

Newsletter: October 2025

Market Update

Evidence of the market's exuberance and complacency continues to accumulate. The S&P 500 recently made a new all-time high and its price/earnings multiple remains well above its long-term average. Corporate credit spreads are the tightest they have been this century. Initial public offerings are back. In artificial intelligence (AI), companies that do not make money are promising to spend tens or even hundreds of billions of dollars that they do not have, and executives' boosterish rhetoric is reminiscent of prior technology bubbles. The largest ever leveraged buyout was just announced. There are public companies that exist only to issue equity and use the proceeds to buy cryptocurrency. One again hears about "meme" stocks. Risk-taking and animal spirits are alive and well.

Buoyant market sentiment prevails despite mixed signals in the underlying economy, which is growing but adding far fewer jobs this year than it did last year. There are more job openings than unemployed people for the first time since 2021. The Federal Reserve has lowered short-term interest rates, but elevated mortgage rates continue to weigh on the housing market, which makes it more difficult for people to move to where the jobs are. Consumer spending is growing in the aggregate, but lower-income households are under increasing strain. A subprime auto lender and an auto parts supplier suddenly filed for bankruptcy within weeks of each other. The economy continues to grapple with inflation and tariffs.

The AI investment boom has been extraordinary. Hundreds of billions of dollars are being invested in the construction of data centers, which require massive amounts of electricity, semiconductor chips, computer servers, and other technical infrastructure. These enormous investment flows are contributing to economic growth and creating jobs. To what extent all of this activity turns out to be economically productive in the long run, however, remains an open question, the answer to which will depend on the willingness of consumers and businesses to pay for AI products and services. In our most recent newsletter, we argued that for many businesses the adoption of AI has thus far been evolutionary rather than revolutionary and incremental rather than transformative.¹ The same is probably true for individual people in their daily lives.

Like any other investment utilizing real economic resources (capital, labor, technology, and time), the optimal amount of AI investment will ultimately be determined by its profitability as compared to the potential alternative uses of its underlying resources. Beyond its sheer magnitude, **there are some aspects of the AI investment boom that warrant scrutiny.** More and more of it is being funded not by internally generated cash flow or even equity financing but by debt financing, which banks, asset managers, business development companies, and insurance companies have been eager to provide. Some of these loans have been packaged into investment products sold to retail investors. And there are instances of circular financial arrangements among those involved in the AI buildout, such as companies owning stock in their customers. **Debt financing, the distribution of risk to retail investors, and interlocking financial relationships raise the systemic stakes for any potential misallocation of capital.**

¹ For prior newsletters, please see our website: <https://beckmack.com/>.

There is also a “land grab” aspect to the AI investment boom, where companies and their financial backers, in response to what they perceive to be insatiable demand, are keen to obtain as much capacity as possible as quickly as possible, with little apparent regard for expected returns on investment. In a positive feedback loop, capacity growth tends to be rewarded with higher share prices, which in turn make it easier to finance additional capacity growth. While investment booms and busts may be endemic to capitalism and free enterprise, prior instances of overinvestment, such as railroads in the late 1800s or fiber optic cables in the late 1990s, left overbuilt physical infrastructure that was eventually put to productive use. Much of the infrastructure supporting the AI buildout, especially fast-depreciating semiconductor chips, has uncertain residual value beyond the next few years.

The enthusiasm behind the AI investment boom mutually reinforces the exuberant sentiment in the stock market, whose recent appreciation has been heavily concentrated in AI-related companies, many of which have risky capital structures or do not make money. Thus, any potential diminution in AI enthusiasm is apt to hurt equity market sentiment. When broad market sentiment runs hot, we tend to lean more conservative, buying less or selling more of a particular investment at the margin, but we do not make major portfolio management decisions based on attempts to identify stock market inflection points. Repeatable success in identifying market inflection points is tremendously difficult, errors tend to be very costly, and tax inefficiency becomes unavoidable. In our view, **it is much better to own, for long periods of time and while exercising valuation discipline, great businesses that are led by excellent management teams and that can double their earnings power every five to seven years.**

Portfolio Update

What kind of mattress do you sleep on, and how long have you had it? To the extent that you struggle to recall the answers to those questions, that is an opportunity for **Somnigroup International (SGI)**, a recently initiated investment that we introduced in our April 2025 newsletter. Somnigroup is the new Tempur Sealy, which acquired Mattress Firm earlier this year in a transaction that vertically integrates mattress manufacturing and retail distribution, which we expect to lead to greater market share, a stronger competitive position, significant financial synergies, and valuable customer access.

People often buy new mattresses when they move to a new house, and below-average housing turnover in the last few years has resulted in fewer mattresses sold across the industry. We believe that the industry’s suboptimal advertising has also been a factor. Some competitors are financially challenged and have pulled back on advertising. Mattress Firm itself, prior to its acquisition by Tempur, would target its advertising to get people into its retail stores rather than to buy a particular mattress brand; consumers were therefore less aware of product innovation (e.g., cooling) and brand differentiation. The combined company will benefit whether people buy its mattresses in Mattress Firm stores or in other locations, and it can now directly email and otherwise target customers who last bought a mattress many years ago. We expect this more effective advertising to create greater category awareness, drive store traffic, and contribute to revenue growth. Thus far, we have been pleased with management’s business execution and integration of the two companies, led by CEO and Chairman Scott Thompson, as well as with the share price performance.

Waters Corp. (WAT) is a life science business that we have followed and owned for decades. WAT designs and manufactures liquid chromatography (LC) and mass spectrometry (MS) systems, which identify and analyze substances at the molecular level. Applications include pharmaceutical quality control, late-stage drug development, food and environmental safety, chemical analysis, and materials testing. WAT is a leader in LC/MS, generates significant recurring revenue and strong organic growth, and has industry-leading margins—as a result, the stock usually trades at a premium valuation multiple.

WAT recently announced the acquisition of two business units from Becton Dickinson (BDX), a much larger healthcare company. One unit is flow cytometry whose customers also buy LC/MS from WAT, and the other is a diagnostics business, which has similar characteristics as WAT's core business and will provide access to new selling channels. Through the realization of revenue and expense synergies, the transaction is expected to enhance the rate of WAT's earnings growth over the next several years.

And yet WAT's share price declined on the deal announcement. WAT has an impressive track record as a focused LC/MS business that has eschewed large acquisitions, but it is now undertaking a large acquisition. The two business units it is acquiring are emerging from a temporary period of below-average growth and usually grow about as fast as WAT does. And as part of the deal consideration BDX shareholders will receive stock in the combined company.

We believe that the market is not appreciating how much better the WAT management team, led by CEO Dr. Udit Batra and CFO Amol Chaubal, will be able to run these businesses. BDX is a large organization with many different business units, and the acquired assets will benefit from the focused attention and rigor of the WAT management team, which has revitalized commercial execution and implemented more disciplined pricing since Batra joined the company in 2020. Prior to his time at WAT Batra successfully oversaw a large and complex M&A transaction, and WAT itself in 2023 acquired Wyatt Technologies, which has gone well. We expect WAT to overdeliver on its revenue and expense synergy targets, which will lead to even faster earnings growth, and hence we view the current valuation multiple, which is lower than is typical for WAT, as an opportunity.

As noted in recent newsletters, **Enstar Group (ESGR)**, an insurance company, was acquired in July by a financial consortium for \$338 per share in an all-cash transaction. We owned ESGR for many years, during which the company grew its book value per share at attractive rates. Due to the all-cash nature of the acquisition, the realization of capital gains in client accounts was unavoidable. As we approach year-end, we will continue to look for opportunities to realize available capital losses in order to mitigate clients' tax liabilities.

Where appropriate, we have added to our positions in **Fiserv (FI)** and have trimmed positions in **Alphabet (GOOG, GOOGL)**. The former has become newly compelling at a lower valuation and with a largely intact growth algorithm, while sentiment on the latter has rapidly improved. We continue to be enthusiastic about the long-term growth potential for the alternative asset managers, especially **Blackstone (BX)** and **Apollo Global Management (APO)**. We look forward to discussing these investments in greater detail in future newsletters.

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