

Cutlass

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The Latin word *cutellus* (in Italian, *coltello*) generally means “smaller knife” or “dagger.” It is a common Latin root for several Italian and French words that, today, refer to small swords. As well, it is the origin of the English word *cutlery*.

Cutellus became *coutelas*, a 16th-century French word for a mid-length single-edged blade. A *coutelas* then became a **cutlass**, a 17th-century English abbreviated sword. This tool (or weapon, depending upon its use) has a short and more or less curved single-edged blade. The grip is generally of wood, but some specimens show a brass grip with spiral grooves, the fancier ones perhaps adorned with stones. The length of the blade is usually about twenty-four inches.



The cutlass was best known by sailors. It was robust enough to hack through heavy ropes or thick canvas, while being short enough to be used in relatively close quarters combat, such as during boarding actions, in the rigging or below decks. Another advantage to the cutlass was its simplicity of use, as it required less training than that to master a sword. It is common amongst historians to tell of the skilled use of cutlasses by pirates.

For much of the next 300 years cutlasses were widely used not only by sailors, but by policemen, hunters and the military. The cutlass remained an official weapon in the U.S. Navy up until 1949, at which time it was decommissioned.

But do not fear, as the Cutlass name would live on. Introduced in 1951, the U.S. Navy F7U *Cutlass* was a carrier-based jet fighter produced by the Chance Vought company (today a part of Northrop Grumman). It was the first tailless production fighter as well as the Navy’s first jet equipped with swept wings. Ultimately, though, it was not very successful, dogged by what was believed at the time to be an underpowered engine (that had a habit of stalling in the rain).



While stalling was not a trait to boast of, beginning in 1961 came the greatest “rendition” of the *Cutlass* name. The Oldsmobile division of General Motors [GM] named a new class of mid-sized cars after the Navy’s airplane.

GM found that the Cutlass name, perhaps because of its history, projected a perfect combination of style, sturdiness and aggression, but none to excess. In 1964, the car line took a step up in prestige and recognition, basking in the glory of the *Cutlass 442*, Oldsmobile’s popular entry in the “muscle car” category. The brand continued to gain in popularity, peaking during 1977, ’78 and ’79 with more than one million Cutlasses sold each year. Today there is no single car or light truck model that sells even close to one million units in the U.S.



Why the popularity? Like the airplane, the Cutlass car actually never received rave reviews. They broke down just as much as most GM cars of that era, got lousy gas mileage, rattled and squeaked quite a bit, and had a suspension system ... well ... about on par with a galloping pony. But for their time, they were seen as (somewhat) stylish, and most of all, that is what EVERYONE ELSE was buying. Thus, the main reason for the Cutlass’ popularity was that ... it was popular. Seeing (a shiny new) one in your neighbor’s driveway implied you couldn’t go wrong. It was an “easy” decision amongst a myriad of choices.

What may this teach us about investing?

Hard Decisions

Just as an “easy” decision to buy an Oldsmobile Cutlass was not always the “optimal” one, so too do we find ourselves often presented with what appear to be easy(er) investment decisions. Be they economic, political, personal financial or corporate, there is almost always an “easy” way (typically coincident with being popular), versus a choice requiring greater diligence.

➤ Economic “hard” decisions. Ever see an economist’s long-term track record? Neither have we! Most famous predictors made one truly monumental prediction that came to pass – like the prediction of a recession made during good times. Rarely are subsequent forecasts so prescient. At Aristotle Capital, we rarely rely on economic predictions. Rather, with the understanding of inevitable cycles, we aim to identify unique businesses that do not rely upon certain types of economies. While it is difficult to truly thrive in a downtrend, we have found that some companies hold up better than others, with some regularity. So, instead of relying upon a famous prediction put in front of us, we take the time to analyze businesses across a variety of scenarios, one-by-one, favoring those with proven records of (at least relative) resilience. To be clear, we endeavor not to be *too* conservative, as in the long run, most developed economies expand, personal incomes grow and corporate profits rise along with both.

➤ Political “hard” decisions. It is our belief that, contrary to what politicians may espouse, their policies (if enacted) may not fully play out for years. It is usually *after* an administration (and accompanying Congress) have finished their terms that their actions may be judged by the actual results. It would be much “easier” to take one side or another than to keep track of what was promised and come back some years later to measure its success (or consequences). Similarly, even when “front page,” we will allow for governments’ fiscal and monetary policies to play out, sometimes with many unknown or unintended consequences from the time the policy was enacted.

➤ Investment “hard” decisions. There was an adage that “... *nobody gets fired for owning IBM.*” It meant that owning IBM in one’s investment portfolio was a safe, easy, predictable choice for which one would not be faulted. Fast forward to recent times and one could replace IBM with ... name your choice ... Nvidia, Apple, Amazon or Meta, as a few examples. They are so widely held, could it be that these investments are simply as “popular” as was the Oldsmobile Cutlass?

We consider that just because an investment is *in favor* is not, by itself, a reason for *including* or *excluding* such companies from consideration. Indeed, the Cutlass was an *optimal* choice for many, and rightly so. But, perhaps, not as *optimal* as its popularity would imply. So, instead, we largely ignore popularity and stick with what we believe are *optimal* investments based upon long-term fundamental factors.

These fundamentals typically revolve around predictable cash flows. Two opposite examples:

➤➤ WEC Energy Group [WEC] (not currently in Aristotle Capital portfolios) is an electric utility holding company that, by design, and by law, earns returns on the capital it *spends*. Having a guaranteed “monopoly” to provide electric power in parts or all of Midwest states including Wisconsin, Illinois, Michigan and Minnesota, WEC must spend money to build generation and distribution systems before it receives revenue from the electricity provided. In exchange for these monopoly territories, WEC will advance the funds for the facilities, then be guaranteed an allowable “rate” so that it earns (typically ~10%) a return on the capital spent. This makes for a very predictable business, allowing for generous and growing stock dividends paid during “good” times and “bad.”

➤➤ Opposite to WEC above, JetBlue Airways [JBLU] (also not currently in Aristotle Capital portfolios) competes in a **semi**-regulated industry whereby enormous costs (for safety, security, unpredictability of weather, not to mention the airplanes, etc.) are mandated to be borne by the company. Unlike regulated utilities, JBLU must “duke it out” with competing airlines whereby ticket prices are essentially a perennial “open season” of competition. With little that meaningfully differentiates it from its (mostly larger) peers, JBLU’s business model is the worst of all worlds. Its expenses are large, regulated and mandatory while its revenues are subject to free market forces. While subject to regulatory changes (and the whims of politicians), this basic industry structure is unlikely to change. While there are times when JBLU, as well as other airline companies, may be “popular,” rarely would we believe that it was an *optimal* investment for long-term investors.

The last Cutlass rolled off the assembly line in July of 1999, and on December 12, 2000, GM announced its plans to phase out Oldsmobile, the company’s oldest brand (pun intended, we guess).

[Much of these descriptions of Cutlass were taken from public sources including *Wikipedia The Free Encyclopedia*, as referred to by the Gemini AI Overview of the Google search engine.]

EQUITIES STRATEGY

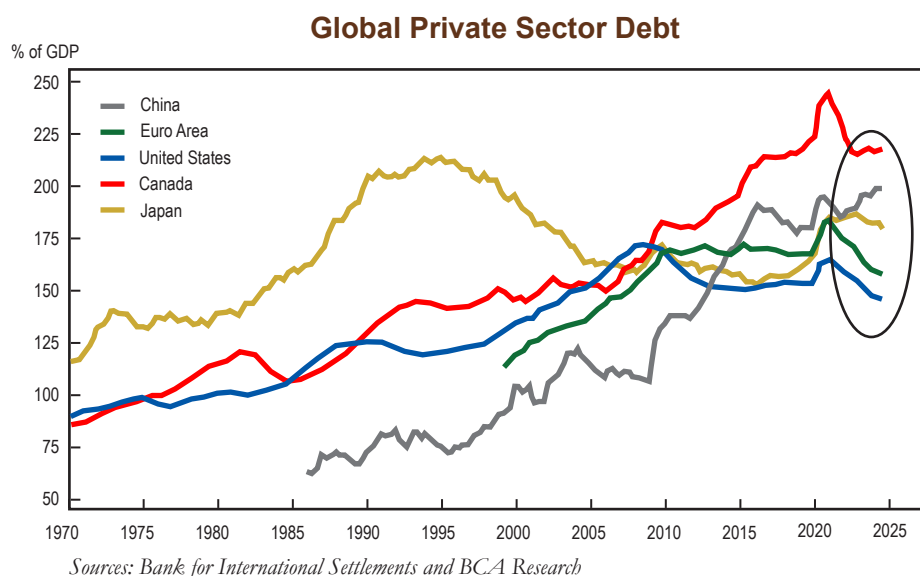
In our last edition of *The Essence* entitled “*Bab Humbug*,” we juxtaposed government versus private sector debt. We noted that, in the U.S. since the late 2000s global financial crisis [GFC], private sector debt has declined meaningfully as

a percentage of GDP (a lot of which has to do with the decline in mortgage debt). At the same time, public debt (90% of which is the federal government) has ballooned to now greater than 100% of GDP. Here follows a chart expanding the analysis to other countries.

This chart shows that while U.S. private sector debt expanded rapidly to peak at 170% of GDP in 2009, it has subsequently declined to now, ~140% of GDP. On the other hand, many foreign countries have had a continuous **rise** in private sector debt, even following the GFC. This is as public debt, for most, continues to expand as well.

History has shown that *some* amount of debt is beneficial to society in allowing for capital to be formed and utilized to enhance productive capacity – building a factory, for example. But the output of that factory must be sufficiently profitable to pay back both interest and principal on the debt. Otherwise, interest on that debt could become prohibitively expensive – such as a **refinance** rate. It is difficult to determine precisely where that “breaking point” may be for governments (which, as opposed to private enterprise, may **print** money to make payments). We have seen instances in countries where too much debt causes runaway **inflation** that may lead to the need for bailouts. But we have also seen instances (Japan comes to mind) where increases in debt have led to periods of **deflation**. What will come to pass?

Without too much pontification, and with the proviso, as discussed earlier, that we don’t emphasize such predictions in our investment work, we remain sanguine that human ingenuity is not nearly ready to run out. Thus, productivity improvements may indeed help to repay the public debt we are amassing. Meanwhile, if private/individual debt levels remain flat (in the U.S., generally, as we see from the chart), then the total of all debt can be manageable (even



if it grows somewhat). But unless there's a "hockey stick" curve upward in productivity (could Artificial Intelligence provide for this – to be seen), society must be careful with its debt load as it may not be fiscally prudent to add more debt in advance of that which may be unknown.

INVESTMENT ACTIVITY

We would now like to highlight two recent additions to Aristotle Capital equity portfolios.

- **Uber Technologies** has, in its history, withstood an onslaught of competition in its largest businesses of ride hailing and food delivery. It is now a market leader, or strong and growing #2, in the vast majority of geographies in which it competes. An inflection point was reached for the company in recent years when its cash flows exceeded its capital expenditures for the first time. There is now a clear path to sustained FREE cash flow, which we estimate could exceed \$14 billion in the near term (coming few years). In addition to the generation and favorable deployment of FREE cash flow, business *catalysts* include: Uber One membership combining both Rides and Eats; new geographic penetration both inside the U.S. (including more suburban areas) and internationally; freight delivery and advertising revenue to augment its pay-for-service model. While becoming ubiquitous, Uber's businesses remain, by our estimation, underpenetrated, resulting in its "normalized" revenues and earnings to be far higher than reported today. Its services are so desired that, around the world, we have seen reports that "... *people have literally stood right next to my cab and ordered an Uber.*"

- **Verizon Communications** with, today, an economic value of \$350 billion, takes us nearly full circle from an investment in AirTouch shortly after its spin-off from Pacific Telesis in 1994. This wireless telecommunications pioneer merged into U.K.-based Vodafone in 1999. Verizon itself was formed from the merger of Bell Atlantic and GTE in 2000. In 2014, Verizon became the sole owner of Verizon Wireless by buying out Vodafone's 45% stake. Today, its consumer wireless business provides the lion's share of its revenues and profits.

A material *catalyst* for this business is our expectation of a decline in its capital intensity,

beginning recently. With little new spectrum to purchase, few new geographies to enter, 5G having been meaningfully deployed and the competitive environment now in a new period of stability, capital expenditures will be used primarily for maintaining existing plant and a gradual expansion of Fixed Wireless Access throughout the U.S. We expect that the annual cash flow may approach 10% of the market capitalization of Verizon. Thus, the current 6.25% dividend yield could rise modestly further, combined with other shareholder friendly corporate actions.

STANDARDS OF LIVING / INTEREST RATES COMMENT

After lowering short-term interest rates three times towards the end of 2024, thus far in 2025, short-term interest rates have been held steady with the fed funds rate remaining at 4¼-4½%. While always pertinent, the attention to inflation (and its impact on interest rates) seems more critical now than ever. For this reason, a bit of context is warranted. Here follows two charts, both of sub-components of the yearly percentage change in inflation as measured by the U.S. Bureau of Economic Analysis. The first is a measure of durable goods inflation. These are items with a lifespan of typically greater than three years. Durable goods includes vehicles, appliances, furniture, lamps, rugs, tools, pianos and tennis rackets, amongst others.

Personal Consumption Expenditures Deflator: Durable Goods
(yearly percent change)



Shaded gray represents recession.

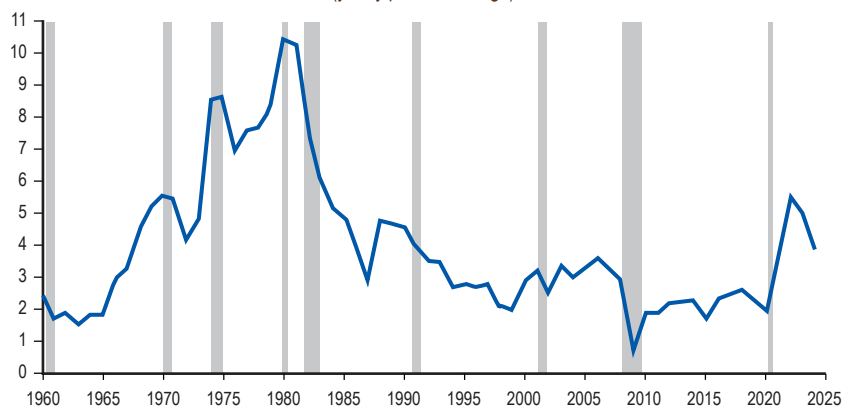
Sources: U.S. Bureau of Economic Analysis and Yardeni Research

Note that for much of recent history – at least back to 1960, with the 1970s and the Covid-19 period being exceptions – durable goods prices have generally been in decline. This deflation has had many causes, most notably efficiency in manufacture.

Alternatively, services prices are in a perennial ascent – by about 2% annually, on average.

Personal Consumption Expenditures Deflator: Services

(yearly percent change)



Shaded gray represents recession.

Sources: U.S. Bureau of Economic Analysis and Yardeni Research

As part of our “hard decisions” work, we have been giving careful thought to services inflation, and how it has been differentiated from that for durable goods. We have marveled at how we can, for example, chop down a tree in the state of Georgia, ship the wood overseas, and have the wood processed, cut, shaped, nailed together, varnished, boxed back up for shipping, loaded onto a container that sits atop a seafaring vessel, and travel perhaps thousands of miles to land back in Georgia where a child’s high chair may be sold for the same \$100 that it cost a decade ago. **Yet**, in some salons, a child’s haircut may now cost \$100, up from half that price not too long ago. This vast difference of experiences is due to automation and efficiency in **building** “stuff” versus a lack of such progress of a worker **doing** “stuff.”

Perhaps we are at an inflection point in services productivity. At the “white collar” level, we have witnessed advances in compute capabilities allowing for the automation of

everything from airline ticketing to processing mortgage applications. There is some early anecdotal evidence of productivity in select “blue collar” work – apps for ordering food and its delivery, for example. But these advances appear to be in their infancy. Autonomous vehicles may obsolete cab (or Uber) drivers someday (go **Waymo!**), but while advances seem swift, the level of automation relative to the level of employment remains miniscule. We remain hard at work learning everything we can about those companies that may become meaningful in these businesses.

CONCLUSION

In this edition of *The Essence*, we chose to highlight the historical popularity of the Oldsmobile Cutlass. For historical context we first described how the name came into being. It does seem as if the items associated with the Cutlass name (from a dagger to a fighter jet to the car) were all mediocre, even for their time. The automobile, in particular, became the best-selling vehicle of its time. It was an “easy” decision and one that could not easily be criticized – because **everyone** was buying them.

We compared this to investing whereby the easy decision is often to follow the crowd and invest in what is popular at the time. While some may describe this as “momentum” investing, others point to the favorable news “of the day” as part of the decision-making process. We at Aristotle Capital choose to take our time (often measured in years) to understand what makes a business truly unique, defensible and able to stand the test of time throughout various economic and business environments. We may often look different from what is popular; this is by design.

We acknowledge last year’s retirement of Gary Lisenbee, our long-time partner who has been instrumental in the successful development of all aspects of Aristotle and its predecessor firms. Gary remains a close and involved advisor and owner of the firm and a trusted sounding board, both professionally and personally. We wish him and his family all the very best in the long future chapters of their lives.

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***“I need to listen well, so that
I hear what is not said.”***

~ Thulisile (“Thuli”) N Madonsela

ACM-2507-52

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