Five Mile River Investment Management LLC
Client Quarterly Letter
3rd Quarter 2025

October 4, 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 Q3	5.22%	8.12%	4.84%
2025 YTD	9.06%	14.83%	9.90%

The third quarter of 2025 ended with strength across fixed income, equity, and precious metals markets. The S&P 500 during September had the strongest monthly gain for any September in over 15 years. The markets overcame a declining dollar, trade confusion, intractable inflation, and a worrisome labor market. Infused with the notion of lower interest rates, considerable breadth was evident in the stock market – lifting stock market prices of small, medium, and large capitalized companies. Can this continue?

The most overwhelming positive for the stock market, now and well into 2026, is that interest rates as set by the Federal Reserve could decline by an additional 150 basis points! This would imply a federal funds level of 2.75%, a far cry from the 4.50% that the U.S. has lived with for most of 2025. The prospect for this level of interest rate decline is something the stock market has not fully discounted, nevertheless, it is a real possibility. This is based on that which is known, and not because of some impending economic weakness. What we now know is that inflation is running at a relatively benign level of 2.50% to 2.75%, but employment is stubbornly weak. This is what underpins the notion that the federal funds rate will fall another 50+ basis points during the balance of Jeremy Powell's remaining seven months in office as Federal Reserve Chairman. We also know that President Trump's stated replacement for Powell on May 15th 2026, is Stephen Miran, former Chairman of the Council of Economic Advisors. Reading through statements by Stephen Miran, he has staunchly supported the narrative that tariffs are NOT inflationary, and that the federal funds rate should be at least 150 basis points lower, in a range of 2.50% to 2.75%. If Miran is correct, the implications are quite bullish because most stock market followers believe that they should "stay invested and not fight the Fed."

However, the possibility for substantial economic weakness has not been taken off the table. In fact, there are over 500,000 laid off government workers who will start hitting the unemployment lines beginning in September, with that number potentially gathering steam through the balance of the year. The monthly non-farm payroll data released by the Labor Department may start revealing a rather dire employment picture. While Elon Musk's efforts to trim government spending were news in April and May, the effect of these layoffs will now start to show up in the unemployment data for September and accelerate through the fourth quarter. Would a single month's <u>decline</u> in non-farm payroll of 100,000 workers cause concerns for further economic deterioration?

Continued employment weakness may tie the hands of the Federal Reserve, ensuring an even lower interest rate policy than what FMR has suggested. How this will be interpreted by the stock market will be a function of the trend in inflation data. If the tariff price increases start to filter into an expanding inflationary trend, this would produce a negative stock market reaction by combining a softening economy and a rising level of inflation......in other words causing stagflation! Markets may soon get a taste of this issue when the September payroll data is released. This data is posted on the first Friday of the new month, or normally the September employment data would be released on Friday, October 3rd. Because of the current government shut-down, this data will not be released "until further notice."

As many of you realize, Five Mile River is very mindful of the market outlook, nevertheless, FMR portfolio managers focus on investing in companies, and are constantly watching for changes in how FMR client portfolio companies are positioned.

In 3Q25 FMR added three new health care companies to client portfolios: Johnson & Johnson, Medtronic, and Pfizer. These three names were all trading close to multi-year lows, and each has an overlooked growth runway in new products due to roll out over the next three to four years. Significant new product offerings are exactly the prescription for long-term, out-performance of these stocks. To fund these purchases in client portfolios, FMR has booked some tax losses for 2025. In addition, the long-term holding in Paychex was sold, driven by concerns that weaker than expected employment could significantly slow Paychex's growth. Five Mile River's investment strategy has focused on a number of investment themes that have been highlighted in client quarterly letters. In addition to the recent overweight in **health care** and **finance**, clients remain overweight in **defense** industry investments, as the world is not becoming a safer place. FMR's **technology** investments are in the "food chain" that supports the buildout for artificial intelligence (AI) applications. Below in this letter is an update of FMR's outlook for the ever-increasing electrical demands associated with the roll-out of AI.

When do booms become bubbles? The difference now is that the four major hyperscale companies are all established, cash-rich businesses and are spending money furiously on development of AI. In 2026 alone, these four companies plan $600 Billion in capital expenditures for AI. The vexing question remains: how will these companies generate a rate of return, and when? A growing portion of this **spending will be devoted to securing the required energy to power the massive data centers each company plans to build to support AI**. A single data center is about the size of ten Home Depot stores and will consume an equivalent amount of energy as a city with 1.3 million people! AI spending is now forecast to reach a level that will represent the largest capital spending boom in world history! The fourth industrial revolution is here!

THE U.S. ELECTRICAL GRID & THE INDUSTRIAL UTILITY SERVICES SECTOR

QUANTA SERVICES INC. (PWR) to handle THE PERFECT STORM

Five Mile River's 2Q25 client letter highlighted the major forces behind the growth over the next five years in the U.S. for baseline demand of electricity. It is estimated that electric demand will grow at a rate of **+3% *annually*** versus demand which has been flat over the past 20 years. This incremental demand is rapidly outpacing electricity capacity. WHY? The majority of our electrical grid was constructed in the 1960's and 70's. Today, 70% of our transmission lines are near the end of a 50 to 80 year lifespan. The U.S. transmission and distribution infrastructures are less than five years away from the end of their safe and useful life (over 31% of transformers, and 46% of high and low power transmission lines will have to be replaced within five years). **The American Society of Civil Engineers has downgraded U.S. electric infrastructure to a D+ vs a C- in 2021**. The 2Q25 FMR letter stated that power demand is surging beyond current capacity in multiple states. It is the tech sector causing this demand because of the very large next generation gigawatt data centers (Microsoft, Amazon, Google, Meta, Oracle). Data centers consume 10 to 50 times the energy per floor space of an average commercial office building. New large industrial projects such as Taiwan Semiconductor (building in Arizona a $165 billion investment in six semiconductor fab plants) are reshoring to the U.S. and outpacing current available electric capacity.

Why are many states and U.S. "behind the curve" and experiencing serious electrical shortages? The answer is simple and yet complex. The U.S. does not have a national grid, which means the U.S. grid is highly fragmented into three different regions: Western, Eastern, and Texas. Within those three super grids, electricity is managed by huge regional operators. The regional grids are almost completely isolated from each other. For example, only seven DC lines link the Eastern and Western interconnections and electric capacity is minimal. The result is that there is little power sharing between regional grids, and they cannot provide electricity to another grid in the event of power shortages. Texas has little to no power connections to either of the other two regions, thus risk of blackouts or rolling shortages is high as data center growth continues, and old power plants keep closing. The U.S. grid structure is one of the most complex yet fragile machines in the world.

What is the problem in planning and supplying enough electricity? Isolation of grids (as discussed above), and the decision-making politics is another. So, who makes the decisions on upgrading and building more electric capacity? There are three separate boards overseeing the three regions of operations. The boards are comprised of utility operators, independent line and power operators, and have done little to anticipate or address the necessary capacity needed to satisfy the surge in electric demand. The biggest power grid in the U.S. is the Eastern region, where electricity prices are surging as AI Data Centers' demand outpaces the connection of new supplies.

Quanta Services Inc. (PWR). . . . to the rescue to replace lines and add power capacity. PWR is the largest North American public company that builds and provides infrastructure services for U.S. electric and gas utilities, pipelines, renewables (wind and solar), communications in Canada, the U.S. and Australia. It is the number one services and solutions provider for design, engineering, construction, upgrades, replacements, repair and maintenance covering all these networks. The U.S. electric utility capital expenditures (CAPX) are expected to grow at 9% to 10% annually for the next five years. Approximately one half of utility CAPX will be outsourced to the specialty contractors with PWR the biggest beneficiary.

In the industrial utility services sector, PWR has only one smaller competitor and PWR is twice its size. PWR has the largest and best skilled labor to handle the most complex projects. The targeted market is made up of power plants, transmission lines, transformers and distribution networks, both low and high voltage lines. The U.S. has approximately 6.3 million miles of electoral lines which will need replacement. PWR's compound annual earnings growth over the next five years should be in the 10% to12% range as these major grid upgrades can take years for approval and up to ten years to build. PWR has both the scale and expertise to capture a large share of the major grid projects. PWR is an attractive holding in portfolios that facilitates and complements the growing demand for electricity. Five Mile River client portfolios also own three of the best nuclear electric utilitiy companies, located in Arizona, Georgia, and Louisiana.

Five Mile River portfolio managers are always available to discuss your investment account's performance, portfolio composition, and investment strategy. If your financial objectives or goals have changed, this would be a good time to review your individual portfolio strategy to ensure that it is aligned with your financial goals. We wish you a wonderful fall and holiday season and a happy and healthy remainder of 2025.

Sincerely,

Lee Todd Martha Mary

Lee Todd Martha Mary

**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 includes the dividends issued by these 500 companies. This index is used for a comparison for FMR accounts. 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.*

*** The S&P 500 Equal Weighted Index (EWI) is a version of the S&P 500 index however the difference is that all 500 companies of the S&P 500 are given an equal weight of 0.2% of the total index. This differs from the S&P 500 which gives the highest valued companies the largest weight in the index (otherwise known as the market cap weighted index). The EWI eliminates the mega cap concentration that produces a distorted market index performance.*

This letter is not meant as a general guide to investing, or as a source of any specific investment recommendation, and makes no implied or express recommendation concerning the manner in which any clients' accounts should or would be handled as appropriate investment decisions depend upon clients' investment objectives. Any offer to sell or the solicitation of an offer to buy any interests in any securities may be made only by means of delivery of a Five Mile River Investment Management Agreement and/or other similar materials which contain a description of the material terms and various considerations and risk factors relating to such securities or fund. Different types of investments and/or investment strategies involve varying levels of risk, and there can be no assurance that any specific investment or investment strategy will be either suitable or profitable for a client's or prospective client's portfolio, and there can be no assurance that investors will not incur losses.