

ST. JAMES INVESTMENT COMPANY

INDEPENDENT INVESTMENT MANAGEMENT

VALUE INVESTOR'S QUARTERLY LETTER

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"I know of no way of judging of the future but by the past." — Patrick Henry (1736–1799)

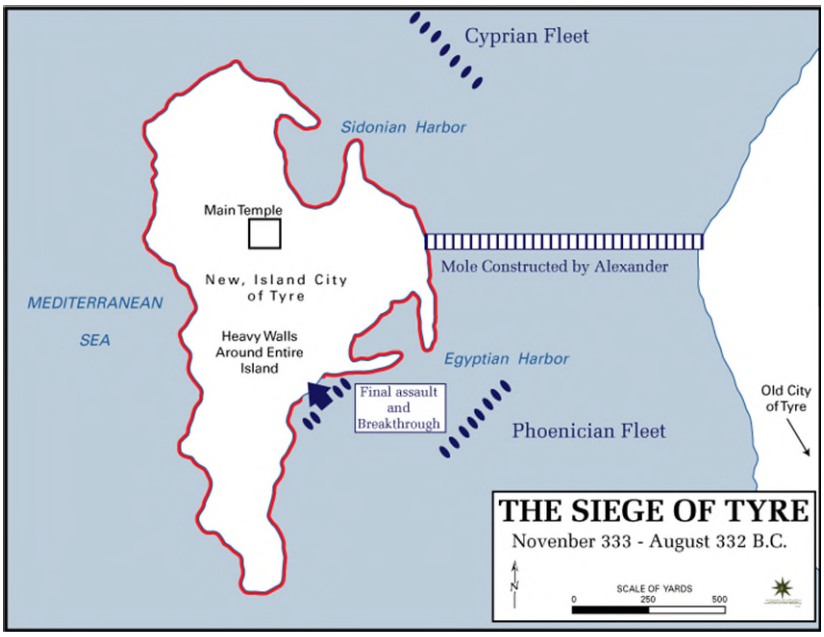
The Phoenician city of Tyre was among history's best-fortified cities. Located on the Mediterranean coast of southern Lebanon, 12 miles north of today's border with Israel, Tyre was long considered impregnable. Its ancient settlement stood on a rocky island roughly 800 yards offshore, protected by the sea, massive walls rising directly from the water, and a navy that kept the surrounding waters open. No earlier land power possessed both the engineering ability and naval strength needed to close that gap and assault the island citadel. The city consisted of two parts: the mainland settlement, which was vulnerable and captured or destroyed more than once; and the island city, the true fortress. If Tyre controlled the sea, it could not be starved. Supplies, water, mercenaries, and reinforcements arrived by ship. An army could occupy the coast and cut off overland trade, but without a strong navy it could not blockade the harbors or stop resupply.

Assyrian kings in the 8th and 7th centuries BC repeatedly campaigned against Tyre, captured mainland towns, imposed tribute, and occasionally established naval blockades, yet they never seized the island fortress by force. That remained true until 332 BC, two years after Alexander the Great, king of the Macedonians, began his invasion of the Persian Empire. In his first clash with the Persians, he defeated one of their field armies at the Battle of the Granicus. A year later he routed King Darius III himself at Issus. Rather than push toward central Persia, Alexander decided to secure his supply lines. He could conquer Persia only by controlling the sea, but his naval forces were too small to challenge the Persian fleet. He therefore sought to remove the threat by capturing Persian-controlled port cities along the eastern Mediterranean coast.

The Tyrians trusted their ability to defend themselves against Alexander's army. With walls reportedly greater than 150 feet high, Tyre stood directly at the water's edge, leaving potential attackers nowhere to assemble for an assault. Catapults were positioned all along the city's walls. The island had two good harbors, one to the north and one to the south, making resupply easy, while a Tyrian fleet of 80 ships controlled the nearby seas. Nevertheless, Alexander launched his siege in January 332 BC. The most crucial military problem he faced was how his forces would reach the island's walls. Alexander's approach was to build a causeway from the mainland and advance slowly toward the city. The work was not technically challenging but required significant human labor. Alexander addressed this challenge by compelling the mainland's local inhabitants to work alongside the soldiers. Stone came from the ruins of ancient mainland Tyre, and wood came from nearby Lebanese forests. The water was shallow, and the work went quickly.

Tyrian soldiers responded with torsion catapults from the city walls, while boats sailed close to the causeway, launching arrows and missiles at the workers. Alexander's army, in turn, built a protective wall and erected two siege towers at the causeway's far end—reportedly among the tallest ever built. The towers were covered with skins from freshly slaughtered animals, making them difficult to burn. The Tyrians modified their ships, filled them with flammable substances, and sent them toward the causeway. The ships set the Macedonian towers ablaze, while Tyrian soldiers tore down Alexander's palisade. Rising seas then flooded the narrow causeway. The Tyrians won the first round. The attack on the causeway exposed Alexander's main weakness: he needed ships. Fortunately for the Macedonian king, other Phoenician naval bases had already surrendered, and Alexander soon assembled a fleet of over 200 ships to stop the Tyrian fleet.

Alexander and his engineers constructed a wider causeway farther north. They built new siege towers, while ships protected the workers. Throughout the summer, the Tyrians fought an increasingly desperate battle to defend the city, but the Macedonians eventually found a weak point on its southern side. Alexander launched a coordinated assault on both ports and the southern eark point, while also attacking from the causeway. His army breached the wall, and his ships entered the ports. The soldiers fought from street to street, while the main Macedonian force entered the city from the causeway. Tyre was burned to the ground, and the attack reportedly cost 8,000 Tyrians their lives. The surviving non-combatants were sold into slavery, and Alexander now had complete control of the waters.



The Macedonians spent seven months besieging Tyre but lost only 400 men. The young Macedonian king now controlled the Eastern Mediterranean and had gained a foothold in Phoenicia from which to launch attacks against the Persian Empire. Tyre's long-standing reputation of invincibility rested on three interlocking advantages: an island location that turned the sea into a moat, walls that denied attackers a foothold, and a navy that kept that moat from being closed. Alexander succeeded only when he neutralized Tyre's moat.

As an investment concept, the "moat" metaphor first appeared in Warren Buffett's 1986 letter to Berkshire Hathaway shareholders. Discussing GEICO's cost advantage, he wrote:

> The difference between GEICO's costs and those of its competitors is a kind of moat that protects a valuable and much-sought-after business castle. No one understands this moat-around-the-castle concept better than Bill Snyder, Chairman of GEICO. He continually widens the moat by driving down costs still more, thereby defending and strengthening the economic franchise.

Buffett expanded on the idea in subsequent letters, but the 1986 letter remains the original written source. In Buffett's understanding, a "moat" offered a durable investment advantage that prevents rivals from taking a company's profits, much as a castle's water barrier keeps out an army. Buffett's 1993 letter was the first time he applied the castle-and-moat image to his two flagship consumer franchises, Coca-Cola and Gillette. Buffett remarked that Coke and Gillette's shares had lagged their businesses from 1991 to 1993: operating earnings per share rose 38% and 37%, while the share prices rose only 11% and 6%, a reminder that market prices and underlying economics can diverge for years even when the underlying businesses remain durable. Buffett wrote:

> Worldwide, Coke sells about 44% of all soft drinks, and Gillette has more than a 60% share (in value) of the blade market. Leaving aside chewing gum, in which Wrigley is dominant, I know of no other significant businesses in which the leading company has long enjoyed such global power.

> Moreover, both Coke and Gillette have actually increased their worldwide shares of market in recent years. The might of their brand names, the attributes of their products, and the strength of their distribution systems give them an enormous competitive advantage, setting up a protective moat around their economic castles. The average company, in contrast, does battle daily without any such means of protection. As Peter Lynch says, stocks of companies selling commodity-like products should come with a warning label: "Competition may prove hazardous to human wealth."

In a later 1993 letter, Buffett specifically identified three sources of protection: brand power, product attributes (taste, quality, and habitual use), and distribution systems. Together, these advantages expanded Coke's and Gilette's global market share over time rather than merely preserving it. In 1986, Buffett first used "moat" to describe GEICO's cost structure. By 1993, he had applied the metaphor to brand-and-distribution franchises, explicitly contrasting them with commodity businesses, high technology, and retail. Later letters (1995, 2007) added "unbreachable" and "enduring," along with the warning that a moat requiring constant rebuilding is no moat at all.

For roughly two decades, beginning in the late 1980s, Intel Corporation occupied the position Tyre once held. Intel's "island fortress" combined the x86 instruction set (the language processors speak), world-leading manufacturing, the "Intel Inside" brand, and the Wintel software ecosystem (Intel x86-compatible processors running Microsoft Windows). Nearly every PC and server ran Intel silicon because almost all software assumed x86 architecture, while Intel's factories remained a generation or two ahead of the competition. Rivals could claim parts of the ecosystem—niche chips or brief performance gains such as AMD's Athlon—but they could not defeat Intel. Intel's moat was a PC-and-server world where raw x86 performance and backward compatibility mattered most.

The introduction of the smartphone reshaped the battlefield through extreme power efficiency, a different instruction set (ARM), and a foundry model in which the best factories no longer belonged to chip designers. Intel tried to respond with x86 Atom chips but failed. It treated the new market as a sideshow rather than recognizing it as the place where volume, talent, and the next computing platform were emerging. AMD's answer, beginning in 2008, was to go "fabless" and later stake everything on a clean-sheet architecture (Zen) manufactured at TSMC's facilities. Because AMD could not match Intel's capital spending, it spun off its factories and outsourced its chip production to TSMC. This innovation removed the requirement that a challenger be a world-class manufacturer while TSMC's rise made the fabless chip company possible. A competitor no longer had to control the entire channel; it could buy access to the best process while Intel shouldered the cost of the entire production value chain.[1]

Intel planned to launch its first 10-nanometer (nm) CPUs in 2016, but its development never arrived on schedule. The delay pushed Intel away from its long-running Tick-Tock cadence (a two-year process-development cycle), kept the company at 14 nm for years, and helped TSMC and AMD narrow the manufacturing gap. While TSMC shipped 7 nm and then 5 nm, Intel spent years refreshing its 14 nm products. By the time "Intel 7" (a rebranded 10 nm process) reached critical production volume, its competitors had already closed the performance and efficiency gap. Intel assumed its largest customers would never leave the x86 island, but its dominant moat no longer existed. Apple was once Intel's most prestigious PC customer, yet beginning in 2020, it transitioned the entire Mac line to its own ARM-based M-series chips. Hyperscalers, a market segment Intel once completely dominated, began dual-sourcing AMD's EPYC processors and later designed their own silicon. Microsoft promoted Windows on ARM, while OEMs that had treated Intel as the default began viewing it as just one option. The moat that had once protected Intel's business quickly disappeared.

[1] https://www.aakashg.com/globalfoundries-story-amd-to-ipo/

x86 compatibility had once been a genuine barrier to competition: rewriting the world's software was unthinkable while Intel chips kept getting faster. Once process leadership vanished and new platforms (phones, then Macs, then parts of the cloud) no longer required x86, Intel's structural moats began to erode. Compilers, emulation, and new operating-system support removed the assumption that "everything important runs on Intel." AMD did not need to destroy x86; it only needed to make "good enough, cheaper, better efficiency" available on the same instruction set, and then let customers decide. An overconfident Intel had beaten back AMD in the early 2000s and assumed that its process leadership and installed base were permanent. Yet Intel's dominant moat slowly eroded: first its manufacturing leadership, then its performance leadership, then its pricing power, and finally its market share. Server market share, ~95% in the late 2010s, fell to 50–70%; client PC share, once overwhelmingly Intel's, became contested. The company that once earned more profit than TSMC, Nvidia, and AMD combined began generating large losses while its competitors pulled ahead.

Intel's moat was once real and formidable, and the company had every historical reason to believe it was safe. But when competitors changed the battlefield and adopted a manufacturing model Intel had dismissed, they increasingly peeled away the company's customers. Andy Grove was Intel's CEO from 1987 to 1998, having already served as president since 1979. He became chairman of the board in 1997 and, in May 1998, handed the CEO title to Craig Barrett, but remained chairman until 2005. Andy Grove popularized the phrase "Only the Paranoid Survive" as the title of his 1996 business book. Grove himself addressed its origin in the book, writing: "*I am often credited with the motto, 'Only the paranoid survive.' I have no idea when I first said this, but the fact remains that, when it comes to business, I believe in the value of paranoia*." Grove's business mindset evolved as part of his long-standing management philosophy while he led Intel through the intense competition in the semiconductor industry, particularly during the company's mid-1980s pivot from memory chips to microprocessors. Japanese firms nearly wiped-out Intel's memory-chip business in the 1980s, forcing a painful but ultimately successful full pivot to microprocessors.

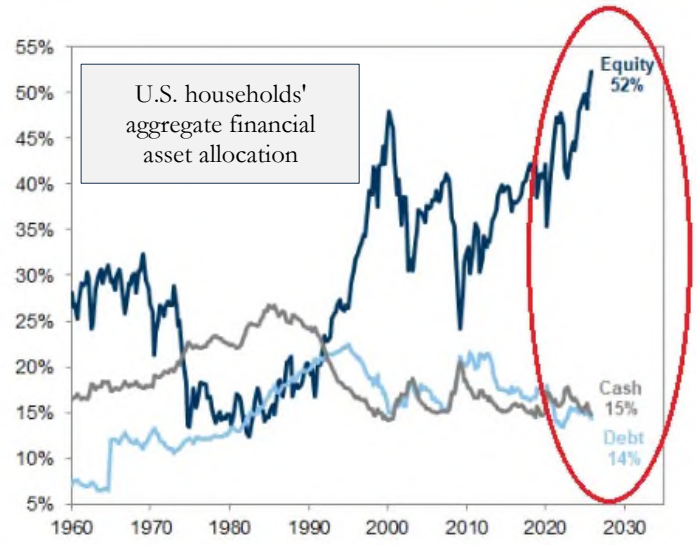
Only the "paranoid" survive because they remain constantly alert, even during good times. Grove connected this mindset to his personal history as a Hungarian-Jewish Holocaust survivor who escaped Communist Hungary in 1956—experiences that taught him stability can vanish overnight, and that vigilance is a survival skill. Born in 1936 as András István Gróf in Budapest, Hungary, Grove was seven when Nazi Germany occupied Hungary in March 1944. To avoid arrest and deportation, his family went into hiding and assumed false Christian identities with stolen papers. Grove became "András Malesevics" and posed as his mother's illegitimate son. The family later survived the brutal Soviet siege of Budapest in early 1945, which devastated the city. After liberation, Grove lived under successive Communist regimes in Hungary before fleeing in 1956 during the failed Hungarian Revolution. He resettled in the United States in 1957 and later anglicized his name to Andrew S. Grove. Although he rarely discussed the Holocaust publicly in depth earlier in his career, he described it as shaping his lifelong "productive paranoia"—the vigilance that became central to his management philosophy.

Financial markets remain surprisingly unbothered by the ongoing energy crisis and rising interest rates. Diesel prices have surged past $200 per barrel, roughly doubling crude oil prices. Given diesel's widespread global use, this price increase risks destabilizing markets, damaging economic activity, and increasing the risk of stagflation. What was initially expected to be a brief conflict with Iran is now nearing its eighth month and has expanded from the Strait of Hormuz to the southwestern Arabian Peninsula. Oil shipments heading west through the Red Sea to avoid the Strait of Hormuz face hurdles: supertankers are too large for the Suez Canal, and recent Houthi attacks on Saudi Arabia's East-West Pipeline—an alternative route that bypassed the Strait—have worsened the situation. This pipeline

transported 4 to 5 million barrels a day, about 4% of the global supply. Eight months after Iran's attack, most of the pre-war 20 million barrels per day of oil flows from the Persian Gulf remain disrupted.

Meanwhile, long-term borrowing costs are hitting multi-decade highs amid rising inflation concerns, driven by higher energy prices from the Iran conflict, government deficits, and record corporate borrowing fueled by AI investments. The U.S. 10-year Treasury yield stands at 5.23%, with the 30-year at 5.55%, its highest since 2002. Increasing debt levels are likely to force tough political choices and strain the economy over time. This trend is secular rather than cyclical, as government debt continues to grow. The U.S. has made little effort to address record deficits, with annual deficits of roughly $2 trillion and national debt surpassing $40 trillion. Politicians tend to favor spending more rather than less. Real interest rates (nominal minus inflation) are only slightly positive if one accepts government inflation figures; in reality, they are negative because the cost of essential goods and services is rising faster than official inflation statistics report.

Since COVID, the U.S. stock market has outperformed U.S. bonds by an average of 28% annually—the largest stock-over-bond outperformance in 100 years.[2] While such dramatic stock outperformance over bonds doesn't necessarily mean the stock market will decline, it has often preceded periods when it significantly underperformed the bond market. Like today's stretched valuation metrics, this multi-year record of stock outperformance over bonds is another warning sign for stock investors. Wall Street attributes this performance gap to strong economic growth and the seemingly limitless potential of AI. That could be true, but with both interest rates and oil prices rising, an allocation to cash and a dose of productive paranoia might not be misplaced.



Source: Federal Reserve, Goldman Sachs Global Investment Research

And yet, U.S. households currently hold 52% of their financial assets in equities, the highest level in the Federal Reserve's records. Higher than the dot-com peak, higher than 2007 just before the housing bubble; in fact, higher than any point in the last 65 years. This isn't just a portfolio choice; it's the entire American household balance sheet levered to the stock market. With 52% of household financial assets in equities, a market correction impacts consumer confidence, spending, and the economy. Because a feedback loop runs both ways, the rising stock market currently reinforces the AI trade, one of the most crowded in history.

Perhaps nothing exemplifies this trade better than the levered ETFs focused on the semiconductor sector. The Direxion Daily Semiconductor Bull 3X Shares (SOXL) provides three times levered exposure to the NYSE Semiconductor Index (SOX). For example, $100 in SOXL creates $300 of exposure by borrowing $200. If the index rises 10%, you now have a position at $330, but you still have $200 of debt because you started with $100, so your net position is $130 ($100 + $100 x 3 x 10%). To recreate the necessary leverage for the next trading day, the ETF needs $260 in debt for $130 of equity, for a total

[2] Jim Paulsen, "Market Warnings," Substack: Paulsen Perspectives, September 8, 2026.

exposure of $390. Therefore, the ETF needs to buy an additional $60 of the securities in the SOX index, even though market participants provided no new inflows. The SOXL ETF currently has $25 billion in assets but invests with $75 billion in index exposure, an amount large enough that the ETF's daily rebalancing impacts the overall S&P 500 index.[3] The companies in the underlying semiconductor index now account for almost 20% of the S&P 500's weighting, up from about 14% at the beginning of 2026. This single leveraged ETF now influences the prices paid by every 401(k) retirement account passively invested in an index fund.

Patrick Henry said he knew of no way to judge the future except by the past. Henry's point was that history is the best guide to anticipating future events. Because human behavior tends to follow consistent patterns, studying past actions and consequences helps people make informed decisions and avoid repeating mistakes. Tyre's island fortress fell to Alexander's army not because the stone was weak but because the defenders trusted a configuration that had always worked until the attacker changed the battlefield. Intel's x86 instruction set, process leadership, and the Wintel ecosystem formed a moat as real as Tyre's — unassailable until it was not. Andy Grove understood how competitive markets operate. "Productive paranoia" was Grove's defense against complacency. He actively sought the opinions of those not tied to the current business model.

The last time the S&P 500 closed at a record high with so few companies participating was March 24, 2000, the day the S&P 500 reached its dot-com bubble peak. Similar conditions also occurred in December 1998, but the market climbed another 30% until March 24, 2000. The current investment landscape is marked by rising interest rates and energy prices, record government debt levels, record-high stock market valuations, and conflicts in Eastern Europe and the Middle East. Yet the S&P 500 sits at or near all-time highs. Few dare to question the current market environment; both institutional and retail investors remain heavily invested in the most speculative end of the stock market. Stocks can certainly keep climbing to new record highs, but history suggests caution. Fortunately, the value investor need not argue with Wall Street, because he is under no obligation to transact in today's AI-driven market. He can remain steadfast in owning businesses with durable moats rather than narratives, while demanding a discount large enough to absorb the unexpected.

With kind regards,



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[3] Grant Williams, "The End Game," Episode 61, podcast, Michael Green (14:31).

We founded St. James Investment Company in 1999, managing wealth for our family and friends in the hamlet of St. James, New York. For over twenty-seven years, we have been grateful for the trust placed in us to invest alongside our own capital.

St. James Investment Company is an independent, fee-only, SEC-registered investment advisory firm managing the Select Value portfolio for individuals, family offices and private companies.



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