

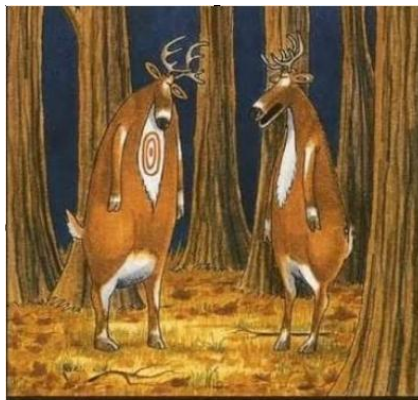


## ELM RIDGE

### *"AI, AI, AI, AI"*

June 30, 2026

*"Graham and Dodd investors are people who place a very high value on having the last laugh. In exchange for the privilege, they have missed out on a lot of laughs in between."*  
– Michael Lewis, *The New New Thing*, 2000.



"Bummer of a birthmark, Hal."

I didn't want to write this. And I'm guessing most of you are flying high enough that you couldn't care less what we think about the markets. Yes, our big picture prognostications (long rates jumping and holding well above previous expectations; the love affair with private investments ending very badly; and excessive crowding in asset-light "compounders" giving way to a stampede for something more substantial) still look to be on track. But as the semis grabbed the HALO (Heavy Assets with Low Obsolescence) from our favorite Pay Low bets, the stocks in those industries (Energy, Petrochemicals and Aluminum) that stand to benefit the most from the US-Iran war resembled Hal in Gary Larsen's 1986 *Far Side*.

## AI, AI, AI, AI



*Ay, ay, ay, ay,  
Canta y no llores,  
Porque cantando se alegran,  
Cielito lindo, los corazones"*

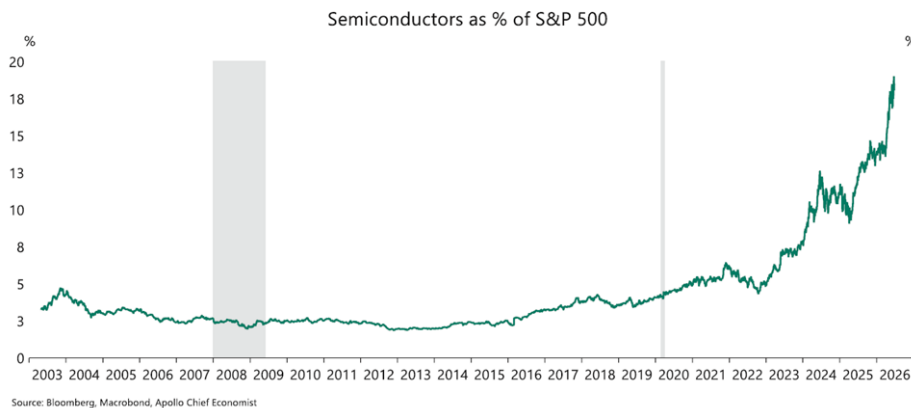
–Cielito Lindo<sup>1</sup>

*Ay, ay, ay, ay,  
Your sister...*

–Rugby ditty to the same tune

AI, AI, AI, AI. How I went from hearing AI all the time to ruining Sheetal's eardrums with a combo Mariachi<sup>2</sup>/Rugby ballad is better left to the professionals. AI is still dominating the markets. While the case for the hyperscalers and their huge investment programs has been called into question, investors found a new love in those selling the "Picks and Shovels" to the AI gold rush – just as was the case toward the end of the internet bubble. And so, the extremely cyclical commodity memory producers have now captured the public's eye.

In fact, this sector's nearly 100% return during the quarter (as measured by the Philly SOX Semiconductor Index)<sup>3</sup> drove most of the market's advance. Not that the stocks had been beaten down to begin with. As the semis tripled since last summer, the chart below shows how your momentum index fund purchases are now spending four times as much on the sector as you did 5 years ago.



There is some method to the madness. Excessive (to us) hyperscaler spending has driven shortages throughout the semiconductor complex. As a result, Micron has gone from posting a loss in FY23 (ending August), to \$1.30 in EPS in '24 and

\$8.29 last year, to consensus estimates north of \$150 for FY27.

If the big guys can continue to access the markets to keep spending, spiking prices should continue. But as cheaper Chinese models have become more competitive and AI customers are questioning its cost versus benefits,<sup>4</sup> that

<sup>1</sup> <https://www.youtube.com/watch?v=n1S-1XCrSnM>

<sup>2</sup> That a real picture of a friend from the neighborhood with the sax. He did spend a summer playing in a Mariachi band at Great Adventure although we did employ Claude to dress him as he did back then. In his defense, he also got to play with the Four Tops that same summer and ended up helping to create, as well as play in, *The Lion King*, on Broadway. In a further stab at gratuitous irrelevance, I'd like to note that the police showed up at my Bar Mitzvah to ask him a few questions, where he dutifully rehashed his inner Sergeant Schultz.

<sup>3</sup> <https://www.youtube.com/watch?v=nKRgAGWPE8I>

<sup>3</sup> As measured by the SOXX semiconductor ETF.

<sup>4</sup> See *Bloomberg*, "Ford Mistook AI for a Quick Fix. It's Not Alone," 7/2/26, among many other articles noting how companies are now clamping down on AI expenses.

effort has been called into question. The Magnificent Seven (as represented by the MAGS ETF) is still down from last October. Indeed, the investment cases for GOOG, META, MSFT etc. rest on the belief that, at some point, they can turn down the spigot. And then the process will run in reverse.

We've seen this before. During the summer of 2000, well after the internet bubble itself had peaked, Cisco, the Nvidia of that period<sup>5</sup>, sold in the \$60-70 range, based on FY02 EPS estimates approaching \$1.00. As their customers slashed spending, earnings ended up at just half that level before swinging to a loss the following year, with the stock falling below \$10. Turning to Micron, the \$4 estimates for FY02 turned out to be overly optimistic by nearly \$5, as that stock tumbled from \$90 to the single-digits.

Here we go again, telling stories about prehistory to try and piss on your parade.<sup>6</sup> But don't you worry 'bout a thing<sup>7</sup>.

## All the Young Dudes are Trading the News

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*All the young dudes  
Are trading the news  
Trading the news  
–Not David Bowie<sup>8</sup>*

Meanwhile the Cramer/machine learning method of investing – that every incidental bit of news requires an active trade, regardless of whether the stock price in question already anticipated such an outcome – is running rampant. We realize that we're being all theoretical and egg headed, but can someone please tell me how the Iran war was bad for North American energy, petrochemical or aluminum producers?

It was for the stocks. We understood that pricing bumps were bound to end. But as we entered the quarter, they were still trading well short of what we thought was reasonable, based on sustainable earnings. These markets lost a significant amount of production capacity, which could lead to higher prices later as countries (both China and the US drained their strategic oil reserves) and customers drew down inventories. Meanwhile, the supranormal profits the companies earned to this point have strengthened their balance sheets.

We weren't so naïve as to think that the markets would suddenly reflect our calculations and recognized that they were going to get hit on any indication of a cessation of hostilities. To us, this was just a necessary bump on a very long road. We just didn't realize there would be so many of them. The stocks got pummeled every time there was a new cease fire announcement, and there were plenty of those, while the resulting backtracking lacked the presidential megaphone. Newer converts, who had been bidding them up since the turn of the year, threw up their hands and once again moved back into the "I can't take it" camp. As a result, not only were the stocks whacked by 15% or more during the quarter, trailing the S&P by 30 points, but they fell below their prewar prices as well.

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<sup>5</sup> Take it from Andy Serwer in *Fortune*, now writing for *Barron's*; "Suppose you were stranded on a deserted island and could own just one single stock. What would it be?... Would it be a stock that's been battered this spring and is down 20% from its high? A stock that trades at more than 100 times earnings?... No matter how you cut it, you've got to own Cisco."

<sup>6</sup> I don't know how many times my father countered me with this phrase.

<sup>7</sup> I owe you this one to balance out the Mariachi. [https://www.youtube.com/watch?v=mMTkujnftIs&list=RDmMTkujnftIs&start\\_radio=1](https://www.youtube.com/watch?v=mMTkujnftIs&list=RDmMTkujnftIs&start_radio=1)

<sup>8</sup> [https://www.youtube.com/watch?v=ToXGVcrgNZA&list=RDTToXGVcrgNZA&start\\_radio=1](https://www.youtube.com/watch?v=ToXGVcrgNZA&list=RDTToXGVcrgNZA&start_radio=1)

Once again, the real winner was momentum, the method by which almost all retail investors pick stocks. They are not going to concern themselves with our theoretical calculations of what kind of cash a share of stock can earn and return over time. A good stock is one that has done well and vice versa. The (MSZZMOMO) index going long those stocks with the best prior 12-month return and shorting the opposite gained 25% in the quarter and 40% for the six months. And, as we've said ad nauseum, while momentum does tend to work most of the time, when it fails (see the chart on the right), it does so in a big way – as was the case in 2000 and 2008.

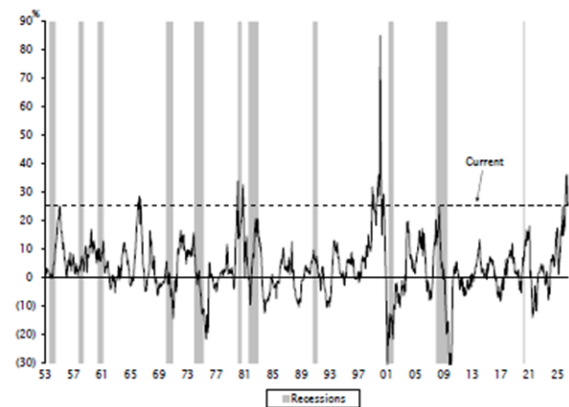
Retail investors have been taught to buy the dips, and it's likely they'll continue to rule the roost until they have exhausted their last available dollar. As *Barron's* echoed one investment strategist (supporting independent financial advisors): "tech stocks could struggle more in the days ahead, with chip stocks seeing particular weakness—potentially dropping another 20% or 30%. But that shouldn't scare investors away from the market. 'They should remain fearless'".<sup>9</sup> And they will until it's too late.

It's this fact that keeps us running our calculations while reaching for the Prozac. When the \$%^& hits the fan, the trend followers get wiped out, leaving only those looking for a real cash return on their investment to rescue stocks. That's when we get our last laughs.

Believe it or not, we have grown up in the past quarter century. Back then, I would embark on a similar rant and expect readers to be swayed by my inner wisdom. Now, as we explain our approach, we try to hold your interest with tangentially related YouTube clips, recognizing that our shpiel just leaves you feeling more convinced of your and your broker's investing skills.

This is what we do and we're sticking to our guns. We knew back in March a beating might be coming. But it still hurts every @\$%ing time.

**Exhibit 2: Large-Capitalization Stocks  
Trailing-Twelve-Month Relative Returns  
to the Top Quintile of Nine-Month Price Momentum'  
1953 Through Late-June 2026**



Source: Empirical Research Partners Analysis.

<sup>1</sup> Equally-weighted data.

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<sup>9</sup> *Barron's*, "Tech Took a Header. The Rest of the Market Marched On" 6/26/26.

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