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& CO
Chief
Investment
Officers

INVESTMENT PERSPECTIVE

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MIRROR, MIRROR ON THE WALL

The stock market is nothing if not a reflection of our collective beliefs. Sometimes it functions like the looking glass on the Queen's wall in the Grimms' Snow White, confirming our deepest fears. At other times, it operates like the Mirror of Erised in Harry Potter, reflecting back our hearts' desires. By early March it prefigured stocks as perhaps not the fairest of them all. Barely four months on, it shows nothing but our most arduous longings. But as Dumbledore warned Harry, the Mirror of Erised showed neither knowledge nor truth.

Nothing epitomizes the current bipolar zeitgeist better than Goldman Sachs' portfolio strategy moves. In early July the team raised their 12-month S&P 500 price target to 6900 as opposed to 5300 in late March. It was the fourth revision this year. A week later the team felt compelled to issue a note entitled "Investor Feedback to our revised S&P 500 Forecasts" wherein they bemoaned clients' "discomfort with the level of valuation multiples relative to history." Not to worry, they soothed. Valuations in the 97th percentile

of observations since 1980 are justified by (soon to be) falling interest rates, strong corporate profitability and low unemployment. Furthermore, the current high multiples, Goldman assured us, were not suggestive of “investor exuberance.” Two weeks later the same team published a note observing that speculative trading activity had accelerated at rates approaching those of Spring 2000 and early 2021. This has been characterized by abnormal trading activity in penny stocks, unprofitable stocks, high multiple stocks and call purchases. Of course, they might have added, price target revisions by prominent Wall Street investment banks. Adorning this lottery ticket mentality have been the rise of Digital Asset Treasury companies, meme stock ramps and SPAC issuance. This month saw the listing of a \$2 billion crypto currency called “Pump.fun.” The point is, we have reached the point in the cycle where no one is even pretending anymore. The naked Emperor is parading through the streets and no one even bothers to dissemble that he is clothed.

There are two quite cogent responses to this euphoria. The first is that artificial intelligence is such a tectonic shift that investors should hold judgment to see which of the miracles currently discounted emerges. Another variant of this strain of thought is that technology is moving so fast that there will be applications which we cannot dream of and it’s worth suspending disbelief for a little while. The second reasoned view is that this is indeed a speculative mania — but that once valuations become untethered to reality there is no limit to the absurdity. Whichever you subscribe to, the sage advice is to bide your time. I mostly concur. But I believe that while circumspection is warranted, it also makes sense to take some precaution against an abrupt awakening to risk.

The moral failing we are witnessing is a loss of patience. The marginal investor is possessed by immediate gratification. The stocks that are most sought after are the ones that are printing the best numbers today, that have unimpeachable current business flow and glowing media. The problem is that they are priced for all that and usually more. In the meantime, there exists an anti-bubble. Companies that are undergoing current known difficulties are priced for perpetual decline. This is largely the province of our active managers. The second anti-bubble is the U.S. Treasury. It’s currently suffering from the indignities of the U.S. fiscal largesse and (perhaps) the prospect of a lower trade deficit. We are overweight duration on the belief that high real rates will eventually migrate to lower levels, that inflation will continue to ebb and that a sudden slowdown will highlight their defensive attributes.

The origin of “patience” was the Latin “patientia” which means “suffering” or “enduring.” The “Passion of the Christ” maintains this original sense. Whenever I visit a physician’s office, I always recall the etymology. To be patient means “to suffer.” Your portfolios are currently set up more for patience than immediate gratification. But I am confident that this configuration provides the best path to long term success. Your investment department has sourced a number of excellent reward/risk opportunities on a standalone basis. Better yet, they represent reasonably distinct — or uncorrelated — opportunities. We look forward to meeting you in person this quarter to discuss our positioning.

—*T. Brad Conger, CFA*
Chief Investment Officer