# The Price of Enthusiasm

Weitz | INVESTMENT MANAGEMENT



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During the 3rd quarter, investors (and speculators) continued to focus squarely on artificial intelligence "plays." The list of stocks driving the S&P 500 to record highs ranges from the mega-cap leaders to smaller companies that have found a way to capitalize on the current boom in demand for computing power and data centers. Our take is that enthusiasm for many of these stocks has run ahead of reality. We believe that broad swaths of "the rest" of the market are being ignored and present better opportunities for patient value hunters. We think that it is telling that as the S&P 500 set a new record high on October 6, fewer than half of its component stocks were selling above their 200-day moving average. While waiting for valuation "truth" to be recognized, it is hard to keep up with the index, but we feel confident that our collection of businesses, less dependent on the AI boom, will serve us well over time.

As our shareholders know, our focus is on the growth in business value of individual companies. The "news of the day" is generally less important than corporate developments, but there are some "macro" topics that deserve comment.

The **midterm elections** are upon us. They are a wonderful opportunity for advertisers (and we own several), but for the TV watching public, not so much. We may or may not have a change in control of the House and/or Senate, but it seems likely that political gridlock will continue to hamper legislative effectiveness.

However, the outcome of the elections may give some clues as to the mood of the electorate and its attitudes towards some of the significant policy changes made by the current administration. Investors will be trying to anticipate changes in healthcare, education, and scientific research funding. Construction and agriculture industries will be interested in potential changes in immigration policy. Signs of interest in returning to more traditional relationships with allies and trading partners could affect business behavior even before any policy changes are made.

**Interest rates** are always in the news and on investors' minds. With 10-year Treasury rates moving above 5%, there have been louder expressions of angst among investors, and even some politicians. We have regularly bemoaned the fiscal irresponsibility that has brought us a $40 trillion national debt and $2 trillion annual budget deficits. There has been no hint from either party that Congress is willing to make the unpopular, but necessary, changes to tax and spending policies, but we can hope that elections bring some movement on this front. Stubborn inflation and record amounts of corporate borrowing (especially for AI projects) have added upward pressure on interest rates. It is impossible to predict whether the current uptick in rates will rattle the stock market but the possibility is real.

Finally, the most colorful subject in the news might be called "**AIs behaving badly**." We have written about the huge amount of capital spending, the promises to buy enormous amounts of computing power, and the questions as to whether customers will buy enough AI services to generate adequate returns on this invested capital. These are all still (important) unknowns. But the AI topic of the moment is **safety**.

Movie goers may remember Arnold Schwarzenegger's Terminator ("I'll be back!") or Hal, the computer in 2001: A Space Odyssey ("I'm sorry Dave, I can't do that"). We now have press reports that OpenAI models operating as AI agents escaped their controlled environment, or "sandbox," communicated among themselves and broke the 'rules of engagement' by hacking into Hugging Face's system (an AI research platform) to complete their assignment. While news coverage of this incident may have been somewhat hyperbolic, there have apparently been numerous other instances of AI agents behaving in unexpected or unauthorized ways that have stayed mostly under the radar.

Wall St. is quick with the black humor. It did not take long for “FOMO” (Fear of Missing Out) to give way to “FOBE” (Fear of Being Extinct”). One can imagine a research report opening with, “Setting aside the possibility that the product may kill all of humanity….” So now, safety is front and center as we all try to come to grips with how AI will reshape our world. Debate among policy makers and the public is now raging as to whether, and how, to regulate or control AI. Even the builders of the models are divided on how to manage their creations. This is another wrinkle in the AI story that makes investing in AI so interesting. And complicated.

We are working overtime to learn about all of these aspects of AI. Companies are scrambling, too, to incorporate AI into their workflows while simultaneously defending against AI-wielding potential disrupters. The developments in AI are amazing and the investment opportunities are tremendous. But, some of the expectations are probably unrealistic. Surprises and disappointments are inevitable in an arena this big and growing this fast. **Expect high volatility.**

Our job as investors is to take advantage of mis-priced assets—selling the overvalued and buying the undervalued. In this pursuit, volatility is our friend. It may not feel that way when stocks seem to be on a rollercoaster, but this is part of long-term investing success. There have been other seemingly crazy times like this, and having a calm, sensible group of clients has made it possible for us to take advantage of these opportunities. Thank you.

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