Marble Harbor Investment Counsel, LLC
Fourth 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,

Paul Davis, L.J. Harrington, Eric Robb, Daniel Rosenblatt and Howie Cowan

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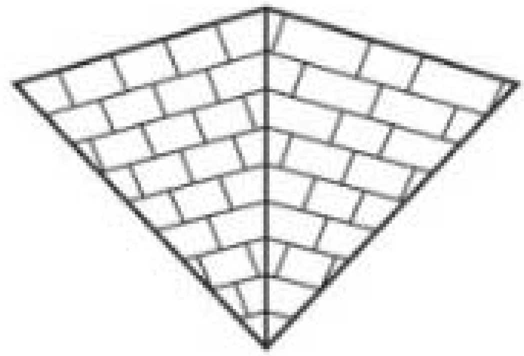
We don't spend much time pondering the unknowable, for example, the future direction of the economy. When so much ink and air time are spent on such speculation, you may ask "Why not?" The quality companies you own are not primarily beholden to economic cycles that are out of their control, rather they have far more command of their own long-term destinies than the average company. Sure, in a severe recession or rocketing economy they might shrink a little or jump ahead, but your companies are more like all season tires: They won't go as fast as slicks on a track, but neither will they slide off the road when they inevitably encounter ice or snow on the pavement. We're New Englanders, and by nature we're prepared for inclement weather.

Most investors and speculators, on the other hand, think quite a bit about the economy, and many view certain indicators as critical predictors of its direction. Reading tea leaves, such as the price of commodities ("Dr. Copper") or inventories, are followed with religious devotion; however, few are followed as closely as interest rates. Lately, the needle on this barometer has been jumping around. The great debate is whether the post-COVID rebound and the resultant inflation was a transient product of lockdowns and inventory cycles or if it was a more insidious, persistent, 1970s-style inflation that would require a Volker-like recession to tame it. It seemed to us that inflation would abate as we got further away from the COVID disruptions, and this would allow the Federal Reserve to relax its interest rate policy and spare the economy.

The economic data at the November Fed meeting certainly seemed to indicate that the worst of the inflation was temporary and behind us and that the Fed could start on the path of lowering interest rates. This already seemed like the most likely outcome to us and would have little effect on how our companies would perform. The market, however, treated this as an inflection point, and some stocks appreciated 20 to 30% in a matter or weeks. We know the value of some of your businesses didn't grow 20% in a few weeks, but apparently the market thought they did. The good thing about buying quality businesses at a discount is that you can develop comfort with their long-term value – if you're patient, you know that eventually the rest of the market will recognize that value.

The rally at the end of the year included many types of companies that had been at best flat during most of 2023: real estate investments (+18%), smaller companies (+17%), companies with strong dividends (+10%) and regional banks (+25). Up until November, what worked in the stock market was the share price recovery of the Magnificent Seven (Amazon, Apple, Facebook, Google, Microsoft, Nvidia and Tesla) – the largest tech companies in the market, and ones that are viewed as Artificial Intelligence (AI) darlings. As you'll recall, we discussed these companies at length in our second quarter letter (*http://tinyurl.com/q2-letter*). It's important to remember that although the Seven were **Magnificent** this year – up more than 100%, they were **Miserable** last year – down 40%. The S&P in 2023 was the most concentrated it has ever been, with the Seven making up 28% of the index. This is much like an upside down pyramid with the weight of the whole market resting on a few companies. As you can imagine, this can be a precarious balancing act. The index was powered by the Seven, which were up 26%; excluding the Seven, the other 493 were up a more modest 13%. Because 2023's performance came on the heels of 2022's loss of 18%, over the last two years of dramatic volatility the S&P has returned just a few percent and the NASDAQ has actually lost money.



Beyond the Magnificent Seven, the market was obsessed by the GLP-1 obesity drugs. By now we imagine you've seen the storm of TV ads. We have spent several years researching and talking to doctors about GLP-1s. Novo Nordisk's Ozempic and Eli Lilly's Mounjaro are diabetes drugs that have a sought-after positive side effect – significant weight loss. They were used for weight loss off label and created quite a buzz with the Hollywood and Silicon Valley set. The companies performed follow-on clinical trials, and then the drugs were approved for weight loss. GLP-1s induce satiety by tricking your gut and your brain into thinking that you are full while the desire for food also abates. Patients just don't feel like eating, and their caloric intake drops to about 800 calories a day. Combined with diet and exercise, this can result in the loss of 20% of body weight.

Obesity makes many other conditions such as diabetes and heart disease worse. Recent studies have shown that GLP-1s can reduce the risk of heart attack by 20%. What else might they treat? If this wonder drug – which you have to take forever – fixes everything, then clearly we will sell fewer stents, diabetes monitors, artificial hips and knees – not to mention snack food. This is exactly what the market decided would happen, and while Eli Lilly and Novo Nordisk stock grew to the clouds, medical device and food stocks traded for a hill of beans.

We've all read the story of *Jack and the Beanstock* and know that magic beans typically come with some hobgoblins. Most medications have side effects, and those for the GLP-1s are particularly unpleasant: With the rapid loss of fat, "Ozempic Face" is a real thing. They also include many major GI issues, loss of interest in food, and both muscle and bone wasting. Doctors with whom we have spoken say their patients have struggled with these side effects, consequently they don't recommend the drugs for the long term, and when patients discontinue the drugs, the majority of them gain back the weight, unless they are able to keep their diets in the 800 to 1,000 calories range. Oh, and the weight that returns is 90% fat and only 10% muscle.

While GLP-1s represent a new, important therapeutic category of drugs, especially for Type II diabetes, they are not the panacea that the market would have you think they are. Plus, these drugs will not impair medical device or snack food companies. In fact, through our discussions with the diabetes device companies whose patients have been on diabetes drugs for years, we learned that the use of Ozempic actually leads to *more* demand for Continuous Glucose Monitors, not less.

The market is increasingly dominated by passive indexing and short-term speculators who follow the momentum wherever it takes them, regardless of fundamentals. This past year, they charged into the Magnificent Seven and GLP-1s, only to rush into smaller companies and high-dividend stocks when they thought the interest rate environment had changed. While this can be a frustrating time to be a fundamental investor, it is also a fertile time to look for hidden gems. Because the market often overlooks what we believe are good values, we have a full slate of companies we would like to buy at the right price. We know that with patience, the market eventually recognizes quality, and we will be there for you.

Sincerely,

Paul, Eric, LJ, Dan and Howie

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