BECK MACK + OLIVER

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Market Update

Imagine that we can turn back the clock to early April. The US administration has just announced a sweeping new tariff regime on dozens of countries, which threatens to unleash a global trade war. Within a week the S&P 500 declines by more than 11% and makes a new 52-week low, which puts the index down 15% year-to-date. Imagine further that you could have known then that towards the end of June Israel and then the US itself would attack Iranian nuclear sites in a massive airstrike. Would it not have seemed wildly optimistic in that moment to think that the S&P 500 would go on to make new all-time highs before the end of the second quarter? And yet despite those dramatic quarterly bookends, that is exactly where we are, with the S&P 500 having finished the month of June above the 6,200 level, up from less than 5,000 in mid-April and up 6% year-to-date.

The little thought experiment above illustrates not that markets are irrational but that short-term market predictions are difficult. In recent months the equity market has been nothing if not resilient. It is easy enough to imagine that it could have been otherwise, but the market's resilience in fact corresponds to a combination of the following notions: (i) that hostile trade war rhetoric will translate into substantially more moderate actual changes in trade agreements and polices; (ii) that the economy and corporate earnings will continue to grow, with low unemployment, consumers still spending, inflation at an acceptable rate, and ongoing enthusiasm about artificial intelligence; and (iii) that markets will not undergo any kind of sustained shock, whether borne of a fiscal crisis, geopolitics, or otherwise. Each of these notions is plausible enough in its own right, but the undermining of any would be apt to upset the prevailing sanguine market sentiment.

Artificial Intelligence

Artificial intelligence (AI) is becoming increasingly salient in the equity market, the economy, and in our daily lives. We have addressed AI in recent newsletters, primarily in the context of large technology companies making enormous capital investments in semiconductor chips, data centers, and other infrastructure.[1] What type of returns these investments will generate is a question that continues to motivate our investment research.

Nothing we have to say about AI relies on any technical definition or specialized knowledge. Compared to what we think of as conventional computers, which carry out preprogrammed instructions, what is novel about AI is its ability to engage in tasks that resemble human intelligence, such as learning, adapting, reasoning, and problem-solving. AI in fact goes back several decades, but its more recent surge was facilitated by semiconductor innovation, which made possible the much greater quantities of data computation required to run AI models.

NVIDIA, whose market cap is approaching $4 trillion, remains the most prominent AI-related company. It designs a kind of semiconductor chip, known as graphics processing units, that is ideal for AI computation. Microsoft and Alphabet (Google), which are core Beck Mack + Oliver investments, are also key players within the AI ecosystem. In their respective public cloud businesses, Microsoft and Google build and operate data centers

[1] For prior newsletters, please see our website: https://beckmack.com/.

that perform AI workloads. Microsoft is also incorporating AI across its enterprise software business, while Google is incorporating it into its core search business.

To an increasing extent, however, virtually all of our portfolio companies are involved in AI. Roper Technologies today generates a large majority of its revenue from its various software businesses, for which AI represents an opportunity to deliver more value to customers or to reduce operating costs. JPMorgan will spend approximately $18 billion this year on technology, a meaningful portion of which will be related to AI. RadNet utilizes AI in its diagnostic screening for various cancers and degenerative brain disease.

For most businesses today, including our portfolio companies, AI is evolutionary rather than revolutionary and incremental rather than transformational. It makes back-office processes and systems operate more efficiently but does not fundamentally change the underlying business. It provides enhanced tools to salespeople but does not replace the sales force. At Beck Mack + Oliver, we utilize AI applications such as Microsoft CoPilot, ChatGPT, Google Gemini, and Fathom, all of which contribute to the more efficient execution of our workflows without changing the fundamental nature of those workflows.

There are some areas, however, where the implementation of AI will usher in changes that are more rapid or more pronounced, such as call centers and language translation. Today when we call customer service, our common experience is to impatiently try to bypass the automated voice in order to get a person on the line ("Representative!"). We predict that in the not too distant future AI-based customer service will be superior not only to the automated customer service with which we are now acquainted but also to live customer service, and that we will actually come to *prefer* interacting with AI. Similarly, for most practical purposes, AI will become not just quicker but better than human translators for both text and speech.

On a macroeconomic level, AI presents various intriguing possibilities. Some have sounded the alarm about the potential for widespread unemployment, as AI replaces humans at more and more tasks. A few historical observations suggest the ways in which this fear may be misplaced.

- For more than 10,000 years, most human beings were primarily engaged in agriculture, which was still true of the US well into the 1800s. Today, only about 1% of the US labor force works on farms, and yet agricultural output is higher than it has ever been.
- In 2009, former Federal Reserve Chairman Paul Volcker said, "The most important financial innovation that I have seen in the past 20 years is the automatic teller machine."[2] Following the rollout of ATMs throughout the country in the 1990s, the total number of people employed as bank tellers did not decline but continued to increase. While the number of bank tellers per bank branch declined, as some of them were replaced by ATMs, the total cost to operate a bank branch likewise declined, leading to a greater number of bank branches and to a greater number of total bank tellers.[3]
- In 1930, the economist John Maynard Keynes predicted that his grandchildren's generation, on account of enhanced productivity through technological innovation, would only work about 15 hours per week, which proved to be spectacularly wrong. As the US has grown ever wealthier, we have largely chosen to continue working and to enjoy the additional wealth created by our work rather than to enjoy more leisure.

[2] While the principal point of his comment was to cast aspersions on dubious financial innovations, such as subprime collateralized debt obligations, in the years leading up to the 2008 financial crisis, he was spot-on in highlighting the importance of the ATM, prior to which one had to visit a bank branch to withdraw cash.

[3] There are many comparable examples. The introduction of scanning technology connected to cash registers and the introduction of electronic discovery software led to increases rather than decreases in the total number of people employed as cashiers and paralegals, respectively. Our research in this context has been inspired by the work of economist James Bessen, investor Ken Griffin, historian Daniel Boorstin, and others.

These historical observations illustrate two related principles. The first is that enhanced productivity allows us to do more with less, which frees up resources that can then be allocated towards other uses. This does not mean that there are no temporary losers from productivity improvements, but it means that the overall economic pie becomes larger, which creates new demand for different kinds of labor—this is certainly the lesson from the extraordinary agricultural innovation experienced over the last century or two. The other principle is that while there can be a *substitution* effect between labor and technology, whereby technology alone can do the job previously done by a person, there is often an *augmentation* effect whereby the greatest value is delivered by the combination of a person and technology, which in turn leads to increased demand for both.

Perhaps the most enticing promise of AI is the potential for enhanced productivity to lead to faster economic growth, which could improve our precarious fiscal situation.[4] For almost all of the 21st century, federal tax revenues have been an insufficient source of funding for federal spending, necessitating the issuance of Treasury debt, which has grown dramatically, not just in dollar terms but as a percentage of gross domestic product (GDP). The four ways to improve a country's debt/GDP ratio are to reduce spending, raise taxes, create inflation, or improve economic growth. The first three are politically toxic and would threaten a recession; the fourth is nice work if you can get it. The 1990s offers a hopeful precedent: the widespread adoption of information technology—computers, software, the internet—created a positive productivity shock, leading to faster GDP growth, greater tax revenue, and, towards the end of that decade, budget surpluses.

Portfolio Update

In our most recent newsletter, from April 2025, we noted that Enstar Group, an insurance company, last year announced that it would be acquired by a financial consortium for $338 per share in an all-cash transaction, and that we had been selling Enstar stock as we approached the expected mid-2025 closing. Beck Mack + Oliver has owned Enstar for many years, during which the company has grown its book value per share at attractive rates, and the sale of stock will have realized capital gains in many client accounts. Any such capital gains would have been realized in any case, as the all-cash acquisition is expected to close soon. During the second half of the year, we will look for opportunities to realize available capital losses in order to mitigate clients' tax liabilities.

Overall we remain pleased with the underlying performance of our portfolio companies, including the most recent addition to our buy list, Somnigroup International, which we discussed in detail in our most recent newsletter.

Partners of Beck Mack + Oliver

[4] We wrote at length about this topic in our October 2024 newsletter.