorating public finances around the world are well known. Data is abundant and available. The UK and France are approaching moments where there has to be a political reckoning, and where financial markets might revolt. It would be foolish to imagine that this would not affect US financial assets. A global perspective is very important.

Dancing till the music stops

Why do institutional investors always dance till the music stops? One answer is that for publicly owned businesses, their opportunity is in gathering more assets than their competitors, and their risk is in performing worse than their competitors when markets rise or fall. There is no absolute return criterion. Cynically, the logic is that institutions are happy to perform with the crowd, for which they won't be blamed. It's other people's money, but their share price.

Productivity, Time, and Complexity

Why is productivity data for the last 25 years so disappointing in spite of significant technological changes? This is a topic for its own paper, but here are a couple of clues that interest us. First, time is like real estate. It's only possible to build so much on a piece of land. Technology has given us each the tools to do more and more. Our limitation is time. It's possible that AI reduces this constraint eventually, though the evidence so far isn't



encouraging as corporations report dedicating humans to check AI outputs. Second technology permits and therefore increases complexity. Complexity is a friction. The GFC, for example, was a crisis caused in part by complexity masking the fallacy of composition inherent in massive securitizations. This is enough on this topic for this letter, but the point is that it would be wise to be cautious in imagining that technology this time will produce large productivity benefits that will solve our economic and financial problems. Two thirds of economic growth through history has been attributable to population growth. The other third has been attributable to technology improvements i.e. productivity. The burden on productivity is heavy today, and the evidence since the advent of digital technology and the internet is not compelling.

Portfolio Positioning

We hope this discussion helps you to understand portfolio positioning. The main allocations in our Global portfolios are set out below. Energy Transition portfolios are a subset.

1. We're still wary of starting aggregate valuations for equities in the US. We think that global frictions in the form of retooling supply chains, tariffs and growing national and regional competition are headwinds to company returns. We also believe that, as a rule of thumb, greater government involvement in enterprise, as is now evident, is an increased risk best accommodated by using higher discount rates for valuation purposes. By this yardstick, starting valuations look even higher.
2. We don't assume liquidity in financial markets, nor do we believe that we can time when our investment ideas work. We prefer to position portfolios when we can, rather than when circumstances dictate. We avoid illiquid investments.
Circumstances when liquidity might be worth a significant premium now seem likely.
3. We are wary of the weight and concentration of AI investments in equity indices. We prefer in our portfolios to make careful individual stock choices, and to have much lower aggregate exposure in our portfolios than in equity indices. This is a somewhat contrarian view, which allows us to diversify portfolios better.
4. We believe we are in a world of digital abundance and physical scarcity. This supports the case for proportionately much greater exposure to energy in portfolios than is present in equity markets. The tech companies' continuing scramble for available, reliable power (and water) supports the notion of a bottleneck. Our logic is that these investments should be at least the same weight in portfolios as exposure to technology. Under the general heading of energy, we're careful to avoid categories where capital has been overallocated, and instead to focus on areas where capital is scarce. Our working assumption is that long-term energy supply will be a



mix of hydrocarbons, nuclear and alternatives. For alternatives, the prerequisite is distribution and storage infrastructure that is so far lacking. Although the energy complex is caught up in fears for economic growth, we think the medium term case is strong, as an essential prerequisite for a successful economy.

5. We're wary of the degree of leverage supported by the economy. To us, at least, private credit is opaque, and probably provides better returns for its intermediaries than for end investors. It's definitely illiquid. Recent news suggests problems are surfacing. We avoid credit risk and leveraged balance sheets in portfolios. Recent adverse developments in rates and credit markets support this view.
6. We have some exposure to undervalued pharmaceutical company R&D. This is largely uncorrelated to global political and financial headwinds, and in the meantime these companies pay attractive dividends. Healthcare spending accounts for about 17% of GDP in the US, almost double European levels. We avoid the complex chain of intermediaries in the US system that are likely to come under political pressure in the search for lower healthcare costs, and in the tariff agenda.
7. We maintain holdings in gold bullion while the possibility of more extreme financial or geopolitical discontinuity exists, and while inflation appears stubborn. We view this position as an insurance policy that would be valuable in times of distress.
8. For similar reasons we hold a significant position in cash (see fact sheets for allocations). Interest rates still make this decision easier. The value of cash will be realized if and when we can act in times of significant market distress.

Please get in touch if you have any questions or if you would like to join the investment conversation. All ideas are welcome!

Sincerely,

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