FORTITUDE CAPITAL MANAGEMENT

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April 15, 2025

"In the short run, the market is a voting machine, but in the long run, it is a weighing machine." – Benjamin Graham

"Any measurement that you make without any knowledge of its uncertainty is completely meaningless." – Walter Lewin, MIT physics professor

Fellow Investors:

The year was off to a disappointing start in the first quarter of this year; and then the second quarter started. We will try to put some perspective to all of it as it relates to our investments. We do not usually include a disclaimer in our letters, but with market activity as the second quarter unfolds, all could be different by the time this is read.

First, let us quickly cover the action of the first quarter of 2025. Equities were lower, with declines focused on a few mega-cap names and small caps. The S&P 500 was down 6.48% in the first quarter (4.6% including dividends). The Magnificent 7 accounted for two-thirds of the decline as all seven declined and six of the seven by double digits (excepting META). TSLA was hit hardest, declining by 35.8% in the quarter. As we have discussed before, these companies have an outsized effect on the index as they represent about 30% of the index. To further demonstrate their impact, the S&P 500 Equal Weight Index was only down 1.08% for the quarter. Small caps were hit much harder in the quarter as the Russell 2000 declined by 11.3%. As investment funds moved toward a risk-off posture and inflation expectations continued to moderate, the 10-year treasury rate declined to 4.23% from 4.58% and the two-year treasury declined to 3.89% from 4.25%, producing a slight steeping in the two to ten-year yield curve.

So much for the first quarter. What we can take from that period is that the risk of concentration cuts both ways. Riding the Magnificent 7 up comes with the risk of riding them down. The first week of the second quarter was a different story, primarily driven by the uncertainty introduced by the administration's trade policy and tariffs. We have since realized a level of bounce back. The S&P 500 was down 11.91% in the first week of this month, however the contribution of the Magnificent 7 represented 25% of that decline, a smaller contribution than their weighting. The equally weighted S&P 500 lost a similar percentage as the capitalization weighted index, dropping 10.02% in the first few days of April. Small caps continued their decline with the Russell 2000 dropping an additional 12.16% from 1 April to the 7th after its 9.8% drop in the first quarter. There is no better indicator of the uncertainty inflicting the equity markets than the measure of volatility, the VIX, jumping from 21.67 to 46.98 over the first week of April and at one point reaching a high of 60. The ten-year treasury rate continued down to 4.15% and the two-year treasury rate fell to 3.73%. Typically, we see interest rates come down when equity markets are unsettled as some money moves to bonds, particularly US treasuries, which are viewed as the safest investment. At least for now.

Since the first week of April, markets have come back a bit, granted sporadically resulting in the S&P 500 being down 3.7% for the current month and treasury rate higher by 20 to 30 basis points.

Let us put this recent equity sell-off into historical perspective. Focusing on the S&P 500, we have had four notable pullbacks since 2018, all for differing reasons. In the final quarter of 2018, the S&P 500 declined by 15.18%. Due to

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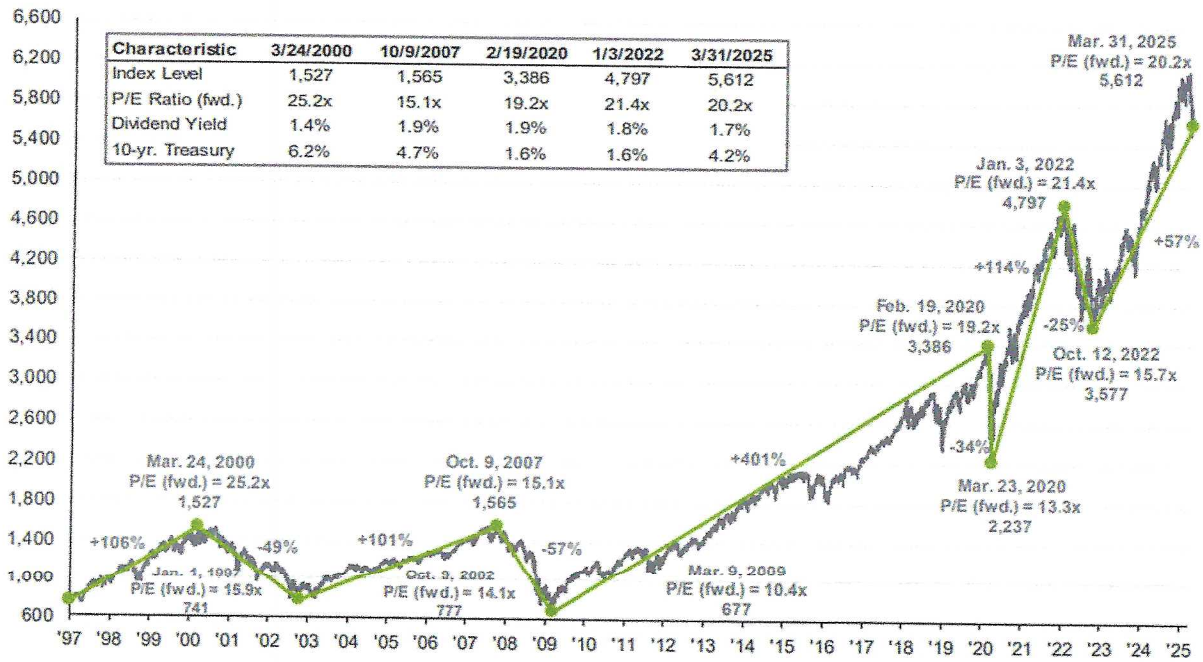
Covid, the S&P 500 fell by 27.4% in late February and March 2020. Over the first 10 months of 2022, the S&P 500 lost 25.13% as inflation peaked, the money supply exploded, and federal spending remained high post pandemic. Our current decline in the S&P 500 is so far under 20%. It has happened before, and unfortunately it will happen again, but our psychology tells us this time will be different. In each of the above cases prior to the current one, the market went on to set new highs. Please see the chart below for history going back to 1997, which includes a number of major market setbacks and subsequent recoveries.

S&P 500 Price Index



Source: Compustat, FactSet, Federal Reserve, Refinitiv Datastream, Standard & Poor's, J.P. Morgan Asset Management.
Dividend yield is calculated as consensus estimates of dividends for the next 12 months, divided by most recent price, as provided by Compustat. Forward price-to-earnings ratio is a bottom-up calculation based on IBES estimates and FactSet estimates since January 2022. Returns are cumulative and based on S&P 500 Index price movement only, and do not include the reinvestment of dividends. Past performance is not indicative of future returns.
Guide to the Markets – U.S. Data are as of March 31, 2025.

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The frequency of market declines to various degrees is easily forgotten. The S&P 500 experiences a 5% decline on average three times a year. We see a decline of 10% approximately once a year. A 15% decline occurs about every two years and the 20% sell-off rears its head on average every 3 ½ years. They happen, we recover and move on.

In fact, at some point in almost every year, the S&P 500 has been negative, even in years when it ended with a significant gain. The chart below shows annual returns going back to 1980 along with the low point reached during each year.

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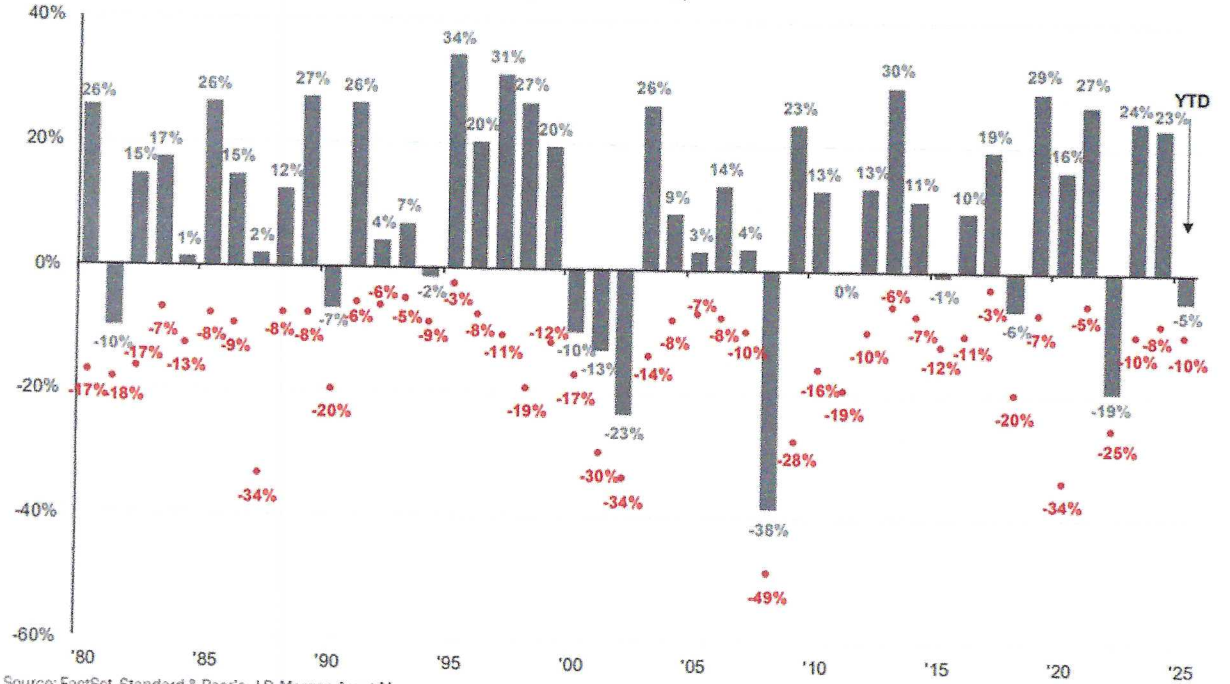
S&P intra-year declines vs. calendar year returns

Despite average intra-year drops of 14.1%, annual returns were positive in 34 of 45 years



Source: FactSet, Standard & Poor's, J.P. Morgan Asset Management.
Returns are based on price index only and do not include dividends. Intra-year drops refers to the largest market drops from a peak to a trough during the year. For illustrative purposes only. Returns shown are calendar year returns from 1980 to 2024, over which the average annual return was 10.6%.
Guide to the Markets – U.S. Data are as of March 31, 2025.

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The topic affecting the markets as this is written is trade and the administration's use of tariffs to change the structure of global trade flows. Also playing a role is the political divide in Washington and the focus on government spending. One thing is clear, the status quo of running a trillion-dollar trade deficit and a two trillion-dollar budget deficit is not sustainable, and something needs to be done. Think of our economy as a bathtub filling with water. The twin deficits of trade and spending is like having the drain open, reducing the potential fill rate of the bathtub. Somehow, we need to close the drain. Are these the solutions? We will eventually find out, and that unknown is why our equity markets are reacting to the uncertainty.

Here a few numbers for consideration regarding trade. The US economy represents approximately 26% of the world economy as measured by GDP. The United States has about 4% of the world population. Clearly, we swing well above our weight. The US consumer accounts for 68-70% of the US economy via consumption. Working through the numbers, the US consumer accounts for 17-18% of global GDP. That is a big bat to swing. There is also a concern that the imposition of tariffs and trade restrictions will reignite inflation. Prices in some areas will certainly be affected but it is important to keep in mind that as large as our imports may be in dollar terms, imports of goods only represent 11% of US GDP. While not insignificant, that level is not likely touch off a jump in inflation in our opinion.

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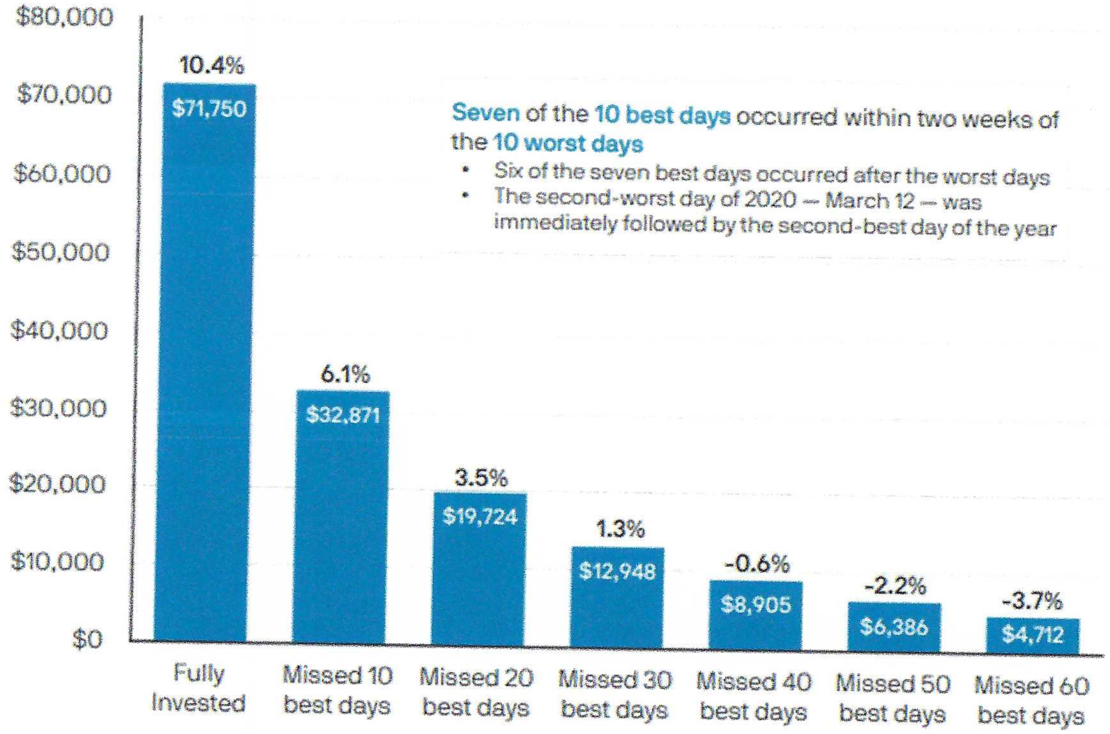
As with all market corrections, they are unsettling to investors, especially those who may be nearing retirement. Proper risk assessment and allocation can be reassuring in markets like the current one. Volatility and market fluctuations are more impactful over shorter periods and less so as time frames become longer. As beings that are naturally short-term oriented, the psychological effect of a sharp decline makes us want to do something. We refer to a couple of human biases as part of the explanation to our behavior. Recency bias is our tendency to focus on what has happened most recently to assess what we expect to happen next. Anchoring bias is the tendency for us to anchor a value in our mind, so that a deviation from that value, especially downward, gets our attention and puts us in a mind for action when history tells us no action may be our best course. Missing just a few of the market's best days can have a large effect on returns over time. See the chart below to demonstrate the value of "time in the market versus timing the market".

Returns of the S&P 500

Performance of a $10,000 investment between January 3, 2005 and December 31, 2024



Source: J.P. Morgan Asset Management using data from Bloomberg. Returns are based on the S&P 500 Total Return Index, an unmanaged, capitalization-weighted index that measures the performance of 500 large capitalization domestic stocks representing all major industries. Indices do not include fees or operating expenses and are not available for actual investment. The hypothetical performance calculations are shown for illustrative purposes only and are not meant to be representative of actual results while investing over the time periods shown. The hypothetical performance calculations are shown gross of fees. If fees were included, returns would be lower. Hypothetical performance returns reflect the reinvestment of all dividends. The hypothetical performance results have certain inherent limitations. Unlike an actual performance record, they do not reflect actual trading, liquidity constraints, fees and other costs. Also, since the trades have not actually been executed, the results may have under- or overcompensated for the impact of certain market factors such as lack of liquidity. Simulated trading programs in general are also subject to the fact that they are designed with the benefit of hindsight. Returns will fluctuate and an investment upon redemption may be worth more or less than its original value. Past performance is not indicative of future returns. An individual cannot invest directly in an index. Data as of December 31, 2024.

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We do not intend to minimize the impact of the current market on our investments or our psyche, only to keep perspective, review investment strategy and allocation, but keep the long-term in perspective. It has always rewarded us when we take a deep breath and have patience. Not always easy but historically has worked to our benefit.

Sincerely,

Erik Ford

Jason Marrs

The S&P 500 Index, or the Standard & Poor's 500 Index, is a market-capitalization-weighted index of the 500 largest publicly traded companies in the U.S. It is not an exact list of the top 500 U.S. companies by market capitalization because there are other criteria to be included in the index.

The S&P 500 Equal Weight Index (EWI) is an equal-weight version of the popular S&P 500 Index. Although both indexes are comprised of the same stocks, the different weighting schemes result in two indexes with different properties and different benefits for investors.

The term Russell 2000 Index refers to a stock market index that measures the performance of the 2,000 smaller companies included in the Russell 3000 Index. The Russell 3000 is a capitalization weighted index representing approximately 96% of the investable U.S. equity market.

The "Magnificent Seven" include AAPL, AMZN, GOOG and GOOGL, META, MSFT, NVDA and TSLA.