Five Mile River Investment Management L.L.C. April 23, 2025
Client Quarterly Letter
1st Quarter 2025

PERFORMANCE

	Dow Jones Industrial	S&P 500* (Capitalization Weighted)	S&P 500* (Equal Weighted)
2025 Q1	-2.25%	-4.27%	-0.61%

The S&P 500 performed at a **- 4.27%** in the first quarter of this year, marking the worst quarter in two and a half years of strong positive returns post-COVID. The index is currently at a level of approximately 5250, down from a high of 6000 on February 18th, and flat with 5254 one year ago.

Clearly there have been a lot of moving parts, announcements, and volatility focused on the type and size of tariffs that the U.S. might impose on its trading partners. Closely following Trump's announced tariffs on April 2, 2025, markets were thrown into correction and, in the case, of the NASDAQ, resulted in a bear market (-20%). Hoping to calm markets, Trump announced on April 9, 2025, a 90-day cooling off period before tariffs became effective. It is FMR's belief that reciprocal tariff agreements will most likely prevail. Mitigating whatever finally emerges from these tariff negotiations is the fact that total imports only amount to 11% of GDP, so it is likely that tariffs' effects will be muted and not cause significant impact on inflation or slowing the economy, which is different from the media news feeds. Northrup Grumman CEO Kathy J. Warden stated on Tuesday, April 22, 2025, that the worst of the uncertainty has passed. Chairman Warden continued by saying that market volatility will continue until this 90-day period finally concludes, however, Northrup will be successful in mitigating any tariff impact on their business.

Five Mile River recognized last fall that there was likely to be a significant increase in stock market volatility, both before and after the fall elections. FMR began to add more resilient companies to portfolios as well as more domestic focused defensive value companies paying growing dividends. It is not surprising that higher tariffs would be raised dramatically on Chinese imports. It is important to remember that China imports THREE times the dollar amount of products than the U.S. imports from China. The largest of Chinese imports from the U.S. are agricultural products. Interestingly, the impact of a more intractable tariff riff with China will be more significant to their economy than the U.S. A recent surprise announcement by Apple that they are moving iPhone production from China to India and Vietnam, and will be bringing some manufacturing back to the U.S.

Shifting the geographic sourcing of U.S. company manufacturing is an obvious way managements will mitigate tariffs' impact. Many companies will simply absorb some of the cost impact of tariffs, and/or substitute tariff affected parts and products.

The U.S. total trade deficit is currently $1.2 trillion, and about half or $530 billion comes from countries targeted by the first round of tariffs. China represents $295 billion of the U.S. trade deficit. While economic weakness is now being forecast, any improvement in these deficits is the removal of a negative, or said differently, lower deficits will become a positive for the U.S. economy.

Five Mile River does anticipate that the tariff transformation process will impact real consumer spending, which is likely to slow from last year's 3% growth in 4Q24. Why? Slowing increases of wage compensation combined with net worth declines from the stock market's correction will be the main factors for the consumer to pull back their spending. In fact, a recent consumer confidence report shows that 58% of those surveyed believe we are going into a recession…another reason for consumers to stop spending. Perhaps an offsetting positive is that energy prices are lower and while electricity prices are rising, the overall result may help to stabilize inflation.

Highlighted in past FMR Client Letters are the multiple mistakes in FED policies. It is the Fed's job and duty to make sure that changes in prices of consumer services and products do not become embedded in our economy. The Fed has done a poor job in the last five years as inflation has risen about 25% since January 2020. The most recent count shows inflation is still running close to 3% and is well above the Federal Reserve's 2% target.

The U.S. Legislature, with the aid of the Treasury, **raised federal spending about 50% over the past four years**, causing the annual budget deficit to run at more than $850 billion. The U.S. **total national debt is up more than 50% since 2020** to about $37 trillion and still rising. Annual interest on that debt in 2025 will breach $1 trillion. Funding the interest on the annual deficit of $850 billion plus the cost of the interest means the Treasury will have to raise close to $1.85 trillion by selling $1 billion of new paper every WEEK! All this just to keep the U.S. as a going concern. Fortunately, the U.S. dollar has not dropped too much in value so large deficits appear to be mostly tolerated by the markets. This path is not without collateral consequences as the reality of the situation is that it is unsustainable. The Federal Reserve must win the war on inflation, accompanied by our Congress significantly reducing Federal Deficit spending.

In the face of so much uncertainty, it is important to look for and find interesting investment opportunities. One clear demand trend that will not be altered by the uncertainty of the day, is that the world needs more electricity every year for the foreseeable future. A familiar saying, There Is No Alternative (TINA) is appropriate and there are investment opportunities.

UNITED STATES ELECTRICITY DEMAND AND INVESTMENT OPPORTUNITIES

For the first time in decades, the U.S. is experiencing a major and sustained rise in electricity demand. It is driven by widespread electrification. The current and future rebound of domestic manufacturing, and most significantly by the expansion of Artificial Intelligence (AI) are driving electricity demand. As FMR letters have stated, the fact that an AI query consumes 8 to10X the power of a simple Google search suggests a broad rise in power consumption as the use of AI becomes more universal. This is already starting to show in the growth of residential demand rising 2% in 2024. In addition, **the AI hubs and the data centers now account for 6% to 8% of total electricity consumption**. It is projected that in only five years data centers alone will account for close to 20% of total electricity consumption. This growth is coming against a background of a rising trend of electricity demand from: AI, electric vehicles (EVs), machine learning, cryptocurrency mining, as well as, heating with electricity from heat pumps for both commercial and residential use.

Where will the electric power come from to meet this rising demand? Renewables are important, but they can only go so far in meeting this demand as their power is intermittent. Solar installations have demonstrated remarkable growth, increasing by 30% year-over-year through September 2024. Wind is another renewable source with some caveats. Like solar, wind is mostly uneconomic without federal and state subsidies because this equipment is expensive to produce, difficult to install and provides only intermittent service. Wind has very high maintenance costs, particularly offshore because of harsh saltwater corrosion and requires very large scale and long-life battery storage, which does yet exist. FMR does not expect either wind or solar to become dominant factors in meeting this growing demand for electric power.

Investment Opportunities

Five Mile River portfolios have not missed the many implications of the electric power demand discussion above. FMR client portfolios have benefited from owning two major public data center companies, **Digital Realty** and **Iron Mountain**. FMR portfolios also own five of the major natural gas pipeline companies in the U.S. that transport, store, and process natural gas. They are the **Williams Companies, Kinder Morgan, OKE Inc**., along with two Master Limited Partners, **Enterprise Products Partners, and MPLX LP**. These companies will be among the first to benefit from increasing electricity demand as more than half of the US electric capacity runs on natural gas and any increase in demand will immediately pull more natural gas through these pipelines.

The U.S. has the largest natural gas reserves of any country in the world, with reserves estimated to last over 100 years with current discoveries. Today natural gas is the replacement for high carbon emission coal to meet the rapid increase in demand for electric power. Growing natural gas demand is positive for our pipeline companies, and for the electric utilities that have available excess electric generating capacity. FMR client portfolios own electric utilities that have excess capacity because of their massive nuclear facilities: **Southern Company, Entergy, and Pinnacle West.**

FMR Client portfolios own **Williams Companies, Inc.**, a major natural gas pipeline company. It deserves an update on a very new and positive development. Williams has been one of FMR's largest holdings at 4% to 5% in most client portfolios. It has been a strong outperformer and has delivered consistent dividend growth. Williams is one of the largest energy infrastructure companies in North America. It provides midstream natural gas services that include gathering, transportation, treating and processing, as well as, the fractionation and storage of natural gas liquids. Williams owns interests in three natural gas pipelines: probably the most important pipe in the U.S. is Transco, a 1000 mile pipeline from the Gulf to New Jersey, with many extensions along the way. It also owns Northwest Pipeline and Gulfstream Pipeline.

Williams operates a new and very specific proprietary service called behind-the-meter or BMT. This unique opportunity would be the first to run a dedicated natural gas pipeline to a gas turbine without the power going through a public electric utility. It will produce continuous electric power for **only** one data center company. BMT systems can significantly reduce the need for energy from the grid, potentially lowering electricity while also contribute to a reliable and resilient energy source. Estimates are that Williams Company **BMT will provide 500 megawatts of power to an undisclosed major data center company or one of the major cloud providers** (Microsoft, Amazon, Google, Oracle). BMT electricity producing gas turbines for a single, dedicated client may develop into **a major new growth avenue for Williams and other natural gas pipeline companies.**

While the U.S. population has long equated energy security with oil, in the coming years security will mean ample electricity from natural gas and nuclear. FMR client portfolios have significant exposure to this electric transformation.

Five Mile River wants to be responsive to changes in our clients' investment objectives, so please do not hesitate to have that conversation if you wish greater clarity or changes. As is customary with our Q1 letter to clients, we offer (upon request) a copy of the recently filed 2024 SEC ADV Parts 1&2. Also available on request are FMR's Proxy Voting Guidelines, and FMR's policies for protecting client confidential information.

We wish you an enjoyable spring and the fast-approaching warm weather.

Sincerely,

Lee Todd Martha

The S&P 500 Index is a market capitalized weighted index of 500 companies. It is a growth-biased index because the larger the capitalization of a company, the larger the weighting it contributes to the S&P 500 Index performance. The index referenced <u>includes the dividends</u> issued by these 500 companies. This index is used for a comparison for FMR accounts.

*** The S&P 500 Equal Weight Index is included in the performance chart to demonstrate how the S&P 500 Performance looks without the overweighting of a handful of technology companies.*

The performance data included in this letter are not audited and have not been otherwise reviewed or verified by an outside party. While Five Mile River Investment Management, LLC endeavors to furnish accurate information, investors should not rely upon the accuracy or completeness of this information.

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Please remember to contact Five Mile River Investment Management if there are any changes in your personal/financial situation or investment objectives *Please also advise us if you would like to impose, add or modify any reasonable qualifications to your investment portfolio(s).*