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What is Right is not Always Popular
and What is Popular is not Always Right
Albert Einstein

In this letter, I provide my perspective on the stock market and discuss why we are invested differently from popular market indexes. I realize that we live in a noisy world with countless pulls on our time and attention. With this in mind, the following is my attempt to be concise in discussing current market conditions, index performance drivers and our investment strategy.

Not Trying to Keep Up with "The Jones"…

Or the market. At least not as measured by market-capitalization-weighted indexes such as the S&P 500. Historically, index funds were an efficient way to get wide diversification. Now they are more concentrated in mega-cap tech stocks than ever—even more than at the height of the dot-com era. That peak was followed by 10 years of poor performance for the S&P 500.[1]

The New, New Thing

A key to building wealth is not getting caught up in the excitement of the day. Investing in new industries that are attracting massive capital inflows is a common path to poor long-term performance. The hundreds of billions in spending to win the AI race is funding fierce competition that is good for customers but not investors. Looking back, most investors in new industries– from railroads to electric cars and virtually everything in between– lost money. Massive investment in the face of uncertain demand is dangerous. We believe in the power of AI but not in chasing returns in today's hot AI stocks.

Big Mo is Bigger than Ever

Together, retail speculators, indexers, and algorithmic traders (who utilize computerized trading programs) are fueling stock price momentum— the dominant force in markets today. Speculators and index funds are pumping billions of dollars into the same short list of companies while algorithmic traders magnify the volatility. The flood of money into mega-cap AI stocks is driving indexes to record heights while shares of many high-quality companies have fallen to multi-year lows. We think the best opportunities to make money are outside of the market vortex– in healthcare, financials, and communication services— where competitive landscapes are more stable and customer demand is strong and more predictable.

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[1] S&P 500® | S&P Dow Jones indices, accessed July 7, 2026, https://www.spglobal.com/spdji/en/indices/equity/sp-500/; SPX: S&P 500 index - stock price, quote and news - CNBC, accessed July 7, 2026, https://www.cnbc.com/quotes/.SPX.

Pessimism is Good (For Buyers)

Fears of AI destruction have led to indiscriminate selling of software stocks. While we think AI will hurt most software companies, we think AI presents growth opportunities for platforms where security and proprietary data are critical. The selloff in software has created some of the lowest valuations since the depths of the pandemic. To quote John Templeton, *The time of maximum pessimism is the best time to buy, and the time of maximum optimism is the best time to sell.*

The Most Important Thing

In wealth building, as in most competitive endeavors, defense is more important than offense. In Warren Buffett's words: Rule *No. 1: Never lose money. Rule No. 2: Never forget Rule No. 1.*
Berkshire shares have underperformed the S&P 500 by 30%+ since April of 2025. Over that same period Berkshire added $50 billion+ to its cash hoard— now approaching $400 billion. By contrast, several of the companies leading the S&P 500 to new heights have spent billions on AI bets with little-to-no return. The returns, they project, will be great in the future.[2]

We think the best defense against permanent loss is a diversified portfolio of high-quality growth companies. Augmenting equities with laddered high-grade fixed income can increase income and cushion volatility. This is a time-tested strategy but not popular in today's giddy AI market— helping to make prices and interest rates more attractive for us. Being unpopular may not feel good, but it has its advantages.

Money: Who Has It? Who Needs It?

We invest in companies that do not need to raise money— they do not have to borrow money or sell shares to raise capital. They have more than enough cash flow and financial capacity to fund growth. We think this puts us in a stronger position than investors in companies raising capital to fund huge expenditures as they scramble to keep up in the AI race— the most expensive race in history.

We Know a Thing or Two
Because We've Seen a Thing or Two

Market-capitalization-weighted indexes like the S&P 500 are likely to continue climbing as long as enthusiasm for mega-cap AI stocks continues to grow. We do not know how long or how far it will go. If history is any guide, Wall Street will continue to sell new AI-related securities until supply exceeds demand. That is when prices start falling— the fear of missing out quickly turns into the fear of losing money. At that point eager buyers become even more eager sellers. Who will they sell to?

Our focus is on building long-term wealth— just as we discussed in our first client letter in 1998 where we explained why we were not buying the dot-com stocks that were fueling the S&P 500 to record highs. In the internet era, companies that used the internet to deliver more value to customers and gain a competitive advantage over rivals created the most wealth. Not companies that profited from the internet infrastructure buildout. We believe the AI age will be similar and see opportunities to earn double-digit

[2] "2026 First Quarter Report," berkshirehathaway.com, May 4, 2026, https://www.berkshirehathaway.com/.

returns in high-quality growth companies already using AI to offer more value to customers and strengthen their competitive advantage.

Decisions Made at Peaks and Troughs
Can Make or Break Long-Term Returns

In my experience, investment decisions made in times like this— when volatility is high and valuation dispersion is wide— have an outsized impact on long-term returns. Sticking with a high-quality approach when speculation is being rewarded is not easy. It is frustrating to be plodding along when popular stocks are skyrocketing and indexes are setting records. Making money often involves short-term sacrifices. It seems each generation must learn this for themselves.

Thank you for your continued confidence— it is especially appreciated in times like these when many speculators are outperforming. Our mission is to do all we can to ensure that your confidence is well placed. We embrace the responsibility and the work that comes with it. In closing I want to be very clear: we think investing in high-quality growth companies outside of the AI market frenzy puts us on a path to outperforming long term.

Phil McCauley III
July 2026