

A historic market run is now in the “cognitive dissonance” phase. Cognitive dissonance occurs when a person experiences discomfort or tension from contradictory information, beliefs, or experiences. The need to alleviate discomfort and maintain consistency motivates the brain to find a way to cope by resisting, rationalizing, trivializing, or reassigning discomforting information.

I remember watching on more than one occasion news of some doomsday cult’s failed prediction of the apocalypse. Each had pleaded publicly and earnestly that the end was near. When their apocalypse date came and passed, they all had the same response: calculation or interpretation error. Instead of abandoning their beliefs, they simply revised their date.

We all do this to some extent. We tell ourselves we’ll eat healthier tomorrow, a poor decision was someone else’s fault, we deserve some overindulgence. Cognitive dissonance is often why people over-speculate and over-borrow. It’s why people tend to hold on to losing stocks long after they’ve recognized their error.

There’s a cognitive dissonance permeating markets today as record prices and premiums expand while disconfirming evidence and contradictions mount. There’s a growing belief and justification held by investors: *I’ll get out before the party’s over.*

This isn’t a bearish declaration that it’s time to pack it in but rather a recognition that I’m not immune to cognitive dissonance. While our stock allocation is reasonably modest—especially compared to most—I am aware it would be lower overall (with even fewer technology holdings) if I didn’t share the notion that I’ll gear down before things fall apart. *I’ll get out before the party’s over.*

I wrestle with the contradictions and imbalances growing in the world today. I am confronting them more each day, determined to settle on a framework for investing going forward and tease out signal from the noise.

That framework is taking shape piece by piece. So far it consists of good and bad big-picture truths, reasonable secular growth themes, and ideas addressing the risks we want to mitigate. Over the rest of the summer, I’ll be sending over several essays articulating our framework for the road ahead. I use “framework” deliberately instead of “strategy” or anything resembling a recipe or silver bullet. Frameworks are more comprehensive as they address first principles, seek to identify truths and what’s knowable (and not), and put strategies and tactics in their rightful place. A framework helps reduce cognitive dissonance and other biases getting in the way of good decision making. I look forward to sharing our explorations.

For now, with this being a quarterly update of sorts, I'll summarize the bigger themes and ideas behind your portfolio holdings today.

Portfolio themes

The attitude here can be summarized as: the easy gains are behind us, and the risk/reward has shifted in ways that demand a more deliberate, balanced posture. It's easier to elect this route with the highest interest rates in years and commodity prices falling, making both more attractive as investment and diversification options.

Stocks are heading toward a collision point: at some point, stocks and interest rates can't both keep rising. Higher interest rates are a principal scourge of high P/E ratios in stocks. Markets think twice about buying stocks at 40x and 80x earnings when keeping money in Treasuries pays well.

Monetary and fiscal policy tailwinds are fading. Expectations for persistent monetary easing from the Federal Reserve have now reversed; markets now expect the next move in short-term interest rates to rise. Covid-era stimulus is fading, and debts and deficits continue a vicious cycle. The cognitive dissonance here is perhaps the greatest of all. No one expects the picture to improve, and almost everyone expects dire consequences eventually. And yet, markets have been unfazed.

Neither the fiscal problem nor the recent upturn in inflation trends has increased inflation expectations over the medium and long term. The market expects inflation (CPI was 4.2% at last reading) to decline soon to near 2% and stay there permanently. Thus, the rise in interest rates is in *real* interest rates.

Given future inflation is *the* principal risk for long-term investors and the end game for debts and deficits historically, the case for inflation-protected bonds is strong. Today, investors can lock in 2-1/4% real interest plus CPI over 10 years with 10-year TIPS and almost 3% real interest over 30 years plus CPI with 30-year TIPS.

Markets are arguably growing more sanguine about geopolitical risk. Oil prices currently have nearly retreated to levels before the war with Iran, even as the world's most important oil passageway remains restricted.

Gold and silver have had a bruising retreat after a historic run. We still see precious metals as insurance—not something you want to make money in. The case for insuring geopolitical risk and government mismanagement remains strong, perhaps more so than ever. Our 3-6% weighting will remain and perhaps increase if prices continue to fall.

Just as we find TIPS the most attractive place in bonds, we find certain wide-moat businesses in smaller niches the most attractive stocks today. They are technology companies hiding in other sectors. These are the 800-pound gorillas of smaller niches—companies that dominate a specialized market with durable moats, high incremental margins, and pricing power, yet trade at valuations that reflect their industrial labels rather than their economic reality. The market still files them under “machinery” or “materials” or “electrical components” and values them accordingly. But observe their unit economics and you realize they are selling atoms the way a software company sells bits: embedded know-how, razor-and-blade lock-in, switching costs, and compounding installed bases. The precision-motion, specialty-materials, advanced-manufacturing, and even property and casualty names I favor are, in substance, compounding technology franchises available at industrial multiples.

That gap between perception and reality is where I believe durable, lower-risk outperformance is built—especially at a moment when the most obvious “tech” names are priced for perfection and then some.

What investments to avoid is also becoming clearer. At the top of the list are private credit, private equity, and low-quality fixed income securities. Private credit and equity investing is all the rage today and increasingly accessible to retail investors. History is unequivocal when illiquid and opaque investments proliferate: avoid.

Firm update

We are undertaking significant operational initiatives, including embedding artificial intelligence across the firm’s research and workflows. It’s an exciting time of innovation and improvement. This week we are carving out time for our first off-site “hackathon” where we put on our engineering hats and dive into building systems and forging progress. Our efforts are not about novelty but about our desire for continuous improvement and tangible results. I look forward to sharing our journey.

Kayla Cosby will begin maternity leave in a few weeks. We look forward to meeting her new baby girl. In the meantime, clients, please contact your advisor directly (me or Kawika Shoji) if you need anything big or small.

2026 is shaping up to be a pivotal year in many ways. I’m confident it will be a defining year for us. Thank you for letting us be a part of your journey.

Sincerely,

Neil Rose, CFA

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