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Wealth Client Office Hours

Eshani Gupte: Good afternoon everyone, and welcome to Office Hours with the CAPTRUST Investment Team. Before we get started, I'd like to go over a few items so you know how to best participate in today's event. You have joined the presentation listening, using your speaker system by default, and all attendees lines are automatically muted and in listen only mode.

We encourage you to take this opportunity today to submit questions to our investment committee members. Please type your questions into the q and a box on your console, which you can view or minimize by selecting the icon at the bottom of the screen. You may send in questions at any time during the presentation.

These questions will be addressed during our q and a portion of the event or as a post-event follow up today. Today's webinar, excuse me. Today's webinar is being recorded and you will receive a follow-up email within the next week with a link to view the recording. And with that, I'd like to introduce our chief investment officer, Michael Vo Vogelzang.

Mike Vogelzang: Thanks Eshani. And hello everyone. And thanks for joining us on a quiet day in the markets. Not exactly as Eshani said, I'm Mike Gelang. I'm the Chief Investment Officer here at CAPTRUST. I'm joined today by two of my close colleagues, Jim Underwood, who oversees our allocation strategies and portfolios, and Christian Ledoux who manages our individual stock portfolios and the research team that feeds those portfolios.

A quick housekeeping note today, this is for educational purposes. We're going to discuss markets, market scenarios, portfolio construction ideas, and other things around the investment world. So nothing today should be taken as individualized investment tax, or legal advice. Your personal situation is unique as you all of course know.

So please follow up with your advisor for any specifics or questions pertaining to your particular situation. One quick shout out to the team that's helped us put this together. Our communications and strategy team, Sam Kirby and Hanani Gupta, who you just met, and Emma Grace is also here helping putting these

slides together, has done yeoman's work over the last week and had really helped us pull together some really interesting stuff we hope and in a very changing world.

So let's jump in. In a widely read article last week an analyst named Matt Schumer, an AI programmer by. Published an essay. It got a lot of press. It's called Something Big is Happening. The essay was designed to change our perspective on AI's progress, its impact on jobs, the economy, and the, and society.

His main point, no matter how fast you think AI is coming, it's coming faster. By the way, we'll refer to a number of articles and so on. In today's talk, we'll make sure we provide links to these articles and more that we discuss today. So today's goal is really simple and then is to explain how we on the CAPTRUST investment Committee think about challenges like the one Matt Schumer laid out.

We're gonna explain what we think is changing, why it matters for markets and for portfolios and honestly what we're trying to do about it. And of course as we prepare for the webinar today over the last week or so with our preparations this weekend through was a curve ball with the beginning of hostilities in the Middle East with the American bombing of Iran.

We will provide every opportunity for your questions in this topic, but mostly we believe financial events have typically had a longer lasting impact on markets than geopolitical events. We're clearly trying to sort out what's happening in the Middle East today. We've got oil prices are higher. The stock market was down today, but then it recovered about half of its losses.

There should be some nervousness, of course. But we think again, honestly, that the changing of the guard at the Federal Reserve is potentially much more impactful to the market over the next couple of years than a geopolitical flare up or potentially even something more than that. So we're incorporating some comments about Iran here, but they're relatively new and we don't think we have a it will have a huge impact on markets as we've seen the last few days, unless things go vastly differently than they're going today.

Let's start where clients are coming from, what their last quarterly savings shows. The last few years have been an excellent time to own risk assets. Prices have risen tremendously. Valuations have risen. Corporate profitability has been super strong. That, of course, is the headline. Most portfolios, by the way, reflect at least some participation in this incredible bull market We've been in.

The chart here shows the last three years of the US stock market progress. The darkest line in the middle is the S and P 500 of 78%. The lower line shows the Russell 2000 an index made up of much smaller companies, a little less than half the return. The top line is of course the magnificent seven stocks and if you haven't been paying attention, that consists of folks like Apple, Microsoft, Nvidia, Meta, which is Facebook, Google, Tesla, and I'm missing one.

I can't recall. Amazon. Thank you. By looking at this chart, you can almost feel how the Mag seven has pulled up the averages just by themselves. But underneath that headline, there are some important subplots developing and changing almost as we speak today. The first is that the AI narrative has been a major pillar of market confidence.

The idea that AI drives productivity drives GDP, which of course drives and supports earnings and valuations in the markets. Number two is the market has become more sensitive to whether you are on the benefiting from AI side or the disrupted by AI side of the street. That sensitivity is new and it's accelerating and it's worth exploring.

We have a couple of charts to talk about that later,

but first, let's zoom out for the next five, 10, or maybe even 20 years. This graphic made by AI, by the way we've used this before. Provides the context for our discussions today, and this is the big context, the 60,000 foot view. The world is wrestling with two time bombs. The massive debt loads we have and demographic challenges.

The big debt loads governments have around the world carry risk that as demographics shrink, there's more people per dollar of debt, right? And so to pay off that debt requires something more than just business as usual. What it requires to worry about all of those issues is AI and productivity, getting more output per worker, and that's the tension that's in the market today.

The pessimists would point to debt and demographics, the optimists point to AI and productivity enhancement that we believe and many believe are coming. This next slide is one of our favorites, certainly one of my favorites in the industry. This graphic, it provides a useful way to think about investing.

Very often we get stuck on the road that we think we've been on, as it was somehow preordained. But when we think about it, we know life isn't this way. On the left hand side, we have, for example, the last three years in the market took this single green path, this green line in the middle of the red possibilities

that, that, again, that green line was in, in sec, in some ways random in response to the actual events as they occurred.

That path could have been any one of the red lines there. After three great years of markets, we again, have many paths ahead of us on the right side of this page. In fact, we're arguing that with the rapid change in technology and the acceleration of ai, the future possible path. On again, this right side of the page are actually growing larger and more wide, even wider than what we had before.

So the question becomes, as investors, how do we build portfolios in this type of an environment where potential outcomes is widening, the potential paths forward are multiplying as we speak? How do we think about building resilient and portfolios that can ride through any of these different opportunities, these different paths that we see ahead of us?

As we said, AI and the magnificent seven stocks have led the way the last three years. They're up substantially more than the average stock in the s and p 500, or certainly more than the Russell 2000, which we saw a minute ago. But since last October, late in the month, actually, we've seen a significant change in tone in that market.

Remember this magnificent seven technology thing has been going on with some interruption for almost 10 years. So let's zoom in and talk about what's changing since this change. We've seen this tone change in, in, in October. Our internal discussions have flagged October 27 or so as the inflection point where market leadership and the tone began to have this big shift.

You can see this on the slide here on the on, on slide number five, the market slide. The market rotation shows the drawdown in technology, so the left hand scale here is just simply dollars, and what it shows is that technology sector has deflated, has lost \$2.4 trillion since just last October. That is the stocks in the in, in the technology sector have dropped by \$2.4 trillion.

We've seen a little outflow from discretionary and from financials as well. If everything else had stayed stable, the market would be down substantially. But we haven't, we've seen the rest of the sectors that have been languishing for five years, all of a sudden begin to add value and create upward power and upward swing.

So real estate materials, utilities, commercial services, staples, energy, industrials, healthcare, have all added value over this last, what is that sort of

four months or so in a market, a big change in the markets? So what's happened? Two things really. AI capital expenditures and infrastructure spending accelerated tremendously.

That's caused market participants to be a little worried about how much money they're spending at Meta and Google and Facebook or and Amazon and Microsoft and so forth. The hyperscalers, as we call 'em. In addition, we saw sharp revaluation of a sharp valuation reset. I'm gonna skip a slide, I'm gonna jump to the next slide here.

In addition, we saw a sharp valuation reset in software, mostly because investors began pricing in the real possibility that AI and the AI tools would undercut software. So let's take a look at this chart a second. Here's the the blue, the light blue line in the middle is the round hill, magnificent seven ETF.

It's just an ETF made up of the mag seven. You can see it's about flat. Since we backed up the timeframe here a little bit back to the beginning of September. Global data center and AI infrastructure, think computer chips, power suppliers con contractors who build these data centers. Energy suppliers and so on have all gone up about 35%, but software during the same period of time has dropped by about 15 or about 25% or so, right?

So we've seen very different and divergent performance just out of technology itself. What's interesting is that we're now looking here at inside of technology. We're seeing this display, this divergence of value in how people are watching. Christian's gonna talk a lot more about software, particularly in a few minutes, but again, as AI is widening this range of potential outcomes in the markets are repricing these ranges in real time.

This is not something that most folks saw coming. I'll give you a quick example of this in the next slide. FactSet is a company that we use internally and in the investment management business widely, it's almost as ubiquitous as Bloomberg. FactSet is a powerful tool that we've used for years and years.

It's a data platform. And in fact, if you look at the bottom and down here in the very light gray sources footnote, it shows that FactSet helped us put this chart together. Okay? So that's the kind of thing FactSet does. We can dig into the markets and pull out all kinds of data. The dark blue the light blue line is their earnings, and you can see that since 2016, over a decade, earnings have risen nicely.

The stock price has moved around those earnings irregularly and gradually, but generally around earnings. Until just recently, the last number of months, we've seen the price effects that fall tremendously as a publicly traded company. You've seen this sharp software sell off even while these earnings continue to move up.

The market's saying that they're worried that FactSet will be disintermediated, will be undercut by ai. This has happened, again across many software companies. This is a real catalyst for a way to think about what AI might do to the stock market generally. Is this just an example?

So this software selloff has kicked off this buzz in the market with a lot of different individual thinking, and we're trying to summarize it here. There's a lot into these things. Again, we will give you access to each one of these articles. There's four articles here that we talk about.

But over the last week or two we've seen very different ideas come out about how AI will or won't impact the future of the markets, the future of labor, the future of the economy, the future of productivity. All of these things are being debated in real time. As I said, the first was written by Matt Schumer.

Something big is happening. He says that change is coming faster than we realize and you better get ready for it. The second one, this first one here on the left called Prosperity Without Paychecks. It's a dismal and do laden view. This was written by a group called Rinni Research.

Perhaps you heard about it. It was written, it was in Wall Street. It was in the New York Times. It was written on all kinds of and showed up on all kinds of TV shows and in memes all over the internet. They did entitled it Prosperity Without Paychecks. Actually, the day it published, it created a market sell off market fell over 1% just from this one article.

The scenario basically posits that ultimately bullish AI will lose so many jobs through ai, that it will actually become bearish for the economy. Incoming jobs very. Dark kind of warning, I think was what the authors were talking about. And by the way, there's some blogs with these folks who wrote this, we're interviewing.

I think they're worth your time if you have some time for for podcasts particularly. The other two on the right hand side of this page are basically counter arguments to the first two, that the economy will transition more

gradually, that labor erosion isn't visible yet, at least, not much more of the status quo that we're living with today.

We believe that the market is pricing these scenarios in today. And when Rinni came out with our negative article, it actually really shook the market, telling you the market's not really thinking along the lines of that sort of doomsday scenario, this exercise that the market's going through, as one of our analysts described it perfectly.

Is effectively laden with massive extrapolation risk, right? We're in the middle of a change. Things are growing, going, changing. Literally month by month, week by week, we're taking these small samples and we're and analysts rejecting very different endpoints. We are all learning as we go.

The point is that it's worth paying attention to. It's something that we have to be aware is changing. So as we go into our AI future, it makes sense for all of us, particularly investors, to be planning for different paths. The day after Citri Today or two after Rinni article published, that is the more bearish article.

We had two very clear tests of this deflation, doomsday aro, a AI spiral as it has been called the company Block. If the, know the payment operator called Square, they've changed their corporate name to block a 3D Square is what they say. And they laid off 40% of their staff and the stock rose 20%.

A terrific example of capital that is ai as Jack Dorsey, the CEO pushes a smaller flatter AI strategy, AI taking the place of labor and the stock moving up because the 40% slash in staff right, very, is this a harbinger? Is this something that we're gonna see more broadly, or is this just simply a single example?

And even I, we think in more comically, literally a week or two after the post Labor Day the post a week or two after sat trini the right hand side of this page was the announcement of a post labor leaders exchange traded fund. Leave it to Wall Street to take an opportunity and run with it very quickly.

So some Wayang, not us. This was I can't remember the name of the, in the ETF provider, but it certainly wasn't CAPTRUST came out with an announcement that said, in part 80% of his assets will dur, will invest in companies that they believe are durably positioned to enable benefit from, or lead through the transition to a post labor economy, which refers to a broad economic shift and which automation et cetera, replaces and augments human labor across industries.

So here we have in this couple of weeks an article that surprised Wall Street and even Main Street with its dour warning about AI and potential deflation. And all of a sudden there's a couple of things happening in the market. So again, something we really need to pay attention to and something worth thinking about.

We look at this and we say. What's important here is to prepare in the market rather than predict where the market's going. Prepare for extremes. We have these two extremes in these opinions. Our job is to make sure that we think it through. This is this prepare rather than predict slide. So think about this is the right side of that slide I showed you earlier.

So today we're at that far left dot outcome. A is this productivity growth without inflation. This is the best possible outcome. It's good disinflation that is low inflation. Demand remains efficiency gains. Basically, think about this one as everyone's gonna be rich, right? We'll have moderating house prices, we'll have moderating medical prices.

Education will be a lot less expensive. Transportation and energy will be improved and made cheaper. This will be a wonderful world if we can get there. On the other hand. We had this de deflationary demand shortfall and policy response of the citri piece. Between this, you can drive a couple thousand Mack trucks.

And our job as portfolio folks is to make sure that we're building portfolios that are resilient and can ride through all of these different times. And lastly we're not just watching, but we're trying to prepare. We're working hard on preparing. We have dashboards we're building to follow exactly these details.

Lemme give you one example. I'm not gonna read the whole chart. But on the top right, on the right hand side, you see our ai, we're monitoring AI driven shifts in the center there on the top right. We're looking at entry level hiring. We believe that if recent college graduate hiring tapers off substantially, it's already soft a bit.

But if it tapers off substantially and pricing for entry level for recent college graduates starts to fall, that is wages for recent college graduates starts to fall. That's gonna be a significant input into what path we're on as we talk about these issues. Again, prepare rather than predict.

That's our investment strategy and our philosophy as we build portfolios that our clients take care of. So with that this was the easy part, doing the analysis.

The hard part is with Jim and Christian to talk about how they build portfolios. I'm gonna turn it over to Jim and he can chat a little bit about about how we think about portfolios.

All yours, Jim.

Jim Underwood: Thank you, Mike. I often hear the words risk and uncertainty used interchangeably and, but in the investment world, there really is a distinct difference between the two. Frank Knight in his book, risk, uncertainty and Profit pointed out this distinction and it's illustrated on this page.

He said, risk is an unknown outcome, but the distributions of outcomes is known. So you know, where it's, you don't know what the outcome is going to be, generally what's going to be the distribution of those outcomes, they're gonna fall within some type of understandable profile.

Uncertainty is a much, much broader topic, and that's because you have both an unknown outcome and an unknown distributions of outcomes. And while I certainly understand that's complicated, I think today, whether we're talking about the disruptive potential of artificial intelligence or the geopolitical tensions in the Middle East.

We find ourselves really confronting rising levels of uncertainty. And so I'm gonna spend a couple of minutes talking about how do investors prepare for periods of heightened uncertainties.

I, I would say for most people if you have a disciplined investment strategy, these recommendations are probably something you do on an annual basis. But if you don't do that, and I would argue, and we'll see at the very end of this presentation, it's pretty expensive to do some of these things because of the tax burden given the tremendous gains that we've seen.

But again, I would recommend anybody that hasn't done these three things to really think through your portfolios, the first is to review your financial plan. One of my probably most basic fundamental investment principles when we build portfolios. And I want to focus on the probability of success, not the magnitude of success.

We've just come through three consecutive years of strong equity returns. I think this is an ideal time to step back and evaluate where you are on your financial journey and confirm that your current allocation is aligned with what

your long-term goals are and still optimizes that probability of success instead of just continuing to chase, but I think is increasingly uncertain upside.

The next would be to buy time and optionality through liquidity. We clearly, everybody has some visibility on what they're going to need from a liquidity standpoint, and I would use the recent market strength to, to reshore up these four these sources liquidity to me prevents all, never having to be forced to turn a potentially temporary decline into a permanent loss.

I often tell the story. One of my physician friends told me. Oftentimes a doctor's job is to buy enough time to let the body heal itself. That's exactly the same thing with liquidity. Liquidity buys time to let the market heal itself. And so I think this is an adequate and great time after three consecutive years of robust equity gains to refill those equity buckets and make sure you have as much optionality in your portfolio as possible.

The final is to diversify the economic drivers within your portfolio. And that sounds like a mouthful. But I would argue, the economic driver that might referenced earlier is this concept in the risk of potentially a deflationary type market, enviro landscape. It's something that investors haven't had to think about, quite frankly, for the last few decades.

In fact, over the last five years, all we've thought about is inflation fears. Why would we ever be concerned about deflation? And, but if deflation just simply means falling prices, why is that a bad thing? It provides an incentive for consumers to wait. If you feel like six months from now something's going to be cheaper than it is today, why buy today?

And obviously this mentality can really ripple across the economic growth, corporate earnings and asset prices landscape. So it's something that I think policy makers are really aware of. I used to joke that if you want inflation policy makers are, will jump at it. And the fastest way to get inflation is to have a little deflation because the response can be significant.

So the last part of what I'm gonna go through is, what specifically could you do to a portfolio that possibly would better position you for the risk of deflation? First we would broaden our equity exposure. Christian's clearly gonna go into this in more detail here shortly. About what's happening in the equity landscape, but within our centrally managed portfolios, we started this effort middle of last year when we modestly moved outside the us and more importantly we started to begin the process of lowering our concentrated bets on some of the mega cap growth names.

You can review the duration of your fixed income portfolio in 2022. We saw the pain of inflation to a bond portfolio that had any extended duration, but an inflation deflationary scenario. The opposite holds true and duration becomes your friend as opposed to your foe. But I would clearly caution any investor that's doing this to potentially look at your credit risk because again, you need high quality duration in your portfolio.

Not specific credit risk. I know this is going to be difficult for a lot of folks given that I would argue many people on this call today feel like the biggest risk is our debt levels. And I certainly understand that is a concern and the thought about extending duration and bond portfolios.

It would certainly be something uncomfortable if that's your top concern. And then the final thing, and it's something that we're actively doing and that's considering strategies that can really adapt to different regimes. We're actively reviewing managed futures and trend following strategies.

These are not directionally constrained. They can really help capture some of the persistent trends that we might see in the market that if we were to see deflation deflationary regime. And we're also exploring very a more convex tail risk strategy again, which is a very complicated way. We're trying to protect against an extreme market dislocation.

I recognize, you know this, prepare over predict can. Preparing a portfolio for more things that can happen. It's going to be suboptimal because that eventual path, whichever way we see on that, those squiggly lines that Mike showed earlier that's gonna have a better outcome than some collection of all the potential paths.

But it really protects you against the risk that of things that are uncertainty. And so I think that's how we would focus that. So I wanna make it clear, I don't know how much I can overstate this. This is not a prediction that we're going to have deflation or that it's imminent. I think it is a reflection in a rather acknowledgement that the risk has increased.

And I would argue just about every portfolio is not prepared for a deflationary environment, mainly because it's not something that investors have really had to pay any attention to over the last 20 to 30 years outside of Japan. With that, I'm gonna turn things over to Christian to take a deeper dive into the equity market landscape.

Christian Ledoux: All right. Thank you, Jim. I am going to start with software where Mike indicated earlier, and you are looking at a very painful four months for what was one of the best industries in the market for over the past 20 years. Software companies have been at the epicenter of the AI disruption lately, and some of the announcements on this page explain why ai way back when chat GPT was introduced, started as a search bar where you could get simple answers and create cute pictures of your pets.

But these releases are getting far more serious. They're tailored to business in specific ways. One of these is for coding. Another one is for scientists. Another one is for cybersecurity. For engineering, for hr, and much more. In fact. There were many more dots that wouldn't fit on this page, and they all came in a matter of this four month period.

And as these announcements came, the software group just continued to trade lower and lower. It's just a waterfall of announcements that just showed how much more AI is advancing day by day. And investors are getting wise to the fact that this is encroaching on the domains of many of these entrenched software leaders where either the software company is going to use this a new capability themselves and be able to save money and thus likely have to price lower for their customers and lose margin in the process.

Or the cust the customer themselves, the users are going to use these tools themselves to, to save money. And investors are gonna be reassessing the longer term value of these businesses as a result. And it's showing up in stock prices.

This is the price and earnings of Adobe which is the poster child of what's happening in the software industry. And if you don't know Adobe, this is no small company. It's over a hundred billion dollars in market value. And that's even after this downturn. It makes digital marketing and media software something that unfortunately for them, AI is pretty good at doing.

This is, they're the industry standard here. And in fact, they decided to bring out their own AI tools to protect their market share. But that certainly hasn't helped their stock. But as you can see, their earnings continue to rise every quarter, every year. And they're doing just fine.

Thousands of companies, big and small, standardized on their tools and haven't canceled their subscriptions or stopped using their products. But as you can see people are worried, investors are worried that they're going to eventually have problems. They either with their margins or their growth rate, or both.

And by the way, this is not in any of our centrally owned strategies we've sold out of any Adobe ownership in those strategies over a year ago.

Thomson Reuters, this is not officially a stock a software company. This is in the financial sector. And this is a slightly different scenario, a little bit similar to the FactSet example that Mike shared earlier. But once again, you can see that earnings continue up into the right. So no actual disruption disruption in their business.

Reuters sells its data sets to an even broader audience than FactSet to the legal, tax and finance sub-sectors, companies large and small, buy their services. And early on, Reuters was actually believed to be a beneficiary of ai. You could see it rising to a new all time high in mid two, two 2025 on that assumption that AI would actually start subscribing to their services to use an AI output.

But it quickly reversed when it became clear that not only were they not gonna get paid by ai, but they were going to theoretically be replaced by AI when AI could go out and replicate some of their data sets on its own.

Here's one that you might not think of naturally. This is a company called Blue Owl. It's a publicly traded stock of an alternative asset manager. And it's been in the press a lot lately for its funds and private credit. Private credit's, a big majority of their business. It's been a popular area and it's attracted a lot of capital.

But private credit's been under a lot of scrutiny lately. As you can see, their earnings are continuing to grow at a steady pace. Again, no, no actual disruption to their business, but investors are worried because private credit has been investing a lot in, you guessed it, software companies and other asset like businesses that are very vulnerable to AI disruption.

Yes the private markets are mirroring what's happening in the public markets,

but I am an eternal optimist as my fellow investment committee members continue to remind me. And I see opportunity in other areas of the market and despite the fact that we've had turmoil in the things that are at risk of disruption from ai there is always a bull market somewhere and the money has thankfully rotated to other areas.

And these other areas now have a nickname and it's called Halo, which is short for heavy assets, low obsolescence. And those areas actually are having a fantastic year. Most of them are up over 10% for the year, and that's only in two

months. And that's because these are companies that are not vulnerable to AI's advancements.

At least not yet. And the ongoing conflict in Iran has added some extra support for the leader of this group, the energy sector. In our centrally managed strategies, we've invested in all these sectors, of course, and I'd say we're a little bit overweight relative to the broader market in the Halo group.

In fact, our ultra dividend strategy last fall we repositioned it to get less exposed to the AI trade and which effectively gave us more exposure to the Halo group, and that's already paying off nicely this year. To conclude my section our investment discipline is looking for assets that are attractively priced, given the available information and software companies at their peak, which was only about four or five months ago.

Believe it or not, were trading at 40, 50, 60 times earnings because there were such reliable businesses and they were growing nicely. Now, some of 'em are trading at 10 or 15 times earnings. They might be attractive. Despite these ongoing threats. So there might be some babies being thrown out with the bathwater, and we're gonna search through that and see what we find.

Our research teams responding to this AI threat in a number of ways. First, we're looking for businesses that aren't easily disrupted at the right price, of course. And second, we're digging deeper on balance sheets to see what the companies own. If they are at threat, we wanna at least see that they have something of value to fall back on.

And last, we're looking for those babies in the bath water. Again, thrown out with the bath water, not in the bath water. Our team is doing this type of analysis on companies and all these sectors to assemble portfolios that can weather those multiple future outcomes that Mike showed on that chart earlier.

So I'm gonna pass it over to Mike again.

Mike Vogelzang: Great. We'll wrap it up. One, one of the things, one things we want to talk about just briefly here is that Jim mentioned it earlier that, that this three year stock move that we've had is really actually constraining some of the movements in portfolios.

As I said. There, there are, there, every portfolio that's been invested for any reasonable length of time is chock full of capital gains and it's hard to get clients to take capital gains. Nobody wants to pay Uncle Sam if they don't have to. We

are working hard on trying to understand some potential tax planning solutions for some of our clients.

There's a number of things that we can, we could do. None of them are magic bullets, but maybe together we can get some flexibility. One is tax loss aware generation strategies. Another is using an options based hedging strategy. To provide some individual position stability when there's a big gain inside of a particular position.

And then there's something called a 3 51 exchange structure of ETFs that we're also exploring that we're maybe hearing about later in this, later in in 2026. Number of things there. But I was having this conversation with a friend of mine who lives on his investments this past week. And he said I, we, my wife and I really don't like to sell our investments.

We've made lots and lots of money on them, but we don't like to sell 'em 'cause we have to pay on Sam. And I said, Dennis, if that's the case, none of us would've gone to the office and worked and gotten our W2 every year because we wouldn't want it have worked to have to pay Uncle Sam.

And not selling to some investments can be very similar. You control the timing of that. But the whole point as I was explaining to Dennis is that. By investing you're hoping to make money and be able to live on those additional assets. It's really an important part of the investment lifecycle to continue to harvest some gains as, as little as possible, of course.

But it has created lots of challenge actually for portfolios and for clients. So let's wrap up with this key takeaway slide. First is, again, AI is widening the range of outcomes for global economies and markets. We don't think it's status quo. We think there's enough evidence building that says we're going to have some significant impact from artificial intelligence and technological development over the next, one to five years that it's going to impact the investment and investing markets.

Number two is, again, this is our phrase, this is our mantra. Prepare. Don't just predict we're not focused on a particular point in time. Hey, if AI takes jobs, what it's gonna do? We think about portfolios that are resilient and robust. And building portfolios that can get their way through those portfolio through those different options and those scenarios.

And then of course, continue to monitor the situation with as much data as we can bring to bear. Our job as an investment committee is to work hand in glove

with our advisors and by extension with their clients. And that is both to prepare to get ready to think about interesting investments to make sure that our investments are appropriate and fit the environment we're in.

But also to make sure that we're well prepared as we go forward and through. And that we try to prepare everyone through education and through communication and we hope today has been helpful in that regard. So with that I think we'll open it up to some questions. I think we've probably got a few to say the least.

We're gonna introduce Sam Kirby and Asani of our strategy and communications team. They're gonna help us run through Q&a.

Eshani Gupte: Yeah, absolutely. Thank every, thank you everyone. And let's dive right in. Our first question is regarding the conflict in Iran. Why do you believe the initial market reaction was muted other than in energy?

Was it already priced in or are markets just less susceptible to shocks? Given what's happened in the past few years,

Mike Vogelzang: I think it had been so well telegraphed that most of the price action was in the price of energy had gone from what was a Christian 50 bucks up to maybe 65 or so in anticipation.

And then when it happened, we didn't see a huge pop. So that's I think, the simple answer and probably the most, most obvious.

Christian Ledoux: Yeah, we saw estimates that oil is currently about 30% above what is fair value right now. So there's a good size premium already baked in, but a lot of that was done before the shooting started

Eshani Gupte: regarding oil. If it does climb to above a hundred dollars a barrel and inflation kicks back into the economy, how do we see the Fed reaction playing out to that over the next couple of months or years?

Mike Vogelzang: Man, I'll take the easy one, the we have new leadership at the Fed or will soon, and there's an old truism in the business that the Fed, a new Federal Reserve chair gets tested by the markets, and this very well may be. Kevin Washer's first test. If we get that kind of runaway increases in oil and energy prices that will be a very difficult environment for him to manage without without raising interest rates.

And certainly making it very difficult to lower rates as we see in inflation, a commodity driven inflation spike. I think the Fed would have to be very careful to move very slowly. But it would certainly take the any additional cuts this year off the table.

Jim Underwood: I would only add we have some pretty optimistic expectation for economic activity in 2026 already, whether it's because of elevated refund tax refunds whether it's because the World Cup is in the us, which is gonna bring a lot of tourism dollars.

Obviously we're celebrating our 250th anniversary. I think most folks we're hoping. That a fairly stable energy price would keep inflation under control. So I do think this will complicate at least the short term narrative. But I don't believe it'll I'm hesitant to use the word transitory given how much it was punitive to us during 2022. But I do feel like this is a fairly short term conflict. And I think energy prices will recover once hopefully markets and the reaction to that will stabilize. But near term, I do think it's gonna complicate the fed's decision process.

Christian Ledoux: I'll also point out that rising gasoline and other oil related pri prices tend to crowd out the prices of other goods.

'cause it takes away from consumer buying power. So it could offset in other ways.

Mike Vogelzang: It's like a big tax. Yeah.

Eshani Gupte: Okay. What is a. Concerning headline credit space, and could this trickle into the bond markets and the public equity markets?

Christian Ledoux: We missed the first part of that Hanni.

Eshani Gupte: Oh, sorry.

Christian Ledoux: You were garbled.

Eshani Gupte: Sorry. Sorry about that. So what are your thoughts regarding the concerning headlines within the private credit space, and could this trickle into the bond markets and the public equity markets?

Mike Vogelzang: A hundred percent. It could. Whether it will is I think a bigger step. I think it's really important to take to, to make some distinctions here in private credit.

And for those of you who aren't comfortable or haven't had experience in private credit, basically fixed income investing, but inside a private wrapper. And some of these wrappers some of the private credit investments are in vehicles that allow shareholders to get some of the liquidity out.

We think this, we think the rising concerns in private credit are mostly around liquidity. Not so much around credit. We haven't seen credit deteriorate significantly either in public or private markets. That is get worse, right? If you're in invest, overall if banks and private credit funds are lending to corporations if you start to get worried when profitability that these companies starts to fall but right now profitability is booming.

So we don't think it's a private, it's a credit issue. That was the problem in 2008, 2009. There was, there were credit defaults, right? They the credit they simply couldn't pay back all the money they had borrowed. Today, we think it's more about a liquidity problem at least at the moment.

And now we could be proven wrong if the economy slows down because of a high price of oil or some other, externality. But right now I think it's limited to liquidity in the private credit markets. I don't know, Jim, Christian, you guys have any other perspective on it?

Christian Ledoux: We've seen private transactions between these lenders where individual loans have gone for over 99 cents on the dollar.

So that would be evidence that the credit is not the problem, it's just who has the liquidity and when.

Mike Vogelzang: Tion, try again. You're breaking up again. Funny.

Eshani Gupte: I'm sorry.

Mike Vogelzang: That's good.

Eshani Gupte: Okay. Can you hear me okay?

Mike Vogelzang: Yep.

Eshani Gupte: Okay, great. Let's talk about portfolio construction for a bit. Jim, you specifically touched on liquidity, but what are your views on folding cash and potentially gold to diversify? Is it too late for gold?

And then in regards to large cap tech exposure should we diversify away from that international small cap? What are we looking at as the right outlook there?

Jim Underwood: Yeah, I think that those are three com different questions and certain, I'll try to answer 'em in order. Regarding cash I don't think you need to have something obviously in a checking account.

I do think having something that has very high quality, very minimal interest rate risk is something that, and again it can be coordinated with your liquidity needs. So if you need it in a year have it available in a year, whether that's through a treasury some type of ladder instrument.

So again, to me when I say liquidity, it's really knowing where you're going to fund a near term liquidity need. Regarding gold. That is, that's obviously a challenging discussion because it has had a phenomenal run. I do think a lot of that run is because of people's concern about fiat currency.

And I would say typically I wouldn't necessarily wanna own gold. If we do have a backdrop of where inflation's not a big problem and deflation is a bigger risk the one reason why I would caveat that answer would be is if the monetary policy makers in the US decided to flood the system with more liquidity to combat that, which obviously that would put more pressure on our debt, that put more pressure on our deficit, and that obviously would put pressure on the US dollar, which would ultimately result in gold likely having a stronger upside move from here.

I don't think there's a ton of downside risk in gold today, given a lot of the buyers today, or federal or central banks. And they're doing it not-for-profit motivated reasons. So I still think there's a buy, buy and a bid there, but I think the last couple of days we've at least seen with the war in Iraq, we've seen the dollar become that that safe haven again, the dollar has increased in value and to me that's a good sign that people haven't lost.

Confidence in the dollar and likely gonna keep gold reasonably under control unless policymakers have another round of helicopter money to fight some type of market event that's driven because of AI one. And then where are we putting money? Small cap and international. I mentioned earlier, we did put a dip our toe into our make a very modest move to international middle of last year.

That really had nothing to do with anything that we're discussing today. That was more a reflection of, for the longest time Europe was able to get by on cheap cheap energy from Russia, cheap goods and services from China and cheap defense from the United States. All three of those legs of the stool got pulled out from under 'em, and we thought that was gonna be a real catalyst for policy makers to come up with some pro-growth initiatives.

In that region, which would hopefully unlock some of the value discrepancy. We've seen some parts of that. We still think that thesis plays out. But that would certainly be an area that we are looking at closely. Clearly the last couple of days with a dollar we strengthening, that's hurt our results a little bit.

We still feel good about that longer term trend regarding small cap, and I know I've taken more time here, but I would argue there, there's two debates about ai. One is is AI as a u is it going to be a tool that's useful? If people don't believe so, then that's bad for everybody. 'cause as Mike mentioned earlier, we need artificial intelligence to help improve the productivity of our economy because our demographics are going to be challenging.

But if people are questioning the profitability of a, the AI investments that the Mag seven companies have been making, that actually is a positive benefit to the rest of the market because that means all these smaller companies will be able to access. The value of artificial intelligence at cheaper prices.

That is a little bit of our investment thesis. And there's reason why in December of last year we sold some of those mega cap names and started broadening out our portfolios. Not necessarily down into small cap, but in some of the higher quality, upper small cap, lower mid cap area of the market.

Eshani Gupte: Okay. We've gotten a ton of questions on a as expected. Let's talk about both from a investment perspective and then I wanna talk about it from a CAPTRUST perspective. So starting with the investment perspective, are we in an AI bubble? Who are the winners and losers? If that bubble pops

Christian Ledoux: well, were you gonna say something, Mike?

Mike Vogelzang: No, go ahead Christian, you can take it.

Christian Ledoux: We've got some spattering of data from the private markets the pure play AI companies, and the numbers are pretty fantastic. Anthropic, for example has gone from 5 billion to 14 billion in revenue run rate in six months. That, that tells you that it's real.

These are companies that are actually getting people to pay for real ai, and it's doing real things. It's not to say that they're not paying a lot of money to get that output. So profitability is another issue, but that is different than, say, the.com bubble, where there was no real business there.

There was people were making things that nobody really needed in the long run. So this is real value being paid for by businesses. So I would say it's not a bubble by that definition.

Mike Vogelzang: Yeah I would agree. I think I think the substantial nature of the business is particularly led by the hyperscalers, the Microsoft apple not so much apple, but meta Google, Amazon is astonishing.

These companies are so powerful and so strong that we have honestly never seen anything like them in the history of free markets. They make so much money, they're almost becoming nation states under themselves. And that's both revenue generation, it's also profitability. When I was a young lad starting in the business, a free cash flow margin.

In other words, how much cash a company generates after all the expenses and taxes are paid, we're somewhere in the three to five to 6% range for the entire market. These massive companies now. Accepting for a moment. The money they're putting into their data centers and warehouses, these companies are mana are living at about 25% free cash flow margins.

That is again, at the size and scale and growth rates that they're that they have that it's, we've just never seen anything like it. So the answer, answer for us is clearly not in a bubble. I think nine months ago we, there were pieces of the market that were in bubbles. Some of the more speculative AI stuff was in a bubble, but I think overall this market's been reasonably rational, frankly.

Eshani Gupte: Okay. And then from a non-investment perspective, this is from the CAPTRUST view. How will AI impact how CAPTRUST runs its business and supports its clients?

Mike Vogelzang: One of, one of my, one of my jobs is. I get the privilege of being on the on the, a bigger committee at CAPTRUST that helps run the business. And I can only tell you all of you that it is using artificial intelligence in our business, understanding how it can be used, finding productivity, finding cost savings, finding opportunities for us to work smarter and faster or not harder.

Is job one at the moment? It is. And by the way, it's almost for every company on the planet right now AI is real. We are trying desperately and very diligently to find ways to use AI to answer, answer client requests, client needs, anticipate client options in a way that improves our service, that keeps our costs down.

So it is I don't think there's much. Else at the company, at an operational level that, that we're focused on more, more acutely

Christian Ledoux: We're using it in our department for research. Yeah. We continue to push the edge of that. And just a note to every listener out there that has used AI and perhaps been a little bit disappointed by its capabilities, the free version of AI does not have nearly the capability of the paid version.

And I hate to say you're gonna have to pay up to see it, but you do. The paid version that, and some of the vertical situations that I put on the slide that had the software chart those are specialties that have some major capability enhancements that I think you have to also pay extra for.

If you really wanna see AI's capability, you're gonna have to pay for.

Mike Vogelzang: Not only that, Christian, but the last, if you're using AI from a month or two ago, you're already well behind the curve. If you're using an old version, an old model, you're already way behind the curve in terms of what the capabilities are.

Again, however fast you think it's coming faster. Folks, thi this is not slowing down to let you catch up. Ai, AI and its capabilities we haven't even talked about agents and agents are really the next frontier, if you will of artificial intelligence and making life easy.

The way to think about agents would be is if you had a personal assistant, you pick up the you pick up your phone and you say to your agent, order me the cheapest pepperoni pizza in the neighborhood and have it delivered as fast as you can. And it will go through every possibility and you'll, it'll pay for you.

It'll take care of all of the tasks around that little job. And you'll have a pizza at your doorstep in 25 minutes. That's an, that's a tiny little fraction of what agents are doing. They're taking over what companies do with AI and how companies work. Yeah there's a lot there.

But we do have to wrap it up. It's almost five o'clock. It is five o'clock, as I see. Shawnee, are there any single last question we can ask? That's a quick one.

Eshani Gupte: Maybe not so quick, but beyond AI and Iran driven headlines, is there anything that the market is missing that we should be focusing on right now?

Mike Vogelzang: Yeah I think the best example of that was this concern from from SAT and how ai, if left unchecked and if the government can't. Respond in a policy way, in, in anything quickly. I think there could be a dark side here, and we're expanding our expectations for that.

Modestly we are optimists. We think that that the markets society will get through doesn't mean there's not gonna be some societal upheaval to get there. But we think this is gonna be a very powerful force for creating wealth for everyone in the world. Not just a wealthy, but for creating a higher and better standard of living for all, frankly.

And that's what productivity enhancement and growth is all about. And so we're very optimistic, although I do think you think the market could potentially be missing some of the dark sides of ai, and I think we just, we saw that with software as Christian detailed so perfectly. With that, I'll, we'll close.

Thank you all for allowing us the privilege of working with you. We take our responsibility to be your fiduciaries and your investment advisors very seriously. We spend inordinate amount of time trying to understand these really complex times. If you have any questions, please work with your advisor and they'll funnel their questions to us and hopefully we can give you some additional detail.

So thank you all for being here today. We look forward to the next time we can be together. Thanks all.

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