# "Artificial Intelligence"
# Astrophysics or Metaphysics?

What a fascinating month! We've had something for everyone. First, we started with a total solar eclipse over the eastern U.S. and finished two weeks later with roasting a financial "sacred cow" (Nvidia) for a one-day 85 point! (-10%) decline on a Friday afternoon. How could anyone possibly ask for more excitement? We used to blame the tribal medicine men and the sorcerers for the eclipses. But now we need them to explain the daily stock market moves, so they've all found a new gig and moved to CNBC. Just kidding — sort of.

Importantly, we also got a chance to see examples of how abruptly the difference between reality and imagination can affect human behavior and what happens when the two get all crossed up. Here are some thoughts on how realistic understanding, not crowd psychology, is key to investing:

**The Eclipse:**

What made the eclipse over most of the eastern U.S. so amazing was the astrophysics behind it. If you remember from high school science class that the sun is 93 million miles away from the earth and the moon is roughly 240 thousand miles away and moving in an entirely different orbit, the idea that you could line all three of them up in such a precise long-distance straight line that it would cast a moving 115-mile-wide shadow is truly amazing. This type of event only happens somewhere on the earth's surface in more or less the same location every 20-30 years. So, the fact that so many people wanted to watch such a dramatic event is not a surprise.

But many of us have seen eclipses previously, so the fascination came from watching some of the millions of people and their reactions to the eclipse rather than the eclipse itself. It was the behavior of the crowds, based on their expectations around the event, that was so fascinating. 5000 years ago, when primitive man had no understanding of the science behind eclipses, they would often react in panic and create wildly unrealistic stories to explain them. Even today we have science nonbelievers who would rather attach mystical explanations to an eclipse even though we now have remarkably precise science to explain and predict an eclipse before it happens.

**The Nvidia Sell-off:**

When it comes to investing, an understanding of the behavior of crowds is always essential because their behavior can have extraordinarily disruptive impacts far beyond what's fundamentally justified. When one adds today's high-speed computerized trading systems into the mix, very abrupt and occasionally extreme moves can happen in stocks over fairly short periods of time. This was the case with Nvidia on the aforementioned

Friday when the stock dropped by 10% in one day with no fundamental news.

Developing a good understanding of market expectations, often called investor sentiment, especially when those expectations may be wrong, is one of the most important skills in managing investments. Because it is those occasions when one correctly senses that conventional wisdom is about to be proven wrong that provide some of the best opportunities to generate superior returns. This process works both ways. Oftentimes if one can sense that investors are too optimistic about a presumed outcome, avoiding investing in that asset class or sector can preserve your capital. And seeking to invest in areas that are neglected or disliked can provide some of the greatest opportunities to value investors. The key of course is to develop a strong enough fundamental understanding of each situation—especially of each company.

The commitment to in-depth fundamental analysis is one of Long Bridge's core principles. This approach is far less common than it used to be. A fact which was recently highlighted in an interview of David Einhorn, one of today's highest regarded hedge fund operators. It was also alluded to by the legendary Warren Buffett at his annual shareholder meeting this past Saturday. Warren, along with his now-deceased lifelong friend and partner, Charlie Munger, used the approach of buying well-run companies when they could be bought at bargain prices to build the extraordinary Berkshire Hathaway Company. Berkshire, however, has grown so large that it can no longer buy meaningfully sized interests in a lot of companies because Berkshire would own too large a percentage of the company. Happily, that leaves lots of researchable opportunities for us much smaller folk to sift through on behalf of our clients.

So, keeping the foregoing thoughts in mind, here is a very brief synopsis of how we view the current investment outlook:

- The current economic outlook is actually pretty good. The extensive U.S. government spending has offset some of the deteriorating financial position for lower-income consumers, with the result that the U.S. economy is in pretty good shape.
- The global economy is forecast by the IMF to grow a little above a 3% rate this year and slightly better than that next year. There are some countries with specific domestic economic problems, but overall, the prognosis is for a stable outlook is good and a reasonably steady investment environment should persist.
- With the stable, global economic outlook, and gradually moderating inflation, companies should be able to manage their businesses in a modestly positive, predictable fashion.

This outlook leaves us with two assumptions:

1. Interest rates will probably not change dramatically over the next six months or so.
2. Stocks are largely fully priced, but there are a surprising number of compelling bargains, especially in those economic sectors where momentum traders have neglected them.

Keeping the above points in mind, we are optimistic from an individual security standpoint in the near term but will be increasingly more cautious as we approach the election.

Sincerely,

The Team at Long Bridge