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The S&P 500 delivered its strongest quarterly performance since 2020 this past quarter, ascending its tech-built scaffolding to dizzying heights. Though we took a bit of a drubbing in the process, we nonetheless got down to business: we bid adieu to one longtime holding and welcomed back into the fold another. And so does the circle of life play out in our portfolio.

Though the investing backdrop may change, our approach does not. Today, the market continues to set a handful of stocks atop Pride Rock, if you will, with others assembled around its base and the remainder—those with no whiff of AI about them—left to account for themselves on the plains far below. While it is never fully accurate to say that we've been here before (history doesn't repeat itself, but it does rhyme, etc., etc.), one of the sharpest tools in our toolkit is pattern recognition, aka mental models. We've learned several things through long (and sometimes hard) experience: what goes around comes around, just not in the same way each time, nor according to the schedule of one's preference; the close-up view of a phenomenon is rarely the same as the long-term view, especially in hindsight; and abandoning investment principles to go with the flow is not keeping up with the times, it's jettisoning one's compass. And so, while we might not have navigated these Pride Lands before, we've seen a similar lay of the land many times in our past. And we long ago absorbed the lesson that no stock or group of stocks is, over the long term, immune to the humbling forces of economic gravity and human capriciousness.

Let's take each of these observations in turn:

(1) What goes around comes around. There are rules that have governed the stock market since its inception and that no number of fast-talking promoters of "this time is different" have been successful in repealing. And by rules, we're not talking regulations; we're talking limitations on what is possible and sustainable. To the extent that investors continue to care about future returns on investment when they buy and sell, valuation and quality of earnings will always matter. There are, inevitably, times when these rules seem to have been overridden by animal spirits, but ultimately, the delicate balance between hope and cynicism that has long undergirded the market gets restored. The temptation to ignore such rules, whether because of FOMO or weak principles is, in both our estimation and as supported by abundant experience, wrong-headed.

(2) The close-up view lies or at least fails to tell you the whole story. The "wow" factor of the new can deceive us into believing that an innovation is civilization-level momentous when it's really an evolutionary development of a level of importance to which we've largely grown accustomed in this age of technological advancement. Important, perhaps, but world-changing in the way that the discovery of fire accelerated human progress? Eh, probably not. Once new discoveries and developments are integrated into the flow of commerce and forced to navigate competitive threats, politics, and regulations, they tend to resolve into yet more commercial background noise. Even if the hype is real, the fact that cheaper alternatives have been developed that apparently rival well known AI tools should tell you that the battle over which players will accrue the most economic rents from this innovation has barely been joined.



(3) Abandoning investment principles is akin to tossing out one's philosophical compass. No sailor would set sail without a rudder, nor any seasoned hiker venture into unknown terrain without a navigation tool. There is no dead-reckoning in investing; wade into the waters of the stock market without a philosophy and a discipline to guide you and you'll risk reaping the whirlpool. We at Marshfield are not opposed to investing in companies that fly the AI flag or whose value proposition rests squarely in that space. Our objection is to investing in them without valuation protection and a compelling theory as to why the revenues and margins implicit in today's valuations are sustainable.

Which brings us to Cummins and **Nike**. Even applying reasonably generous assumptions as to the continued level of demand for backup power generators for data centers, Cummins blew through the outer limits of our valuation. We continue to admire the company and, assuming it is still operating with its characteristic seriousness of purpose and steadiness of hand, we would buy it again at a price that better reflects our underlying assumptions. As to Nike, a stock we owned many years ago, we pulled it back into the fold based on a combination of several factors, not least of which was an attractive price that we believe gives us ample cover should we have erred in our decision to reinstate it. Nike has suffered numerous slings and arrows over the years, but through the strategic bobbles (e.g., moving to eliminate all but direct-to-consumer sales), inventory pileups, and increased global competition, as well as some lackluster product launches, the company has retained a strong brand and close association in the mind of consumers with athletic prowess and toughness of spirit. In this way, the circle of life continues to revolve here at Marshfield, allowing for the gradual regeneration of our portfolios as opportunities arise and as our tried-and-true principles permit.

Hakuna Matata

Marshfield Associates

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