

*Marble Harbor Investment Counsel, LLC
Second Quarter, 2023 Letter*

We are pleased to send an excerpt from our quarterly client letter that discusses our current thinking. We welcome your thoughts.

Sincerely,

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Computer Generated Art by OpenAI

Any sufficiently advanced technology is indistinguishable from magic. – Arthur C. Clarke

In the words of our mentor, Brad Perry, investing is a marathon. We position your portfolios for the long-term, buying diversified, quality companies with reasonable valuations. This approach has stood you in good stead over many years. In 2022, when markets were difficult, your portfolio was resilient. However, in a marathon, sometimes there are intermediate sprints. At the time of this writing, ten of the market's largest companies* have dashed ahead – up an average of 50% for the year – while the rest of the pack has stepped back from the starting line – down about 3%. Your portfolio is built for the long term, not for an unusual six month sprint.

The stocks leading the pack are mostly participants in the current fashion that is sweeping the market – the Artificial Intelligence (AI) revolution. You may have read about, seen or used ChatGPT, the groundbreaking artificial intelligence application.

When we say fashion, we mean it. The earnings of these companies are up 3% this year – not bad. Yet, valuations – what investors are willing to pay – are up 47%. There is a lot of enthusiasm and FOMO (Fear of Missing Out) about AI that reflects earnings growth that may materialize someday, but this year's market reaction is simply portfolio managers projecting today's hopes and fears onto an uncertain future. We are witnessing a stampede to buy the picks and shovels for a gold rush that doesn't yet exist.

We have been following the arc of AI for a number of years, and ChatGPT represents a step-function improvement in usability and functionality. You own some of the participants in the great stock market scramble to embrace AI, but not all of them. Indeed, you would have to have



a very concentrated portfolio of tech stocks to have kept up with the market this year. As pleasing as that might sound in the short term, it would represent a risky trip to the casino as a long-term strategy.

This year's narrow market – where a handful of companies drive performance – is the most extreme in history. Never have so few companies galloped ahead while the rest of the field stood still. Historically, after a period like this, there is a time of moderation. Though valuations of these companies are not cheap, they are not yet at the extremes we saw in the Tech Bubble of 2000. Current valuations look more like they did in 1999, a year before the bubble popped, so there may still be room for this frothiness to persist.

What is ChatGPT? While it may engage in a bit of self-promotion, let's ask it to describe itself.

The following was written by ChatGPT.

Q: What is ChatGPT and how will it affect the business landscape over the next few years

A: ChatGPT is a special computer program that can have conversations with people. It is like a virtual assistant that can understand what you say and respond in a way that sounds like a human. It uses a lot of information from the internet to learn how to talk like us.

In the next few years, ChatGPT will have a big impact on businesses. It can help with things like customer service, marketing, and understanding what people are saying online. For example, it can answer common questions from customers quickly and help create content for websites and social media. It can also analyze a lot of information to find out what people like and what is popular.

Businesses can use ChatGPT to make virtual assistants and chatbots that can talk to customers and help them with their needs. It can also help translate languages and make sure businesses communicate well with people around the world.

While ChatGPT is really helpful, there are some things to be careful about. We need to make sure it respects privacy, doesn't have any biases, and is used responsibly. But overall, ChatGPT will make businesses more efficient and improve how they interact with customers in the future.

We have started to use ChatGPT in a limited way in our research work. It is like having a lightning fast, overeager intern. Questions must often be rephrased several times. Answers, while delivered quickly, are often wrong or off the mark. Work must be reviewed carefully. While much time can be saved for certain tasks, it is far from perfect.

In the conferences we attended this quarter, each management was asked how they were using AI. Uniformly the answers were vague, though soaring with visionary language. All companies are experimenting with the technology, but few have found how it will integrate into their business model. When we saw the CFO of the consulting firm, McKinsey, speak about AI, it



was clear (and he admitted) that he knew little more about the technology than the rest of the audience. While businesses have a shiny new object, they still must figure out how to get it from being merely a toy to a critical tool.

ChatGPT and other AI will be significant productivity boosters for businesses in the coming decade. The promise is that AI will be as pivotal a technology as the PC revolution in the 1990s, the Internet in the 2000s, mobile computing in 2010s, and cloud computing in the late 2010s and 2020s. Winners and losers will emerge over time. No one predicted the emergence of radical business models like Uber or TikTok before the smart phone; no one knows what enterprises will be built on the back of artificial intelligence. This year's sprint of the favored few AI winners is not the finish line, rather it is the opening mile of a very long race. We are confident that your companies will adopt these innovative AI tools and compete well in this investing marathon.

At the end of June, our friend and Advisory Board member, Brad Perry, died peacefully, surrounded by family. While some of you knew Brad, either from his days at David. L. Babson & Co., where he retired as CEO, or more recently at Marble Harbor, all of you benefitted from the help and guidance he gave us, especially in the early years of our firm. Brad's ability to focus on what was important was remarkable, as was the clarity of his thinking and perhaps more importantly, his ability to express these insights. Whether it was exhorting an analyst to "Do the math!" or calling out the absurdity of a company's valuation or a management's questionable actions, Brad was never obscure in his meaning, though he was unfailingly decent and respectful. We were privileged to work with him for more than 25 years, and during that time he was both generous with his time and a keen teacher. Time spent with Brad was always characterized by studied, fact-based and strongly-held positions. That said, Brad had a rare capacity to learn, evolve and change his mind throughout his life. His respect for and pursuit of truth allowed him to see things for what they were, not necessarily what he wanted them to be.

We are so fortunate to have been beneficiaries of Brad's deep and broad experience; however, the hallmark of his character was his kindness and humanity. He was a true gentleman and took seriously his responsibilities as a person who had achieved so much in his life. We'll all miss his wit and insight and know we are better people for having known him. What he supported continues and will thrive from the foundation we've laid over the past 18 years. Thank you, Brad.

Sincerely,

Paul, Eric, LJ, Dan and Howie

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