

Third Quarter 2025 Commentary

AI AI AI

Macro Commentary

The US economy remains resilient. Growth has exceeded expectations, driven by spending from high-end consumers and significant capital expenditures in artificial intelligence. Without the AI investment, growth would likely be stagnant. Labor markets, however, are softening, creating room for potential cuts to short-term interest rates for the remainder of this year.

Announced artificial intelligence ecosystem deals accelerated in the third quarter with a round of long term deals with unknown, and likely conditional terms. In some cases, we view the deals as “money good”, where both sides can satisfy the order in cash; in others these deals are less likely to be economically resolved without significant equity issuances. In general, we find the warrants and shares issued to customers to be problematic as there are scenarios where Nvidia will own appreciable amounts of AMD through a stake in OpenAI, should deals consummate as envisioned. We believe a mixture of substance and hype has created a bubble in AI related expenditures. While some liken today’s expenditures to the spend on fiber optic cable two and half decades ago - which was 95% unused by 2007, but is useful and rapidly filling today. Fiber optic cable has a lifespan of 25-40 years, while a silicon processor’s obsolescence is estimated and measured in months - 12, 24, 36. In my view, the problem is more severe today than it was then.

Importantly, there’s a lot of spending across sectors behind AI demand. Everything from electricity and associated generation technologies, to water treatment and pipes have become more expensive to deal with data center cooling needs. In many cases, the associated companies are enjoying stock prices that reflect an exceptionally bullish possible reality. Companies in quantum computing, for example, which is multiple generations of computing standards away, if it's economically feasible at all, and if it is, may not be appropriate for artificial intelligence use cases, and if it is, may not be better than alternative approaches - trade at elevated multiples of forward revenue estimates. For example, Rigetti Computing, Inc (RGTI) is generating a whopping \$3 million dollars of quarterly sales and over \$15 million of quarterly loss, but enjoying an \$18 billion market capitalization. That’s thousands of multiple turns of forward revenue. Calling a bubble is easier today in certain segments than it has ever been.

Positively, capital markets are open again, a boon for small capitalization stocks - while bank executives are also bullish on investment banking activity. Attempts to mainstream less regulated cryptocurrencies continue, as do efforts to move stock trading to less regulated exchanges and markets. We have observed, and expect to continue observing, “unusual” trading activity around major events, which we view as a negative market development. We hope that smaller capitalization stocks can take advantage of the easier lending standards while calmer or at least more honest heads prevail around regulation.

The consumer is strong overall, powered by high income households that have driven almost 100% of discretionary spending growth. There are only conflicting signs of that trend declining. The housing market remains near its lows with mortgage rates above 7% slowing transactions. A recent move closer to 6.5% appears to have been met with increased activity, but we have seen similar brief rallies fail over the past 18 months.

Overall we have been impressed by the relative power of narrative and recent price action over intrinsic value in several sectors of the market and are cautious and selective buyers of individual stocks. Companies that generate actual and significant cash flow have had trouble “catching a bid” - a story that has been true for a long time now. This is not a recommendation to stay out of the market, as the possibility of being wrong is significant and “time in market” usually beats “timing the market”, but to do so with eyes wide open.

The Ethical S&P 500 Strategy

The Ethical S&P 500 Strategy officially started on April 16th. Pro forma year to date, it was up 21.48% through Sept 30th vs 24.63% for the S&P 500. As mentioned earlier, the strategy notably does not include defense companies or companies who customize their goods and services for defense and vice companies.

The Index is extremely diversified and is composed of the same companies as the S&P 500 and with similar concentrations - excepting the exclusions. It is meant as an S&P 500 index replacement for those that want passive exposure to the US’s largest companies but do not want to spread death and destruction. We have been pleased with the strategy’s performance and gratified by the interest it has received. The end of the assault in Gaza and renewed focus on ending the war in Ukraine may benefit the index relative to the S&P 500 if military spending, or the prospect of its continuation, declines.

As an example of the work we do for the Ethical S&P 500 strategy - Microsoft is a core holding of other “ethical” indices. We believe the company’s behavior over the past two years disqualifies it from ownership by any investor who doesn’t wish to profit from war. The [write-up](#)

and the strategy fact sheet is available on White Brook Capital's website at <https://www.whitebrookcapital.com/strategies>. The Ethical S&P 500 strategy is now accessible through the Schwab Manager Marketplace and therefore is accessible to any investment manager who custodies at Schwab.

Small & Micro Cap

The Small Cap Absolute Growth Strategy model portfolio, which is a long only strategy that buys small and micro cap stocks with significant growth potential, has had tremendous success in its first year, vastly exceeding expectations. Given their smaller size, the portfolio's companies are less predictable quarter-to-quarter and thus more prone to surprises. However, for the diligent and patient investor, we believe they are also more analyzable, and offer the potential for high returns. Due to the early and significant success of one of the portfolio's first holdings, the model portfolio is concentrated in that company. Continued success is expected in the near term and therefore we have not materially sold down the position. Over time, the portfolio will become more balanced.

Rapid Micro Biosystems, Inc (RPID) has paced gains, up nearly 300% year to date, but other positions have also significantly contributed to the year to date performance. Paysight, Inc (PAYS), a company no longer in the portfolio, was up over 150% from its entry price. Current positions, Infusystems, Inc (INFU) is up 20%, and CareCloud's Convertible Preferred (CCLDO) is also up over 20% but the strike of the convertible is at a much lower price than it trades today, and it is therefore also positioned for more, significant gains. Year to date losses are largest in Jakks Pacific, Inc (JAKK), and BranchOut Foods, Inc (BOF) with de minimis losses in Civeo Corporation (CVEO), and no longer held Quipt Home Medical Corp (QIPT) and American Shared Hospital Services (AMS).

Pursuant to the quarter's close, Tile Shop Holdings (TTSH) proposed delisting its shares at a price higher than the close at quarter end. The stated rationale is that the company is not getting credit for its assets as a public company. We agree with the rationale, but find the proposed price to be significantly below our estimate of the company's intrinsic value. We believe that the public needs to see more home building and renovation activity to realize that value. We sold into the news and hope to re-enter if the delisting maneuver is defeated.

The small and micro cap strategy is only open for accredited investors. Due to our focus on price and the lower than average liquidity in the underlying positions, it should be expected to take some time for new accounts to mimic the model portfolio. The CareCloud opportunity for instance is extremely limited, with only the fewest of shares routinely traded now - while the

position was relatively easy to amass below \$19. Sometime next year, as the number of accounts invested alongside the model portfolio achieves critical mass, we expect to adopt GIPS compliant reporting procedures and then report performance of this strategy more widely.

The All Cap Portfolio

The performance of value oriented stocks continues to be disappointing. While the All-Cap Portfolio bought positions in growth companies as it shifted from mid to an all-cap portfolio, it continues to be overweight value and performance has trailed. Positions in Alphabet, Inc, (GOOG), Nvidia, Inc (NVDA), and Taiwan Semiconductor Manufacturing Company Limited (TSM) lead the portfolio while Portillo's (PTLO), Builders FirstSource (BLDR), and Floor & Decor (FND) detracted from performance. We still maintain our belief in the thesis that the country is underhoused. We believe that as mortgage rates decline further or stay at a sub 6.5% average interest rate on the 30-year fixed mortgage, the number of new home builds and home sales will increase with corresponding benefits to home building supply companies that supply the materials for new construction and remodel activity.

Portillo's and the fourth largest loser, Target, Inc (TGT) both have new chief executives leading the companies forward while producing significant operating cash flow. At Portillo's, while we supported Michael Asanloo's strategic vision, the pace of execution under his leadership was slow, prompting a change from the board. White Brook's thesis, available on the WBC website is still intact with the steps for significant improvement largely the same. That was the problem. We expect the company, which has now stated a desire to pursue the most meaningful parts of that thesis, to execute on them with urgency. Board member, and former CEO of Darden Restaurants has assumed the Chief Executive role, at least temporarily, and we believe has the credibility to make changes to the financing and operations strategy to make Portillo's a successful investment. Target's choice of CEO was more difficult for us to understand, even while the company generates significant cash flow that it can use to return to shareholders and execute an improved retail strategy. We plan to give the new CEO a quarter to outline his plans for the Company and earn investor trust.

As always, feel free to reach out to discuss this or any of your investments at White Brook Capital. I thank you for your support and will strive to continue to earn your trust.

Sincerely,



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