



“The Gravity of Situation”

History often repeats itself, echoing the cyclical nature of human events. However, at times, history is also a collection of events that no one imagined could ever happen. It is nearly impossible to decipher which type of history we are currently experiencing: the repeating kind or the unimaginable kind. Either type, we must learn from history and keep applying its most enduring principles.

When it comes to important principles, two historical titans whose tremendous contributions to science resonate across the ages are Charles Darwin and Isaac Newton. As is typical of significant theories in science, their principles can be equally useful in investing.

Darwin’s theory of natural selection, with its three cardinal principles- inheritance, overproduction, and the survival of the fittest- forms the bedrock of modern evolutionary theory. As investors, we parallel this process and scour the universe for companies that are more fit to survive than their competition. Much like the fittest organisms, these companies endure and flourish across diverse market terrains, outpacing their rivals through sheer resilience. Likewise, we aim to be invested in companies that “survive” in all market environments so your money can continue compounding without interruption. History bears witness to the triumph of financially fit companies over their weaker counterparts, underscoring Darwin’s sustaining relevance in the investment landscape.

However, remember history has also proven that at times, markets, speculation, and manias can overshoot and become excessive. Even as we heed Darwin’s understandings, we must not overlook the immutable laws of Newtonian physics. Newton is most known for developing his laws of physics that describe the relationship between the motion of an object and the forces acting upon it. Gravity is a powerful force, bringing atmospheric bound objects back to earth. A mean reversion of sorts, gravity can also be a powerful force in an investment portfolio, bringing overheated stocks back in check with their counterparts. Gravity will restore objects to their rightful place as it will also return a soaring stock to its rightful valuation.

According to Morningstar, one third of the S&P’s positive performance year-to-date is due to one company. Although strong fundamentals have contributed initially, it seems another Newton law is at work; an object in motion is likely to stay in motion. As many of us remember well, the hype in dot com companies in 2000 kept many stocks in motion- even stocks of companies that had no revenues, let alone profits. In those cases, gravity arriving in 2001 was extremely painful for investors.

In exploring the historical tapestry further, we encounter the origins of contemporary economic paradigms, such as the 2% inflation target embraced by central banks worldwide. Like overheated investments, inflation will likely succumb to the gravitational pull and mean reversion as it has throughout history. The Federal Reserve continues to point to its 2% inflation target as they watch inflation data closely.

The 2% inflation rate target adopted by central banks today has its origins in New Zealand. It is not based on any academic study but rather on an offhand comment made during a television interview with New Zealand's finance minister during the 1980's.

New Zealand had just been through a high inflationary period that ranged from ten to fifteen percent, so when pressed with what would be an ideal inflationary rate, Roger Douglas, New Zealand's Finance Minister, pointed to a preferred range between zero and 1 percent. Not long afterwards, other developed nations like England and Canada adopted targets. The United States soon began pursuing a target as well.

Amidst the ebb and flow of economic fortunes, the specter of interest rate fluctuations looms large, casting a shadow of uncertainty over market sentiment. For investors, one of the most anticipated events this year is whether the Fed will raise, cut, or maintain interest rates. So far, they have decided to keep rates unchanged. On the other hand, the European Central Bank has announced a reduction of .25% in interest rates. The Swiss National Bank also lowered interest rates in March of this year by .25%.

We are beginning to see a dispersion between central bank policies amongst developed countries. During the last decade, all developed countries had lowered interest rates in unison and seemed to move in tandem. However, it seems this is no longer the case. Perhaps the varying responses to the Covid pandemic can explain the dispersion as some countries provided more financial assistance to their citizens and business owners than others. Perhaps political differences are widening and leading to further dispersion in interest rate policies. No longer bound by uniformity, these disparate responses reflect the multifaceted nature of our interconnected world, where political exigencies intersect with economic imperatives in complex ways.

Despite this dispersion, the US stock market and other world markets continue to hit all-time highs. Unemployment has remained under 4% for the last couple of years, wages have increased, inflation is down from its June 2022 high, and we are seeing record spending from the consumer. In addition, many market participants anticipate a reduction in interest rates at some point this year for the US as well.

As inflation reverts to its mean and interest rate policy does as well, we will remain most focused on Darwinian companies that are demonstrating their strength and health regardless of inflation, interest rates and mania around companies that are "in motion." Although, up until recently, we have been through a long period of low inflation, our investment tenets have always focused on companies and industries that do not require large amounts of ongoing capital investment in order to maintain their competitive position. Capital intensive companies are most impacted by inflation as the cost of heavy machinery dramatically rises as does the cost of borrowing to fund such heavy equipment.



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Likewise, our tenets keep us on the hunt for companies with low debt levels that are not negatively impacted by a sudden rise in interest rates. Many companies with large cash positions have instead benefited tremendously from the sharp increase in interest income on those cash positions for the last several months.

And trends, hype and manias have never been part of our investment philosophy and never will be. We are instead in pursuit of companies that we hope to own for years to come. For it is in these stalwart enterprises, untethered to the vagaries of market manias, that true investment success resides.

Thank you for staying in motion with us at Westwind Capital. We are working hard for you and your money and wish you an enjoyable summer!



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