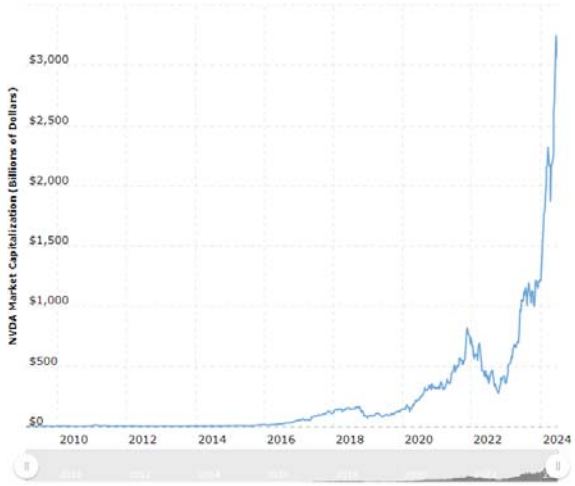
As we enter the second half of the year, we continue to watch the recent drivers of the market's performance and wanted to share our thoughts on what the market may be pricing in for the largest outperformers. For most of the year, the firms most closely associated with artificial intelligence (AI) have been on the sharpest ascent, and expectations for their prospects climb higher almost every day. In particular, Nvidia's market valuation has gained over $2 trillion dollars year-to-date, and we ask ourselves what the implications are given the substantial increase in the company's shares.



To be sure, Nvidia's *business* performance has been historically impressive. As the go-to option for AI-related processors, Nvidia's revenue has more than tripled over the first six months of its fiscal year, relative to the first six months last year. Profits in the same period are up *fivefold*. We wish that we could have accurately foretold this trajectory, and we admire investors that recognized NVDA's market position.

As of our writing this letter, however, Nvidia's market capitalization has risen above $3 trillion dollars, which surpasses the total market capitalization of the entire U.S. banking sector by over 50% (the aggregate market value of banks stocks at last measure was about $1.9 trillion). Even so, the aggregate profit of the banks is greater than 10x NVDA's 2023 profit ($357 billion vs. ~$30 billion). While we share the excitement around NVDA's rise, we struggle to justify its current valuation.

For argument's sake, we think NVDA would need to quintuple earnings once again, to $150 billion, to justify its $3 trillion valuation. According to analysts, the amount of revenue needed to support those earnings would be about $250 billion, which is four times more than the 30-year-old company generated in 2023 and is not projected to come to fruition until the 2029 fiscal year. Again, this amount would roughly rationalize *today's* stock price; an actual return would require earnings growth over and above this amount.

Nvidia's rising market value highlights several intriguing dynamics in today's economy. The market is pricing artificial intelligence to be a considerably larger part of the economy than the entire banking industry that facilitates the transfer of capital between businesses and consumers. When we consider the AI-related gains in the valuations of other technology companies outside of Nvidia (i.e. GOOG, MSFT, etc.) that are involved in other aspects of AI, the picture becomes even further skewed. Inevitably, artificial intelligence will continue to expand, and fairly quickly. Our question is how much of those growth prospects are already priced into the large cap technology

stocks and is it possible to know who the winners will be and the degree to which they will win in the marketplace. Will all the rewards accrue to a handful of companies, or will the marketplace be more fragmented? We are not quite sure. While we are not averse to owning large cap tech stocks, and indeed we have a position in most portfolios, there comes a point in relative valuations where we wonder if such large premiums are warranted.

We never try to anchor our thinking in valuation alone, but we sometimes remind ourselves that when the large tech rally began, back in the early 2010s, we could buy the same, now-dearly-valued household names for single-digit multiples of earnings. Today, we believe the attractive valuations are swinging toward smaller, non-tech enterprises. Might market valuations on both ends of the spectrum be due for a reversion to the mean? We do not know, but we will continue to seek investments where we believe the risk-reward equation to be in our favor.