July 13, 2026

Dear Clients and Friends,

"Buy not on optimism, but on arithmetic." – Benjamin Graham

Amid all the hype driving the stock market, it's worth remembering that business fundamentals and valuations still matter. Our investment process has always been anchored in business quality and intrinsic value, a discipline that protects capital when enthusiasm outruns reality. That discipline carries a cost in exuberant markets, and a payoff in more rational ones. Right now it's being tested. The market has basically become a singular bet on artificial intelligence, and a broader swath of market participants are starting to question that unbridled optimism. In the brief but sharp episodes this year when air came out of the most crowded parts of the AI trade, our portfolios held their ground. Those moments are a reminder of what we are building toward: a portfolio that compounds steadily, protects on the downside, and doesn't require everything to go right to generate good returns.

The last time markets demanded this much discipline of investors was the internet bubble, a quarter century ago. Unix servers then were the backbone of the internet. The technology was created by Bell Labs (AT&T) in the 1960s, and commercialized for various uses by IBM, HP and others. Sun Microsystems emerged as the market leading Unix vendor for commercial internet infrastructure. Its competitive edge was thought to be enduring because it integrated proprietary networking software with its hardware. The promise of the internet sparked fervor in Sun's shares. In a 2002 interview, Scott McNealy, Sun's co-founder and CEO, reflected on the silly valuation his company's shares reached during the boom. "At 10 times revenue, to give you a payback, I have to pay you 100% of revenues for 10 straight years in dividends … that assumes I have zero cost of goods sold … that assumes zero expenses … and that assumes, with zero R&D for the next 10 years, that I can maintain the current revenue run rate … do you realize how ridiculous those assumptions are? What were you thinking?" Sun's shares ultimately declined 96% from their peak. Today, Unix servers are relics, and Sun was unable to keep pace with technological changes underpinning the internet.

Cisco Systems was the dominant provider of networking equipment – the ultimate picks-and-shovels play on the internet build-out. Cisco’s franchise has proven far more durable than Sun’s because switching costs in enterprise networking are severe. Its shares peaked at 26 times revenue in March 2000 when it briefly became the world’s most valuable publicly traded company. Over the subsequent two years, shares fell 90%. There was no fraud, no accounting irregularities, and the need for internet networking equipment continued to grow. The shares were simply overpriced, and they did not regain their peak price for 25 years (December 2025) despite the company having tripled in size.

High price-to-revenue stocks tend to disappoint because their valuations already reflect the enthusiasm that carried them there. The ten highest price-to-revenue stocks in each year since 2004 have averaged 13 times revenue, and they have delivered just half the return of the S&P 500 in subsequent three-year periods.[1] Valuations at that level signify a mismatch between euphoric investor expectations and the harsh forces of economic cycles and competitive disruption. For perspective, the S&P 500 has averaged 1.8 times revenue since 2004.

[1] *Sources: S&P Global, DWA internal analysis.*

One recent story illustrates where we are in the current market cycle. Last month, SpaceX, a rocket, satellite, and artificial intelligence company, began trading publicly in the largest IPO in history. It's currently trading with a market value of $2.2 trillion, roughly 100 times revenue. It trades at triple the combined value in today's dollars of all US venture-backed IPOs during the dotcom bubble.[2] SpaceX generated $19 billion in sales and $7 billion in operating cash flow last year. Its market value last month briefly surpassed Amazon's, which last year generated $717 billion in revenue and $140 billion in operating cash flow. In time, a lot of people could be asking themselves, "what were we thinking?"

Five months ago, SpaceX acquired artificial intelligence company xAI in an all-stock transaction. The deal valued the combined entity at $1.25 trillion, or roughly 67 times revenue, including roughly 400 times sales for the AI business. By our estimate, AI-related revenues now represent about 3% of consolidated SpaceX sales. In most mergers, an outside advisor is hired to confirm the price is reasonable. That step did not occur with the xAI deal because Elon Musk controls both companies. The valuation was set internally. At this transaction size, with this degree of conflict, and with institutional minority investors, skipping a fairness opinion is a significant governance lapse. Euphoria is enabling extreme valuations and governance shortcuts without meaningful resistance from institutional shareholders, boards, or the broader culture that's feeding it.

"We need to make sure not to believe in the delusion that has now spread from Silicon Valley to the rest of the country, and indeed the world. That delusion says that we're all going to get rich quick." – David Cahn, Sequoia Capital

We recognize artificial intelligence as a genuinely transformative technology. We expect it to generate substantial value over time, but much of that value is likely to accrue to consumers and the economy at large rather than to the investors who fund the initial buildout. The history of markets is littered with transformative technologies that changed the world and still managed to disappoint investors who paid too much to own them. The railroad was real. The internet was real. AI is real. The question was never whether the technology mattered, but whether the price you paid reflected a realistic assessment of what the business would actually earn.

Our approach to AI exposure reflects this history. Rather than owning the speculative frontier directly, our clients are exposed to AI-driven demand through proven, cash-generative businesses already monetizing it today. Alphabet, Microsoft, and Amazon, all three of which are core DWA investments, are the largest owners of data centers that power AI. These companies represent AI exposure we find compelling because they each are businesses with multiple earnings streams today, and with emerging AI businesses as an accelerating tailwind rather than the entire investment premise. Amazon, for example, has dominant franchises in commerce and advertising, in addition to its leading data center footprint, which itself has many demand drivers in addition to AI. Amazon develops its own AI-optimized semiconductor chips, and its early investment in Anthropic has positioned it at the center of advanced AI development. Anthropic has emerged this year as the leading AI developer, doing so on Amazon's chips.[3] Three years ago, it would have been difficult to imagine that the world's leading AI lab would train and serve frontier models on Amazon-designed chips rather than Nvidia's, yet that is where we are today. Chips designed by Amazon and Alphabet have matured to the point where they are

[2] *Sources: NVCA, BLS, Bloomberg, CNBC, press reports. 1995-2000 market value adjusted for inflation in 2026 US dollars.*
[3] *Anthropic is generating more inference revenue than any other AI model. Source: Altimeter, Company disclosures, DWA estimates*

significantly reducing their dependence on Nvidia. While Nvidia is still the king of chip design, well-financed competition is loosening Nvidia's grip, and we own that competition.

"Our goal … is to make meaningful investments in businesses with both long-lasting favorable economic characteristics and trustworthy managers." – Warren Buffett

The mania surrounding AI stocks has pulled capital away from the shares of high quality, cash generative companies, which in our view are now priced to deliver higher returns going forward. One stark example in our portfolio is S&P Global, which exists to be the independent referee that was absent from the SpaceX/xAI transaction. S&P Global is the standard by which global capital markets price risk and benchmark performance. Its credit ratings, indices, and commodity benchmarks are the defined reference points embedded directly into bond covenants, investment mandates, and derivatives settlements worldwide. Its indices underpin $17 trillion in passive investments, and its data is the input on which many models run. Standards-based moats tend to be more permanent than product or technology moats because displacing them requires coordinated, simultaneous action across an entire industry's existing contracts and institutional processes. Its businesses are so deeply woven into financial markets that disruption is nearly unimaginable.

The investment opportunity at this moment is notable. Since the November 2022 launch of ChatGPT that sparked the frenzy in artificial intelligence, the forward earnings multiple for the broader market has gotten 20% more expensive, while that of S&P Global has gotten 27% cheaper. S&P Global has become a better opportunity as it has gotten cheaper, while the major indices, inflated with speculation, have become riskier. We believe this is one of many such opportunities in our portfolio at present.

The Douglass Winthrop investment strategy is designed to produce absolute returns that deliver on our dual goal of growing and preserving our clients' capital. In any given year, the market rewards excitement. Companies experiencing temporary pricing power, speculative growers, and story stocks can produce extraordinary short-run returns. But that excitement tends to fade as most companies lack the enduring structural competitive advantages that are foundational to the companies in which we invest. Investing generationally requires discipline and patience. It's not a promise to avoid every storm, but a commitment to building fortified portfolios that withstand them. We strongly believe that wealth built quietly on a foundation of enduring businesses outlasts wealth built quickly on fragile ones.

Firm Update

We are excited to announce the hiring of two new members of the DWA team. Luke Harrington will transition over the next few months into the role of Head Trader, allowing our current Head Trader, Cody West, to expand his coverage as an Analyst. Luke comes to us from HAGO Equity Fund, a long-short equity hedge fund specializing in investments of high-quality companies, where he developed models to track and analyze trading signals. Luke has a B.A. in Economics from Brown University, where he played on the ice hockey team.

Charlie Frentz joins us as an Analyst and Portfolio Manager. Charlie brings a strong global investment background. In 2022, he co-founded Frentz O'Donnell Investments Limited, an Asia-focused investment firm. Prior to that, he worked at Tree Line Investment Management, a Hong Kong–based hedge fund, and began his career in Jardine Matheson's executive training program. Charlie graduated from Harvard College, where he wrote his thesis on the economic decolonization of Hong Kong, with Niall Ferguson as his advisor. He is a CFA Charter holder. We are thrilled to welcome Charlie and Luke to Douglass Winthrop.

We are fortunate to work alongside clients and colleagues who make our work meaningful. We wish everyone a healthy and enjoyable summer.

Sincerely,

Douglass Winthrop Advisors