

FRAGILITY

Throughout history, some of the most disruptive economic and social events share a common trait: systems that are very efficient but lack enough redundancy, diversity, or flexibility. When stress occurs, these systems don't adapt; they make the shock worse.

The Irish potato famine is a clear early example. Ireland had plenty of land and labor; it lacked diversity. Relying on a single crop with little genetic variation created a system that seemed stable but turned out to be fragile when disease hit. The failure was quick and systemic.

A similar structural vulnerability appeared during the 1970s oil embargo. Industrial economies had become heavily reliant on a few energy suppliers, with few alternatives or spare capacity. When supply was cut, it caused sharp price hikes, inflation, and economic stagnation. The system lacked redundancy, and the cost of that absence was felt worldwide.

That same pattern persists today. The Russia-Ukraine conflict and Iran's closure of the Strait of Hormuz demonstrate how modern energy systems are still vulnerable to geopolitical chokepoints. Despite technological advancements, supply chains remain tightly connected and often prioritize efficiency over resilience. Consequently, a single disruption can have widespread effects on inflation, trade, and financial markets.

We see a similar trend in AI infrastructure: a concentration of advanced semiconductor manufacturing and reliance on a few companies, mainly Nvidia, for essential chips. At the same time, AI systems depend on large, energy-intensive data centers. This creates a layered dependence: centralized hardware supply, concentrated computing power, and rising energy requirements. Each layer can be a potential failure point, leading to a system that is powerful but not yet fully resilient.

Concentration, interdependence, and limited slack—these structural features define systemic vulnerability. They also shape common market behaviors during times of stress. Bank runs and market panics are not anomalies but expressions of the same dynamics. When confidence falls, participants hoard resources,

Strong Systems Adapt

Fragile Systems Shrink



Resilience = Redundancy + Flexibility + Diversity

APRICUS 04.26

creating self-reinforcing feedback loops: capital withdrawals lead to more withdrawals, and selling begets more selling. In systems without enough buffers or flexibility, these loops increase instability rather than reduce it.

Markets go through cycles of stability and stress, where pressure builds up and is eventually released through volatility, repricing, or an economic slowdown. This reflects a broader state of systemic fragility, where high leverage, limited supply, and close interconnections reduce flexibility and amplify the impact of external shocks.

Against this backdrop, effective portfolio construction starts with a clear yet challenging goal: to define, protect, and grow future cash flows. Asset prices will fluctuate, often unpredictably, but long-term results rely on the strength and expansion of the cash flows those assets generate. Systems that are fragile weaken cash flows; resilient systems defend and enhance them.

In a world increasingly shaped by interconnected systems like energy, technology, and finance, balancing efficiency and resilience is more than just an operational concern; it's a strategic one. The aim isn't to eliminate volatility, which is natural in complex systems, but to ensure that when stress occurs, it doesn't cause permanent damage to the cash flows that ultimately drive long-term returns.

The broader lesson is that resilience comes with a cost, whether through excess capacity, diversification, or reduced short-term efficiency, but this cost is best viewed as an insurance premium protecting future cash flows. When systems lack that insurance, the eventual adjustment often occurs suddenly, unpredictably, and can be far more damaging.

In this environment, there are often calls for tactical adjustments in response to near-term developments. However, reacting to short-term market swings can introduce more risk than it reduces, especially when underlying conditions stay uncertain and changeable. Short-term volatility often reflects system stress, not a dependable indicator of long-term value. The history of fragile systems shows that the more reliable approach is not constant repositioning but disciplined ownership of businesses capable of maintaining and growing cash flows across different cycles.

Our investment strategy focuses on durable, cash flow-positive, consistently growing companies. It aims to protect capital from major, disruptive events while still enabling

participation in long-term growth. These companies generally possess qualities that fragile systems lack: diversified revenue streams, strong balance sheets, pricing power, and operational flexibility which allows them not only to withstand shocks but also to adapt and continue generating cash flow.

Recent market performance reflects this shift. Value-oriented equities and equal-weighted indices have outperformed, indicating a move away from narrow leadership and toward companies with stronger balance sheets, steady cash flows, and more reasonable valuations. This broadening is not incidental, it aligns with a higher-cost, more constrained environment where capital discipline and resilience matter more than long-term growth expectations.

EXECUTIVE ORDER 14247

On March 25, 2025, the U.S. government issued Executive Order 14247, requiring federal agencies to transition from paper checks to electronic payments for both disbursements and receipts by September 30, 2025. This includes payments such as Social Security and Veterans benefits. In response, *Schwab Advisor Services announced it will stop printing checks payable to the U.S. Treasury effective June 1, 2026. We have asked Charles Schwab to facilitate electronic payments to the U.S. Treasury.*

Although the Treasury and most state and local taxing authorities still accept paper checks, we recommend switching to electronic payment methods.

Our team is prepared to help ensure a smooth transition.
