BECK MACK + OLIVER

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Market Update

During the first quarter of 2025, the S&P 500 generated a total return of negative 4%. Much has been made of this market selloff in the popular financial press, especially with respect to the new administration and the prospect of an economic slowdown. The starting point, however, for thinking about the equity market's performance over the last few months should be its performance during the last couple of years. The S&P 500 generated a total return of +26% in 2023 and +25% in 2024. As such, cumulatively through 3/31/25, the S&P 500's total return has been +20% since the beginning of 2024 and +51% since the beginning of 2023; the index's level at quarter-end was approximately equal to its level in September 2024. Thus what may feel like a sharp market drawdown looks more like a numerically modest correction when a somewhat longer time horizon is considered. Indeed, during the five- and 10-year periods ending 3/31/25, the S&P 500 generated *annualized* returns of +19% and +13%, respectively.[1]

While market movements over short periods of time tend to reflect more noise than signal, the recent choppiness does seem to have been partly driven by perceived disruption and uncertainty related to the new administration's policies, perhaps the most salient of which has been tariffs.[2] Not for nothing, almost all economics textbooks are critical of tariffs, which fail the simple utilitarian test of the greatest good for the greatest number. In the presence of a tariff on imported foreign goods, the relatively concentrated benefits that flow to the protected domestic industry (and to the employees and shareholders of businesses in that industry) will be more than offset by the more widely diffused costs borne by everyone else, which primarily manifest in higher prices for the goods in question, both foreign and domestic. If tariffs are to be justified, they must be justified on particularist grounds—e.g., manufacturing a good domestically for national security reasons, or assisting workers in a certain sector as a political objective. Even if those conditions are met, however, the impact on aggregate economic growth is likely to be negative, which in turn is negative for the broader equity market.

The second-order effects of tariffs, which relate to greater uncertainty, may be even more pronounced than their first-order effects of slower economic growth. It's one thing if real GDP growth is going to be, say, 1.9% instead of 2.2% due to the direct consequences of a new tariff regime. It's another if a corporate management team is deciding whether to build a new factory or hire more employees, but does not know whether its foreign competition is about to be put at a 25% disadvantage or, alternatively, whether its own input costs are about to increase by 25%.[3] In such straits the prudent thing to do is to wait, but that means for the time being that the new factory isn't built or the new employees aren't hired, which in turn will slow down current economic growth. Whether it's businesses deferring decisions regarding capital investment or households deferring the purchase of a new car or a family vacation, greater uncertainty leads to slower economic growth via its impact

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[1] Higher annualized returns over the last five years as compared to the last 10 years are due in part to the former's pandemic starting point.

[2] In our last two newsletters, we discussed why we did not implement changes in our clients' portfolios specifically in anticipation of the November 2024 elections. The market's gyrations since the elections suggest the difficulty, and perhaps even the futility, of trying to predict the market impact of election outcomes. For prior client newsletters, please see our website: https://beckmack.com/.

[3] Tariffs can be applied to goods that are sold to consumers or to other businesses that use such goods in their own manufacturing processes.

on economic decision-making. The corollary is that whichever tariff regime we are headed towards, it would be better to know sooner rather than later.

As business analysts and individual stock-pickers, the best we can tell is that the economy continues to grow albeit at a somewhat slower rate given the aforementioned factors and related issues, such as actual or anticipated reductions in the federal workforce, lower immigration, and the uncertainty associated with policy proposals whose practical implementation remains indeterminate. With regard to existing and potential new investment ideas, we routinely inquire into what the earnings power of an individual business could be in five or 10 years. Recessions are an inevitable, periodic economic occurrence, and when a stock is owned for many years chances are that it will be owned through at least one recession. The best businesses tend to become competitively stronger during recessions—as they are better able than their competitors to take advantage of dislocation due to some combination of healthier balance sheets, smarter capital allocation, and superior management and operations—which then positions them well for the eventual resumption of economic growth. In the months ahead, we expect many companies that are struggling for any number of reasons to "blame the macro," which can serve as a convenient scapegoat, while those that continue to thrive may issue sanguine if any commentary on the economy. The truth may end up residing somewhere in between these dueling narratives, and as the actual economy waxes or wanes in the months ahead, we of course intend to take advantage of any stock-specific opportunities.

Research Update

In our most recent newsletter, we provided a non-exhaustive list of topics and questions that the Beck Mack + Oliver investment team was actively researching or that were otherwise relevant to the companies that we own or follow. Among those various items, the ongoing cycle of capital investment into technology related to artificial intelligence remains an area of intense research interest. Previously, we noted the enormous amounts of capital being deployed into technology such as semiconductor chips and data centers, and we posed the questions of what kind of return all this investment might generate, how quickly investment levels might be recalibrated if returns appeared to be insufficient, and whether these developments would tend to strengthen or weaken the competitive positions of the dominant incumbents.

Earlier this year, many of the largest technology companies, including Alphabet (Google) and Amazon, indicated that capital expenditures would be significantly higher in 2025 than they were in 2024, as they continue to invest in technology and infrastructure related to artificial intelligence. Management teams generally believe that the future returns on all this capital outlay, though difficult to quantify with any precision, will prove to be attractive, and that the risk of underinvestment is greater than the risk of overinvestment. This outlook is situated in an industry in which the pace of change remains very rapid. For instance, the recent release by DeepSeek, a Chinese company, of a large language model, caught many industry participants and observers off-guard. Technical requirements of such models continue to evolve, which affects both the quantities and types of semiconductor chips that they utilize. At the same time, the industry has witnessed a great deal of financing activity, such as the leasing of data centers and the issuance of debt collateralized by semiconductor chips. A company involved in both activities just completed a large initial public offering. We are carefully watching the intersection of rapid technological change and financial risk-taking for any signs of stress.

Another important ongoing investment theme is the efforts by alternative asset managers, such as Apollo and Blackstone, to augment their presence in the private wealth or retail channel. For decades these businesses have served institutional clients such as pension funds, endowments, and sovereign wealth funds, and they continue to do so. In recent years, they have expanded the distribution of their investment offerings to individual investors—e.g., Blackstone Real Estate Investment Trust (BREIT) and Apollo's leading fixed annuity business—and this channel accounts for a rising portion of the companies' capital-raising. Apollo recently launched a "public & private" exchange-traded fund (ETF) where some of the assets will be less liquid debt investments. We believe there is a large and compelling potential opportunity to access 401(k) plans, which would likely require modification of prevailing regulatory guidance from the Department of Labor.

Portfolio Update

Enstar Group, an insurance company that acquires and manages “runoff,” or discontinued, insurance liabilities, last year announced that it would be acquired by a financial consortium for $338 per share in an all-cash transaction, which is expected to close in the middle of this year. Beck Mack + Oliver has owned Enstar for many years, during which the company has grown its book value per share at attractive rates. As the expected closing of the transaction approaches, we have increasingly sold Enstar stock in order to rotate capital into other investments.

One such investment is Somnigroup International, formerly known as Tempur Sealy International, the mattress manufacturer. For many years we had followed Tempur under the leadership of CEO Scott Thompson, who previously had been CEO of the rental car company Dollar Thrifty, where he took over in the depths of the 2008 global financial crisis when Dollar Thrifty’s share price was around $1 and in 2012 sold the company to Hertz for $87.50 per share in cash. In 2015, Thompson joined Tempur as CEO, president, and chairman, and he successfully led the company’s expansion into new product categories and geographies and also repurchased a substantial amount of stock, which contributed to strong financial performance for the company during a period in which various competitors were running into financial difficulty.

In 2023, Tempur announced the acquisition of Mattress Firm, the largest specialty mattress retailer. We were intrigued by the strategic logic of the proposed transaction, which would vertically integrate manufacturing and distribution. The combination could lead to greater market share of the various brands, place competitors at a greater disadvantage, and facilitate direct access to customer relationships and data. There would likely be a significant amount of expense synergies given scale efficiencies and the overlap between Tempur’s retail locations and Mattress Firm’s. In 2024, however, the Federal Trade Commission (FTC) blocked the transaction on antitrust grounds.

After drawn out litigation with the FTC, a judge ruled in the companies’ favor, the transaction closed in February of this year, and the company was renamed Somnigroup. We believe that Somnigroup is the best operator with the best CEO in an attractive industry. We are excited about the company’s earnings growth potential in the years ahead, especially in conjunction with the strategic and financial benefits of the Mattress Firm transaction.

We also like the end-market, which has tended to grow 5-6% over long periods of time, benefiting from both growth in units sold and favorable pricing, but which has softened in the last few years as existing home sales have been depressed. We believe Somnigroup can grow earnings at attractive rates over the next few years even if industry units sold remain near their current cyclical trough. When industry units sold eventually recover to more historically normal levels, perhaps in conjunction with a normalization of existing home sales, that would be accretive, or additive, to the scenarios that we have underwritten. Based on what we have conservatively modeled, we estimate the stock is valued at roughly 12x what the business could earn within a couple of years and perhaps 5-6x what it could earn by 2030. Finally, Thompson personally owns more than three million shares of stock, which aligns his interests closely with ours.

Partners of Beck Mack + Oliver