

The Long Run

Investment Letter
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CAPITAL MANAGEMENT, LLC

*"I find it hard to tell you, 'cause I find it hard to take
When people run in circles
It's a very, very
Mad world"*

—Mad World, Tears for Fears

It was the worst of times, it was the best of times—and all in six months. The 2025 spring market collapse was notable for both its speed and its psychological impact. From the February high to the early-April low, the S&P 500 fell by nearly one-fifth of its value. Sentiment tracked the move: weekly AAI investor sentiment surveys saw bearish responses jump from the low-40% range in early February to roughly 60% by late February and again in early April—readings that coincide with historically significant stress points in equity markets. The combination—rapid price compression and unusually pessimistic survey data—created precisely the kind of dreadful environment in which short-term market timing becomes most tempting.

Several factors drove the intensity of the 2025 correction: escalating tariff proposals and counter-measures; renewed recession concerns; policy uncertainty across multiple fronts; rising funding costs in parts of the credit market; and unease with historically concentrated equity index leadership.

Our counsel at the time was deliberately simple and, we believe, appropriately academic: maintain strategic long-term risk allocations between growth investments and reserves; rebalance where weights had drifted; and avoid the temptation to consider all-in/all-out decisions that would interrupt the compounding engine that drives growth in portfolios over time. The rationale was not based on prescience, but rather on considered probability—history shows that strong “up-days” often occur near the worst “down-days.” Charlie Munger famously quipped, “The first rule of compounding: Never interrupt it unnecessarily.”

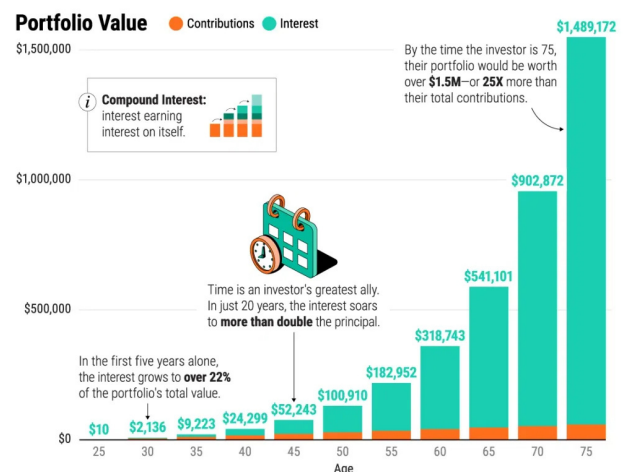
Our April Long Run focused on the value of maintaining discipline in the face of shifting headlines and market volatility.

This issue of the *Long Run* could be considered a coda to April’s commentary—except we will be exploring the other extremes of human behavior in markets.

The Power of Compound Interest AND REGULAR CONTRIBUTIONS OVER TIME

Below, we show how investing \$100 each month at a 10% annual return can generate exponential results—thanks to the power of compounding interest over the long term.

**“The first rule of compounding:
Never interrupt it unnecessarily.”
—Charlie Munger**



The Two Key Ingredients to Growing Money



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Bubbles in Context

First, let's address the renewed use of the word "bubble" in 2025 and place current behavior in the context of what decades of research say about how markets and people interact. We find the term "bubble" most useful as a prompt for better analysis, not as a trigger for wholesale de-risking. As with past episodes, there is genuine economic promise—in today's case, the deployment of artificial intelligence across the real economy—coexisting with very human tendencies toward narrative, extrapolation, and herding.

Behavioral finance gives us practical vocabulary for what we are seeing. Prospect Theory (Kahneman and Tversky) reminds us that losses loom larger than gains, which is why investors who lived through the early-April drawdown felt a strong impulse to sell even as the rebound was forming. De Bondt and Thaler's work on overreaction and mean reversion explains why sharp moves often travel too far in both directions before settling back toward fundamentals.

Barber and Odean documented how overconfidence and excess trading can erode returns, a pattern we see any time short-term narratives dominate daily trading. Shiller's "irrational exuberance" tied price surges to powerful stories and social proof—features of every boom, including today's enthusiasm for AI. And the cycle frameworks associated with Minsky and Kindleberger—displacement to boom to euphoria to profit-taking to panic—help us monitor when leverage and expectations may be having more influence on equity prices than company cash flows.

Lessons Learned

Three practical lessons stand out from this year's whipsaw. First, recoveries often begin in close proximity to the worst market days. That reality rewards investors who stay disciplined about risk positioning and use rebalancing to respond to volatility rather than abandoning allocations altogether.

Second, quality matters most when market narratives are loudest and volatility is elevated. Companies with healthy balance sheets, conservative financing, and transparent reporting tend to absorb policy shocks and demand swings with far less drama than their peers.

Third, long-term perspective matters. We believe that long-term investment success is driven by the steady compounding of earnings and cash flows inside businesses that solve persistent problems for customers over time. This is why short-term trading strategies tend to get in the way of long-term investment success more than they help.

We continue to see many of the same risk contours that concerned us in April: i.e., pockets of opaque credit, governance gaps, and leverage-dependent business models that can falter when funding costs or policy expectations shift. Volatility is likely to remain elevated while markets sort through these cross-currents.

Recent corporate failures underscore the point. First Brands Group, an auto-parts roll-up, has been reported in court filings and subsequent coverage to carry more than \$8 billion in obligations when including inventory-backed financing and related entities. Separately, the collapse of Tricolor, a subprime auto lender, has produced sizable lender losses, with one major bank disclosing a charge-off of nearly \$170 million, with industry commentary suggesting combined losses across creditors could reach into the hundreds of millions. The common features are familiar: rapid growth supported by complex financing, weak disclosure, and underwriting that looks sturdy right up until it is tested.

Looking Ahead

Our guidance is straightforward for this period of new growth and new market highs, and it has not changed. Stay committed to your strategic risk allocations and let rebalancing—not prediction—do the heavy lifting when headlines turn. Favor businesses that can fund themselves, that surface risks rather than bury them, and that turn innovation into repeatable cash flows. Above all, *know what you own and why you own it* so that temporary stress does not derail long-term plans.

We own a wide range of AI-centric investments, but our equity portfolios are intentionally diversified across multiple, distinct growth engines. We see durable opportunity in: water infrastructure and quality as aging systems are replaced; grid modernization and electrification as transmission, storage, and demand-response capabilities scale; industrial automation and robotics, as manufacturers pursue higher throughput and precision; healthcare enablement that lowers cost while improving outcomes; circular materials and waste-reduction technologies that reduce lifetime costs; and secure digital infrastructure that underpins identity, payments, and data integrity in every environment. Each of these themes improves economic resilience without depending on a single policy path or sentiment regime.

This is a time of opportunity for investors who are curious rather than judgmental. It is also a time of increased volatility in markets that rewards those who understand their holdings, align portfolios to durable earnings power, and invest in strong companies capable of sustaining growth through a wide range of economic and market environments. 

SOURCES: AAll Investor Sentiment Survey (2025); Multpl (2025); Reuters reporting (Apr–Oct 2025); Fortune (Sept 2025); J.P. Morgan Private Bank (2024–2025); Hartford Funds / Ned Davis Research (2025); Alight Solutions (2025); PLANSPONSOR (2025); UNFCCC (2020); Carbon Brief (2025); Kahneman & Tversky (1979); De Bondt & Thaler (1985); Barber & Odean (2000); Shiller (2000); Kindleberger (1978); Minsky (1986).

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