



QUARTERLY LETTER, OCTOBER 2026

Fellow Investors,

Adjusted for inflation, the U.S. economy grew 2.2% year-over-year in the second quarter of 2026. This was a bit lower than the 2.6% growth we saw in the first quarter, but was similar to GDP growth in 2025, which averaged 2.1% year-over-year over the four quarters. Unemployment was also largely unchanged, with the U-3 rate at 4.1% on 8/31/26. The latest inflation number, as measured by the Consumer Price Index, was 3.4% on 8/31/26, down from the recent peak of 4.2% on 5/31/26.

With inflation above the Federal Reserve's target of 2%, the Fed decided to raise the Federal Funds Rate target by .25% at their September meeting. Their target is now 3.75% - 4.00%. Interest rates in general have been rising all year, with the interest rate on the 10-year treasury bond starting the year at 4.17%, rising to 5.28% on September 29th. The 30-year conforming mortgage rate has similarly moved from 6.25% at the beginning of the year to 7.18% on September 28th. Historically, a good rule of thumb has been that short-term interest rates should be approximately the rate of inflation and long-term interest rates should be approximately the sum of real GDP growth and inflation. If we apply that rule of thumb today short-term rates should be 3-4% and long-term rates should be 5-6%. That's pretty much where they are.

To summarize the economic picture: decent GDP growth, low unemployment numbers, higher than desired inflation, and rising interest rates.

As I did last quarter, let's review my standing questions. The questions are listed below in italics, with our updates in bold letters.

- *When will the AI boom end?* **Clearly not yet. Even though we are seeing public resistance to building data centers and public calls from the leaders of AI companies to slow the pace of development (I'm scratching my head trying to figure out the motivation for this—no conclusions yet) hundreds of billions of dollars continue to be dedicated to building out AI capabilities. Our direct exposure to AI companies remains very low.**
- *Will the tailwinds for gold continue?* **The price of gold bounced in August when Treasury Secretary Bessent announced support for the Japanese Yen. Basically, to support the Yen he had to buy Yen, which means he had to sell something else—in this case he sold Euro. To provide ongoing support will probably require the sale of U.S. dollars. All things equal this will devalue the dollar, hence the rise in gold. The price of gold is now flat year to date. Our reasons for wanting exposure to gold remain unchanged, and our investments in gold related companies are likewise unchanged.**

- *Will the tariff and regulatory upheaval we saw in '25 settle down, allowing CEOs to start making long-term decisions again?* **Tariffs remain turbulent. The latest round of tariffs was on imports from Canada, and of course the Canadians responded with fresh tariffs of their own. The Supreme Court ruled many of the tariffs initially imposed by President Trump unconstitutional, requiring the government to refund the tariffs it collected. In response President Trump imposed more tariffs under a different authority. So there has been a lot of tariff chaos this year. CEOs seem to have adapted pretty well and rarely mention the impact of tariffs anymore.**
- *What will inflation do this year?* **Inflation in the 3rd quarter was 3.4%, down from 4.1% in the second quarter. However, a bounce in oil prices back above \$100 per barrel may foreshadow higher CPI readings ahead. The persistence of above-target inflation has prompted the Federal Reserve to raise interest rates this month. Inflation has also become a political issue for the upcoming elections. Our expectation is for inflation to remain in the 3-4% range for the foreseeable future.**
- *How long will the Iran war last? I have no idea. How high will oil prices go?* **\$110 per barrel. Clearly, I was too optimistic last quarter when I wrote that the Iran War was largely behind us. The Memorandum of Agreement between the U.S. and Iran has completely fallen apart, the Iranians continue to interdict the Strait of Hormuz and are encouraging the Houthis in Yemen to attack Saudi oil shipments through the Bab al-Mandab Strait. The U.S. blockade of Iran continues. I see no improvement over the last two months and have no reason to believe the war will end soon.**

This quarter I put some money to work. Among the purchases are an integrated oil company, a software company, and an animal health company. I purchased the oil company because I am now concerned that the Iran War will result in higher oil and refined products prices for much longer than most people think. This purchase will provide a good hedge if that happens. I purchased the software company and the animal health company because their valuations are very attractive.

As always, please contact us if you have any questions; we'd love to hear from you!

Jeff Muhlenkamp, Portfolio Manager
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Consumer Price Index (CPI) – *measures the average change in prices over time that consumers pay for a basket of goods and services, commonly known as inflation.*

Federal Funds Rate – *the interest rate at which depository institutions lend balances held at the Federal Reserve to other depository institutions overnight. It is the interest rate banks charge each other for loans.*

GDP (Gross Domestic Product) - *is the total market value of all goods and services produced within a country in a given period of time (usually a calendar year).*

S&P 500 Index® (Standard & Poor's 500) - is a stock market index that tracks the performance of 500 leading publicly traded companies in the United States. The S&P 500® Index is weighted by market value and its performance is thought to be representative of the stock market as a whole. One cannot invest directly in an index.

U-3 Unemployment Rate - U-3 is the official unemployment rate published by the U.S. Bureau of Labor Statistics (BLS). It measures the total number of jobless people (aged 16 and older) who are available to work and have actively searched for a job in the past four weeks, expressed as a percentage of the labor force.

Past performance does not guarantee future results.

The comments made in this letter are opinions and are not intended to be a forecast of future events, a guarantee of future results, nor investment advice.

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