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If you've read any of my previous letters, you've heard this phrase before: "a professional investor is a professional worrier." The same can be said of individual investors, many of whom worry as much as professionals. What is critically important, however, is that we worry about the right things. The world presents a myriad of *potential* difficulties. But the ones we need to worry about are the ones that combine an uncomfortably high probability of occurrence with a potentially devastating impact.

That combination of probability and magnitude of risk is the key to correctly identifying the right things about which to worry. As to probability of risk, let's just say that we at Confluence do not worry too much about space alien attacks, despite the recent news stories regarding the possible release of military files about UFOs. But as to the impact of current wars in Ukraine, Russia, and the Persian Gulf on economic realities in the US? That's high probability, to say the least.

Magnitude of impact is the other feature of risk that must be determined. Some high probability events nevertheless have rather low impacts on markets and the economy, such as thunderstorms across the Midwest next spring. While the wind and hail they bring will damage roofs across the region, from a market perspective, insurers have already reserved for them and roofers will be prepared to repair such roofs. Although the toll will be great for an individual homeowner who loses part of his roof, from an overall perspective, the magnitude is manageable.

Many low probability events can have major impacts. Wars are like that. A kinetic war between Russia and NATO, for example, would have been considered a very low probability event five years ago. The probability of such a war is certainly higher today, and the magnitude of impact on markets and the economy remains high.

While there are always things to worry about that affect many areas of our lives, we at Confluence are concerned primarily with those that have an investment impact. From that perspective, sometimes the key risks are not obvious. We continue to believe that the major issues investors need to worry about are related: the US's actions to back away from world hegemony and the shrinking of global trade. In the long run, neither world hegemony nor globalization was politically feasible in the US and the West, although it took global elites a long time to figure that out.

Two major consequences of these associated changes in world affairs are inflation and geopolitical instability. You read about these consequences in the news every day, but perhaps you didn't realize that they both spring from the same source. Inflation not only pressures consumers but also makes it harder for businesses to make real profits and raises interest rates. Geopolitical instability not only creates product disruptions and shortages but also raises the risk of investment. This increased risk establishes itself in higher interest rates and lower equity valuations. Confluence's macro strategists and economists have been

writing about these issues for well over a decade. These concerns are baked into every investment decision we make, even if the headlines are screaming about something else.

Artificial intelligence (AI) is another risk factor that concerns us, and not only for how it disrupts certain companies and jobs. The data center build-out is rivaling the late-19th-century railroad expansion in capital spending relative to the economy. This spending is propelling economic growth at a rapid pace. Our concern is the same as we have for all capital spending cycles: what happens when it slows down? Many companies are entirely dependent on AI spending for their above-average profit growth, and this isn't limited to technology firms. Electrical equipment, HVAC, and commercial construction are just some of the industries benefiting greatly from this enormous capital spending cycle.

The stocks of AI beneficiaries are carrying premium valuations that are at risk when the cycle ends. Stocks of AI agnostic companies, i.e., those that are neither direct beneficiaries of the AI capex cycle nor directly disrupted by AI technology, have been largely left behind by the AI bull market. Many of these are great businesses, by our definition, and are reasonably inexpensive. This is where our interest resides and where we're doing most of our equity investing.

Should one worry about the upcoming midterm elections? From an investment perspective only, the answer is: "Not much." Why? History has shown that when a newly elected president wins both houses of Congress, he will very likely lose one or both at the midterms. We seem to be on the verge of that happening again. This virtually guarantees that no new legislation will be signed into law during the next two years. Is this a bad thing? Politicians and journalists will complain, but businesses likely will not. They generally appreciate such inactivity, and so do financial markets.

The great political philosopher Marx (Groucho, not Karl) would agree, having once remarked: *"Politics is the art of looking for trouble, finding it everywhere, diagnosing it incorrectly, and applying the wrong remedies."* Likewise, we won't be troubled by gridlock in Washington.

We aim to worry about the things that matter most to your portfolio. In so doing, we work to protect your capital and produce appreciation and income in line with your risk profile.

We appreciate your confidence in us.

Gratefully,

Mark A. Keller, CFA
CEO and Chief Investment Officer

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