

The AI Iran Rollercoaster

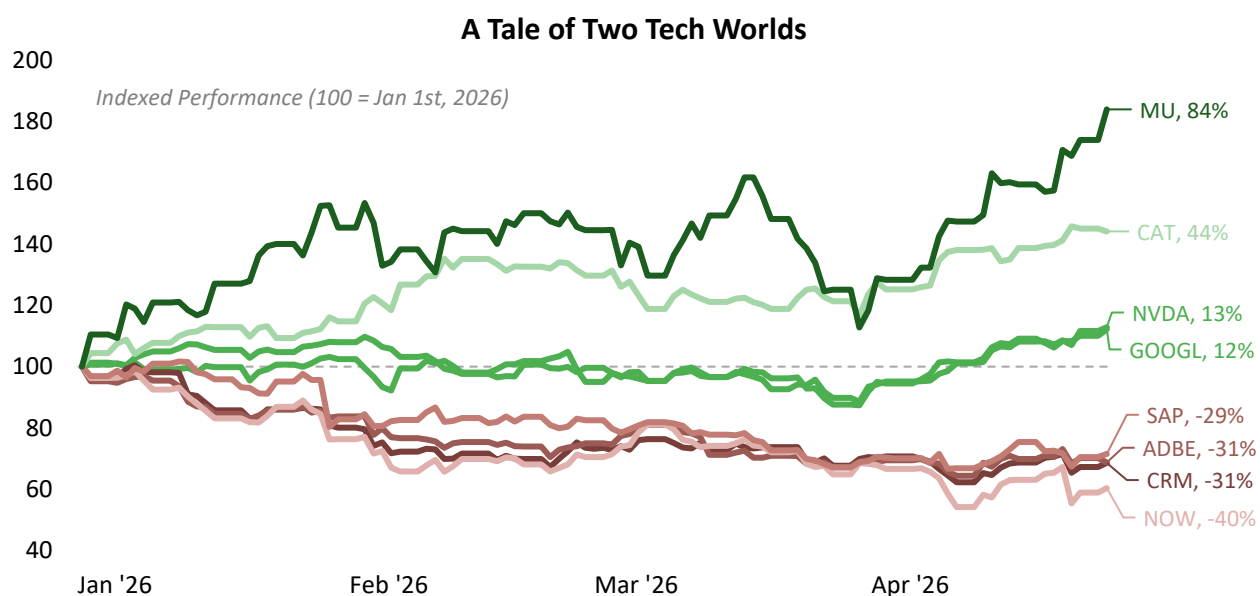
The US shocked the world when Operation Epic Fury was launched on February 28th. Despite devastating attacks on Iranian military assets, Iran's hardline regime has remained undeterred. As we write, a fragile ceasefire is in place with a contested and closed Strait of Hormuz. We hope that for US active military members, the Iranian people, and the safety of the Middle East, the cessation of military hostilities turns into a lasting nuclear weapon free peace. A status quo of agreements, surveillance, and subterfuge with periodic hostilities may be more likely. Spiking energy prices and declining stock markets followed in March. Surprisingly, stocks have rebounded in April. Less surprisingly, energy prices have remained elevated and volatile. A notable phenomenon played out in the US equity markets. Tech stocks, largely cresting in the fall last year, are leading markets higher again, reversing for now last year's trend of value stock outperformance.

We note these short-term dynamics as market observers but lend them no credence as investors. We do not believe that trading on geopolitical events or movements in market categories like tech and value is ever a good idea. Speculators, as distinct from investors, bet on unfolding events and how markets will react to them, believing they can protect the downside and profit from their prescience. Whether wagering on war in the Middle East or tech stock dominance, these speculators are bound to have both unpredictable successes and failures, just like casino patrons. There is an exception. Market makers and some quantitative hedge funds (many of whom we believe create value by trading in front of fundamental investors) can credibly capitalize on very short-term price movements when markets turn more volatile. We have exposure to market-making operations in our diversified bank investments.

The rise in energy prices is causing knock-on producer and consumer price and demand effects, but we believe the negative impact on consumption and our holdings in consumer cyclicals is likely to be short lived and immaterial from a valuation perspective. The US and Iran in our view are motivated to deescalate. Recession is always a possibility, but unless hostilities persist and snowball into something worse, we do not think current events in the Middle East will cause a recession. The investments most impacted by recent events are naturally related to energy, so this is a good time to discuss how we adjust these direct exposures for commodity price volatility.

The value of each company we own is established by our specific model for it, but at a high level our fundamental value estimates for energy producers are all based on long-term commodity price assumptions. These assumptions are anchored in marginal production costs at normalized demand levels. Energy producers are price takers. They benefit when higher prices raise revenues to levels which are significantly greater than production costs, just as they lose money when lower prices result in revenues below production costs. Assuming abnormally higher or lower prices and profits indefinitely is clearly a mistaken approach. Yet an increase or decline in profits, even if temporary, adds or subtracts from fundamental value, something we must account for. Our valuation adjustment occurs over time based on higher or lower profit monetization via dividends and share retirement. Though imprecise and with a lagged effect (which we keep in mind), we believe this is a sensible method.

Despite a closed Strait of Hormuz and little progress in peace talks, the AI boom rolls on, albeit with a peculiar crosscurrent all its own. Privately held frontier model leaders are approaching valuations garnered by today's largest publicly traded companies, which themselves are AI leaders. OpenAI announced a fundraising round at a valuation of \$852 billion while Business Insider reported talks of an \$800 billion valuation for Anthropic. Then there's Elon Musk's combination of SpaceX and xAI with an IPO target reported by Reuters of over \$1.5 trillion. Finally, there are AI leaders like Alphabet, Meta, and Nvidia, each with multi-trillion-dollar valuations. We do not know which of these or the many AI startups with multibillion dollar valuations will be worth today's price of admission, but we are confident there will be disappointments. While the AI bubble continues to inflate, SaaS and information processing related firms are registering modest to steep declines due to AI disruption fears.



Price returns from January 1, 2026 to April 27, 2026. Companies were selected to represent the relative performance gap between SaaS/software stocks and direct AI and AI infrastructure beneficiaries. Data sourced from S&P Global.

We believe it is likely that many of these companies will benefit from LLMs rather than being disrupted by them. Still, this is a one-company, one-market at-a-time assessment that can go either way, and which way can be difficult to discern. The other challenge from our perspective is that many SaaS and other potential AI disruption decliners were high-priced to start and have not gone down enough yet to warrant enthusiasm because of their valuations. Nevertheless, the ACR investment team is hard at work reviewing potential opportunities. Stay tuned.

Nick Tompras
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