KLCM Advisors, Inc.

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Boring is Beautiful

"May you live in interesting times" is often cited as an ironic curse, as interesting times are frequently marked by turmoil, war, instability, and general angst, while peaceful times are forgotten. History books are filled with descriptions of interesting times. The resolution of these periods has frequently gone on to shape future peaceful eras. The first half of this decade can be unequivocally described as interesting.

In finance, investors are often drawn to the excitement of interesting—rapid growth, soaring stock prices, and emerging trends that promise high returns. However, history shows that the most successful investment environments are often the least dramatic. A boring economic cycle, defined by steady growth, low inflation, stable interest rates, and limited volatility, can be highly beneficial for investors seeking consistent and sustainable returns.

One of the main advantages of a boring economic cycle is reduced investment risk. Extreme economic cycles often lead to asset bubbles, where prices become disconnected from fundamentals. When these bubbles burst, investors can suffer significant and sudden losses. In the current environment where capital spending is highly concentrated in a single industry, the development of data centers for "AI" may or may not be a bubble. Only with the benefit of hindsight will any certain determination be possible. What is not up for debate is the concentration of capital investment in one industry. It is difficult to put the scale of this spending into context. The current consensus is that capital spending will total at least four trillion dollars by 2030 and approach 3% of annual GDP by the end of the decade. By comparison, the telecom bubble peaked at a little over 1% of annual GDP, while the construction of the railroad system peaked at 6%. At present, like the early days of the telecom investment cycle, society's ultimate benefit from AI has yet to emerge. To date, we have been collectively chasing the dream of general artificial intelligence. Once that is achieved, the objective will morph into agentic artificial intelligence. In theory, each of us will have an "agent" that handles all the mundane stuff for us without even being told to. Our agents will know what we want. It sounds so simple, perhaps agents will be easier to handle than spouses, children, or employees? While still relatively undefined, the collective belief in achieving agentic artificial intelligence has subsequently led investors to demand participation in what appears to be the most obvious next great thing.

While this narrative seems simple, only over time and with the benefit of hindsight will we discover whether a return on this investment occurred, and then what, if any, the return on this investment was. One of the leaders of this movement, Sam Altman, the CEO of OpenAI, has famously made a "soft promise" to investors. In early fundraising conversations, Altman candidly told investors he had no specific roadmap for monetizing artificial general intelligence (AGI), joking that once a generally intelligent system was built, they would "ask it to figure out a way to generate an investment return." Interesting times indeed!

In contrast, a boring economic cycle encourages more productive capital allocation based on observable fundamentals. When economic conditions are predictable, investors are more likely to fund many types of businesses. Strong fundamentals abound and sustainable business models compete for capital. Capital flows towards long-term projects such as infrastructure, technology development, and workforce investment rather than short-term speculative opportunities. This leads to broad economic growth. The expanded scope of investment opportunities results in healthier markets and improves the overall quality of investment opportunities. Instead of placing all our economic growth eggs in one basket, they are dispersed throughout the economy. This allows investors the opportunity to price assets more accurately.

They are afforded the opportunity to make decisions based on earnings, cash flows, and long-term prospects rather than speculation or fear of missing out on the ONLY game in town.

Predictability, boring's second cousin, tends to improve long-term portfolio performance. During stable economic periods, companies tend to deliver consistent earnings growth, which supports steady stock market returns. This allows investors to rely more on compounding rather than timing the market. Over time, even moderate but consistent returns can outperform volatile cycles that include sharp downturns. For many of our clients, particularly those in retirement, avoiding large drawdowns is critical, and a boring cycle helps protect this precious capital.

A boring economic cycle includes both geopolitical and monetary stability. Neither has been present for the past several years, though there are signs that both are possible. On the geopolitical front, while no falling of the Berlin Wall, a peace dividend appears imminent, conflict globally does show signs of peaking. Robert E. Lee is often quoted as having said, "It is well that war is so terrible, lest we should grow fond of it." That appropriately summarizes our current situation. Resolution of the war between Ukraine and Russia is slowly coming into sight, while neighbors in the Middle East appear to be participating in a necessary though currently tenuous detente. In many ways, the combatants need a break if for no other reason than to retrench and reevaluate. The benefits of a meaningful reprieve would extend well beyond the borders of these conflicts, which have become proxy wars drawing in the collective energy and attention of the world.

Monetary stability experienced via interest rates is another key benefit for investors. Sharp changes in interest rates can disrupt bond markets, equity valuations, and real estate investments. For the past several years, the interest rate policy of the Federal Reserve and thus the interest rates in the market have been anything but boring. We have written at nauseum about the 0% interest rate policy that remained intact for seven years after the great financial crisis and the long-term impact it had on our economy. This policy was revisited in the aftermath of COVID and the results were significantly more pernicious. Inflation returned quickly and was initially misdiagnosed as being transitory. The Federal Reserve has now spent several years raising rates and trying to put the inflation genie back into the bottle. Despite their best efforts to expedite the process, the passage of time is the most important variable in this endeavor. Currently, short-term interest rates will likely be lowered modestly as the Federal Reserve continues to adjust its policy rate to moderate inflation. The key point, however, is that post this adjustment, significant changes to interest rate policy are increasingly unlikely until the economy materially changes.

In a boring cycle, central banks are less likely to make aggressive policy moves, reducing uncertainty across asset classes. Stable rates allow investors to better assess risk premiums and construct diversified portfolios that balance growth and income. A steady economic environment reduces panic and overconfidence, benefiting long-term strategies that balance the preservation of capital with reasonable rates of return. This type of environment supports compounding returns, as investors can remain focused on long-term objectives rather than short-term volatility. When inflation is controlled and recessions are mild or infrequent, real returns are preserved, allowing patience, predictability, and prudence to be rewarded. Over time, this reward compounds and has generated significant wealth for investors.

While exciting economic cycles may offer the promise of quick gains, they often come with higher risks and potentially larger losses, which are only experienced after the thrill is gone. From an investment perspective, a boring economic cycle provides stability, predictable returns, and a favorable environment for long-term capital growth. For disciplined investors focused on preserving capital and modestly growing it, boring is beautiful. After more than a few years of excitement, we believe we are on the precipice of boredom and could not be more excited.