Five Mile River Investment Management L.L.C. July 11, 2025
Client Quarterly Letter
2nd Quarter 2025

PERFORMANCE

	Dow Jones Industrial	S&P 500 (Capitalization Weighted)	S&P 500 (Equal Weighted)
2025 Q1	-1.28%	-4.27%	-0.61%
2025 Q2	5.94%	10.94%	5.46%
2025 FH	4.58%	6.20%	4.82%

VOLATILITY!

The Equal Weight S&P 500 index rose 4.82% in the first half of the year, while the S&P 500 (a concentrated growth index) rose 6.2%. However, the market registered a very volatile path before arriving at these six-month totals, beginning with a dramatic sell-off that began on February 20th with the announced tariffs of 20+%. This decline culminated in a final low on the 7th of April. At this bottom, the S&P 500 had declined 18% since the start of the year while the NASDAQ entered a bear market having dropped 23%.

Tariff concerns dissipated as President Trump extended tariff deadlines on April 8th, and with the combination of strong 1Q25 earnings releases that same week, the seeds of a market rebound were put in place. Quiescent inflation readings were released in April, May and June. The current inflation rate through May was 2.35%. These factors combined to fuel an exceptionally fast and substantial gain for the 2Q25 indices.

Technology stocks' performance was emblematic of the market's volatility. Through the first half of 2025 the S&P Technology Index rose 8%, but getting there was a real see/saw. In the1Q25 the tech index was the performance laggard, declining 12.65%. In 2Q25 technology was the champion, rising 23%. Why the reversal? In the first quarter tariff induced inflation on fears accelerated, causing the rich valuations (P/E's) in technology to compress. During the second quarter, inflation fears abated because President Trump reduced a number of tariff percentages and extended the deadline for tariffs' commencing. It is becoming clear that his negotiating style, using threats of high tariffs, will be satisfied if he can achieve equivalent tariff **reciprocity** with each country. In addition, the government issued three months' worth of favorable low inflation readings between April and June.

FMR Client Portfolio Volatility is Minimal

Five Mile River (FMR) has taken advantage of the market's volatility. Specifically, FMR reduced the heavy overweight in Microsoft (MFST) because the company just announced it third headcount reduction in less than two months. While MSFT attributes these layoffs to the growing influence of AI, FMR believes these layoffs were not simply modest cost reductions, but rather signs that future growth was slowing. Layoffs such as these are usually triggered by revenue (earnings?) concerns, something the stock price is not anticipating.

Simultaneously, FMR boosted client holdings in Northrup (NOC, NYSE). NOC has a long-term contract for building the U.S. fleet of B2 Bombers (used in IRAN) and is a critical supplier for the multi-layered missile defense system, otherwise known as the Golden Dome. Increasing client portfolios' over-weighting in defense is consistent with FMR's investing theme that growing defense budgets are a key secular trend moving through this year and beyond. The flareups in Ukraine and the Middle East will unfortunately continue to focus on the U.S. defense readiness.

Also added to FMR client portfolio holding is Crown Castle (CCI, NYSE), one of only three dominant U.S. cell tower companies. CCI's valuation is attractive at less than a market P/E and it pays a very attractive yield (5.6%). Tower companies benefit from the strong growth in wireless voice and data transmission, and as Artificial Intelligence (AI) gains adoption this will cause data transmission to accelerate.

The Deficit, The Bill, the Federal Reserve, Inflation and Cash Hordes

In past FMR client quarterly letters, attention has brought focus to the mounting size of the U.S. Federal Deficit, currently running at $37 Trillion and growing. The recently passed U.S. Domestic Policy Bill we are told is designed to spur economic growth with the aim to drive real GDP to 3%+. Treasury Secretary, Scott Bessent's math suggests this rate of economic expansion will generate sufficient tax revenues to start a downward path for the U.S. Federal Deficit. If this is to have any meaningful impact on the $37 Trillion deficit, it will have to continue going forward for numerous years. For the short term, the Federal Reserve has refrained from lowering interest rates because they fear tariffs could ignite future inflation readings. The new market highs for the indices are reflecting the overwhelming level of side-lined cash (close to $24 Trillion) is being drawn into the U.S. equity market.

Warren Buffett, long described as one of the smartest investors, has patiently been waiting for over a year with a gargantuan $350 Billion of CASH, approximately 20+% of Berkshire Hathaway's portfolio! It is this cash position that many investors have referenced as their reason for similarly holding large amounts of cash. As has been highlighted in numerous past FMR client letters, FMR does NOT try to time the market by raising cash and hoping to redeploy at market bottoms. Instead, FMR will hold cash positions between 2% and 8% depending on valuations and whether attractive investments present themselves.

The Semiconductor Companies and Applied Materials (AMAT)

Semiconductor companies are the producers of chips. This requires incredibly precise manufacturing equipment capable of printing as many as 100 separate circuit lines within the width of a human hair! To continue the improvements in performance and the shrinking of chip sizes, **it is the semiconductor capital equipment companies that provide the critical technology for making new circuit designs a reality.**

Applied Materials (AMAT) is the dominant semiconductor capital equipment provider with a rising market share, currently at 50%. When the U.S. Chips' Act becomes allocated over the next five years, there will be close to $700 Billion spent in the U.S. alone, with approximately $500 Billion going to semiconductor manufacturing equipment. Therefore, it is logical that AMAT's 50%+ market share suggests a potential revenue boost of $250 Billion spread over five years! This compares with AMAT's current annual revenues of $50 billion.

The semiconductor companies build football sized buildings called FABS, or semiconductor fabrication plants, which house the semiconductor capital equipment that perform the multiple steps required for building a chip. Also, outside of the U.S. onshoring FABs now appears to be a growing country priority. Germany, the UK, Japan, and the Scandinavian countries have each announced separate plans to begin construction of FABs.

FMR anticipates that AMAT will not only maintain its lead in providing the capital equipment for the FABS but will also grow its share as the dominant industry provider. One little known fact is that **AMAT participates with each major semiconductor company on their three and five year capital planning process!** No other capital equipment company has this degree of integration with their semiconductor customers. AMAT's unusually strong relationship with the semiconductor companies gives AMAT a road map for the direction and pace of future new equipment needs. This becomes an insurmountable competitive advantage for AMAT. Equally significant, AMAT's capital spending budget is materially larger than any competitor.

Clients have read in previous quarterly letters about recurring revenues as an important factor in making company stock investments in FMR client portfolios. A stream of recurring revenues provides visibility and predictability of revenue growth and earnings. AMAT has spent the last

10+ years building out a recurring revenue contract services business that supplies maintenance and product support to their semiconductor customers through long term contracts. This services business is a stable underpinning for AMAT because it grows with the number of new FABS; the new equipment upgrades; and because of increased equipment complexity. This service business now accounts for approximately 30% of AMAT ‘s revenues and a like amount of earnings.

From a research perspective, it is accurate to say that AMATs earnings prospects are understated because of the revenue potential from new FAB construction, but also it’s valuation (P/E) should rise as well. AMAT trades at a P/E of 18X earnings compared to the S&P 500 trading at a P/E of 23X, and the Magnificent Seven’s average P/E of over 30X. FMR strongly believes that AMAT has the potential to be valued as one of the premier technology investments, fueling FMR’s enthusiasm for including it as a long-term client holding.

We welcome the opportunity to review with you your portfolio and the investment style employed for your holdings at any time, and please let us know if you have any questions or observations on the market and/or this client letter. We wish you a most enjoyable and healthy summer.

Sincerely,

Lee Todd Martha

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The S&P 500 Index is a market capitalized weighted index of 500 companies. It is a growth-biased index because the larger the capitalization of a company, the larger the weighting it contributes to the S&P 500 Index performance. The index referenced <u>includes the dividends</u> issued by these 500 companies. This index is used for a comparison for FMR accounts.

The S&P 500 Equal Weight Index is included in the performance chart to demonstrate how the S&P 500 Performance looks without the overweighting of a handful of technology companies.

The performance data included in this letter are not audited and have not been otherwise reviewed or verified by an outside party. While Five Mile River Investment Management, LLC endeavors to furnish accurate information, investors should not rely upon the accuracy or completeness of this information.

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