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THE WALL STREET TRANSCRIPT
Connecting Market Leaders with Investors

Identifying Early-Stage Winners in AI, Infrastructure and Health Care

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SECTOR — GENERAL INVESTING

TWST: Please tell us about Essex Investment Management.

Ms. Prial: Essex Investment Management is a boutique investment management firm focused on identifying growth stocks early in their growth trajectory, and identifying what we expect to be big multi-year growth themes that we can benefit from with our focused stock selection strategies. We look to buy these growth companies at a point in time when their future growth prospects are not yet fully recognized in the price of the stock.

We use the idea of fundamental business improvement, which is generally measured by accelerating revenue and earnings trends, to identify companies that are beginning to benefit from the growth trends that they're capitalizing on.

TWST: Can we go a little deeper into your investment strategy? Is there a particular strategy you'd like to focus on?

Ms. Prial: We have three basic buckets of investment strategies. These three strategies are defined by their market cap focus: a micro-cap growth strategy, a small cap growth strategy, and a SMID cap growth strategy, all of which look to identify companies in the less efficient, less institutionalized sectors of the market where we can benefit not only from the growth that the companies are exhibiting, but also from the process of discovery as other growth investors join us in owning these emerging and re-emerging growth companies.

Our second leg of the stool is a sustainability-focused strategy that is focused on environmental solutions for many of the environmental problems that are out there. That is a thematic strategy that is primarily focused on companies that are providing technology, industrial, and service solutions to help solve some of these problems.

And then thirdly, we have a bucket of portfolios that is an all-cap version: a combination of everything we do in the firm. That bucket is more focused on approximately 40 names in that strategy, the best ideas across the firm, and really focused on open-ended secular growth themes.

TWST: Can you tell us about some of the positions that Essex has bought recently and why?

Ms. Prial: I can tell you about some of the thematic areas that we're focused on. We have some major focuses within all of our strategies. I'll speak specifically about our small cap strategy today when I address this, because that's one of the strategies that I manage personally.

Our biggest focus in the portfolio is on the industrial buildout and re-buildout that we are seeing across not only our country, but around the world. And there are a couple of legs to that stool.

The first, which is more of a domestic focus, is focused on the reshoring of manufacturing to the United States. We've been focused on this theme for a number of years now, as manufacturing started coming back to the United States in about 2016-2017, based on the relative cost advantage of manufacturing in the U.S. getting closer to that in other parts of the world.

We're seeing an acceleration of this trend, driven both by the legislation that was put in place during the Biden administration — for example, the Inflation Reduction Act and the Bipartisan Infrastructure Law — but also very importantly by what's going on with our current administration. They are trying to encourage manufacturers to come back to the U.S. or to set up shop in the U.S. if they aren't here to begin with.

That permeates a number of industries that help support that buildout of manufacturing, as well as the revitalization of certain parts of the country that have been suffering with the absence of manufacturing jobs.

The second leg to that stool is, of course, the development of AI, and the buildout of the data centers to support that development. We are seeing a rush around the world to get these data centers in place. It may feel a little bit like everybody is just spending willy-nilly, like this is like the internet bubble, but we think that AI is one of the most important technology trends that we have seen in, frankly, probably 100 years. It is the next industrial revolution.

We cannot underestimate the ultimate benefits and the changes that will come, but in the short run, we want to be positioned to take advantage of this e-infrastructure and the buildout of the data centers.

The third leg is related to that, as well as to the restoring and manufacturing, as well as to where our infrastructure, particularly in the United States, stands right now, and that's the rebuilding of the power grid. That means investing in the power grid in all of its places along that chain, whether it's the transmission, distribution, or generation of power.

We want to focus on that from a multitude of sources, because our power needs are doing nothing if not going up, with data centers, AI, the electrification of everything, the fact that we are all wedded to our devices and we all have an ever-increasing number of devices.

And then the third leg to our stool is health care. Now, health care has been out of favor for a couple of years here. The sector has not done very well. We think this is setting up for potentially a very, very strong performance because of the advances that we are seeing in health care and because of the benefits that might come, again, from AI. We're seeing an improvement in the rate of approvals from the FDA, which is always very important.

More fundamentally, though, we're seeing tremendous advances being made with the use of personalized medicine, genetic analysis, and genome-focused drugs that can solve some of the intractable health care needs that we've had in this country.

We also think that with the advent of AI, we can bend some of that cost curve. We're cognizant of what's going on in Washington and paying close attention to that, but we do believe that companies that have novel products that can really solve some problems, even with perhaps a more restrictive pricing policy out of Washington, will be able to do very well.

And then finally on health care, and this is a little more secular than cyclical, we're beginning to see takeover activity occur again in the industry as the large cap pharma companies are hitting some patent cliffs. They're looking for new products and they're starting to shop in these smaller and mid-cap companies for potential new blockbuster drugs.

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We need electricity generation in this country. We need it to be developed more efficiently, more effectively, and we need it to be distributed broadly so that everybody can benefit. That is our focus on industrials.

Our second major focus in the portfolio, as I alluded to, is AI. We really don't know what this is going to look like in the long run, but we do know that the effects will be very long lasting. It is changing the way that business will be done. It is changing the jobs that people will find. We think it will lead to significant productivity enhancements over time, so we want to focus in our investments not just on the building blocks of AI, these large language models, the data centers, etc., but also on the users of this AI data.

That's really an increasing focus for us now at that end user side, both on software and services that can use this AI data to solve real-world problems, whether it's agentic software for sales forces, drug development and enhancing the ability to do that faster and much more effectively using these large language models to comb through myriad combinations of potential drugs, whether it's using AI for climate change, for defense, for intelligence. I mean, the applications are just endless.

Another benefit that we think might emerge from AI is a re-democratization of the business environment in favor of, or with fewer headwinds, at least, for smaller companies that have suffered because these larger-cap companies, you know, the winner-take-all economy that we've had recently, these smaller-cap companies can afford to spend more on sales and marketing, computing power, etc.

AI will level that playing field as these smaller companies can use technology for things they can't hire people for, and we believe they will have an opportunity to compete more effectively going forward.

TWST: Can you provide some specific names in the areas that you just mentioned — AI, energy, health care?

Ms. Prial: As we discussed earlier, we are focused on both those companies that are benefiting from the infrastructure buildout of AI as well as those companies that will use AI technologies to deliver productivity tools to their customers.

Some examples of names that will benefit from the infrastructure buildout would be server companies such as **Penguin Solutions** (NASDAQ:PENG), e-infrastructure construction companies such as **Sterling Infrastructure** (NASDAQ:STRL), and semiconductor companies such as **Semtech** (NASDAQ:SMTC).

The users of AI technology are very broad and include companies such as **AvePoint** (NASDAQ:AVPT) that provide data management products, insurance companies such as **HCI** (NYSE:HCI) that use technology to improve the insurance pricing and risk modeling, and defense technology company **BlackSky** (NYSE:BKSY) that uses AI in satellite imagery.

We see multiple opportunities arising in energy, particularly in the emerging nuclear area with companies like **BWX Technology** (NYSE:BWXT) as well as natural gas with companies like **Argan** (NYSE:AGX).

TWST: Are there any particular sectors or themes where you would advise investors to hold off on deploying capital right now? And then in the opposite direction: What's timely and strategic? You talked about AI quite a bit.

Ms. Prial: Obviously, with the exception of health care, which hasn't recently worked, there's the industrials theme, and the AI theme; they've been working as sectors. I mean, this is not brand-new news.

Another area that, even though it's had very strong performance, we do think is at the beginning of an outperformance cycle, is the area of smart defense, unfortunately, given the realities of what's going on in the world.

Given the increasing activity, the de-globalization, or lesser globalization trends that are going on, we think that this will continue to be an era where more money is spent on defense going forward.

We think that defense is changing, and so it's moving away from some of the more traditional, very large areas of defense spending and towards, again, what we would call smart defense: drones, radar detection for incoming missiles, perhaps the Golden Dome.

Those are areas where it makes sense to have some exposure in a portfolio, too. We would classify nuclear in there as well. It's still very early and the stocks have moved, but there will be a lot more development on the nuclear side, not just in terms of power production, but also when you think about it from a defense play. There are a lot of opportunities using nuclear in shipbuilding, which is something that the administration is focused on doing. So, there are burgeoning opportunities there.

One area that we would be more cautious about today is the consumer area. We have yet to see where the tariffs resolve, but it seems reasonable to expect that we will have more tariffs going forward than we have certainly had for a very, very long time. And the bulk of this tariff hit will be manifest in the cost of consumer goods.

TWST: Do you see that relief coming in Q3 with the Federal Reserve potentially deciding in their September meeting to lower interest rates?

Ms. Prial: Potentially. Obviously, the market has been anticipating multiple Fed rate decreases every quarter for the last number of quarters. The Fed remains incredibly data dependent, which we think is the right move.

We think the Fed will continue to be cautious on lowering rates. One, because it's very important for the Fed to not only retain its independence, but to keep it very clear that they are retaining their independence. So, they want to make sure when they do lower rates that it's clear that it's being driven by data, but also because the economy has shown that it is very resilient with rates where they are today.

The economy seems able to function very well with the 10-year between 4% and 4.5%, and as long as rates look like they could be stable. At this point, our belief is that the Fed doesn't see a need to potentially accelerate economic growth to a point where we reaccelerate inflation and go back to a rising inflationary scenario, particularly with the uncertainty over the tariffs, which still need to be resolved.

My best guess is we won't really see Fed action until late this year, possibly even early next year, unless we see something untoward happen with the economy. We don't know from the early data we've seen so far this year how much was buy-ahead in the face of the tariffs and how much was underlying demand.

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In addition, consumers are saving more than they have been, whether it's because of concerns about inflation or because of the burgeoning Gen Z and millennial populations that are starting to enter their savings years as well as their spending years. And Gen Z and millennials also spend differently and are thinking about it a little differently than previous generations.

We don't think that consumer spending will be terrible, but we're not going to have terribly robust consumer spending. We still have a lot of competition in retail. We're still overstored, lots of similar concepts. So that, with the tariff pressures, with perhaps a little bit less spending going forward, and employment still OK, but not as robust as it had been, we don't think this is the time to go all in on retail.

You can pick some spots. There are some interesting growth areas in specialty restaurants such as **Potbelly Corp**. (NASDAQ:PBPB), but overall we would be cautious here.

Another area that, although it has not done well and the stocks are very cheap, we think is too early to really go in in a big way would be the entire home building-related area. That's really just a function of interest rates.

Mortgage rates are still very high. There's very little movement in mortgage rates. Even when the 10-year does move, there are some structural issues there that are keeping mortgage rates higher. While housing prices are still very high, and although supply has improved, prices have not really reacted to that yet.

We think that housing will continue to be a moderate source of growth for the economy in the near future until we get some relief on rates and will probably not be a big area and focus in portfolios.

But what we do know today, or what we're hearing from our companies today, is that the underlying demand is still quite good.

Again, when you look at those themes that we've talked about, we are seeing true growth in demand that is not just buying ahead of tariffs. We think that will be enough to continue to power positive growth in the economy, maybe at a little bit of a slower rate, but still positive growth, and that will probably stay the Fed's hand for the time being.

TWST: Would you say in general acceleration is a main theme or an underlying theme for the economy?

Ms. Prial: Well, I think there are opportunities for growth to accelerate going forward, depending on just how much fiscal stimulus we see. If the Big Beautiful Bill passes within the broad outlines that we're hearing about, it will be short-term stimulative to many aspects of the economy with some tax cuts for individuals, and very good tax cuts for businesses, which should help spur capital spending.

Of course, that has a great multiplier effect for the economy, and minimal cost cuts coming out of there.

So, we do think that that bill, if it passes into law, could help accelerate economic growth. If that happens, that should be very market-friendly because that accelerated earnings growth that comes from accelerated economic growth, particularly since the bulk of that will come from the higher multiplier side of the industrial economy, could lead to much higher profits than is currently being discounted in the market. That is really the least anticipated outcome today, we believe.

TWST: What concerns you most? What keeps you up at night?

Ms. Prial: There's a lot of volatility right now, both in the market, clearly, but also coming out of Washington, with twists and turns every day. We are concerned about a mistake being made, that there will be some action, and it could be on any number of fronts, that spooks the market and businesses, and that leads to a negative spiral, as opposed to this positive spiral that we might see from the potential fiscal stimulus.

I think that's probably my biggest concern. It could be tariffs. It could be immigration. It could be geopolitical. It could be something we haven't even thought of. But what we're really focused on is what we hear coming out of Washington and other countries around the world, and whether that could destabilize the market.

The other risk that we see in the market, and the other one that we're keeping a very close eye on, is how the bond market reacts to what's going on in Washington. There remains the risk of the "bond vigilantes" deciding that the pace of government spending is just too fast, or that the pace of government cost cutting is also too fast. It could happen on either side.

If we see a rapid increase in the 10-year, driven by the bond market, that would be a very challenging situation. That's also something we want to watch for. We've not seen any signs of it yet, but we're certainly alert to that.

TWST: Do you have any general advice for investors right now?

Ms. Prial: We think that it always makes sense to dollar-cost average and to invest with a regular pattern. It always makes sense to invest for the long term. There have been many crises in the history of this country. There have been many perceived crises in the history of this country that ended up not being crises, and staying the course has been the right thing to do.

We do think with the volatility in the market, if one wants to be more active in the market, it is an environment where you can use that volatility to get in after a big market sell-off and perhaps take a little bit of profit after a big market gain. But we wouldn't recommend wholesale going in and out of equities, or fixed income, for that matter.

We know that over the long haul, equities are the best place to be. We think that the growth prospects in the long haul of the United States are as good as they've ever been. We think that over the intermediate to longer term, the benefits of AI driving this new industrial revolution will manifest itself in much higher earnings potential than the market is currently discounting.

You want exposure to those growth trends and to those equities that will benefit from that in order to accumulate wealth over time.

TWST: As we wrap up, is there anything else you'd like to share about Essex's investment strategy?

Ms. Prial: Yes. The way we look at the world, as you can tell, we're focused on thematic areas. Those thematic areas come from our bottom-up stock selection as we identify companies and build up from there to industries and sectors that are outperforming.

One of the things that we believe Essex does particularly well and that we're particularly excited about, is our ability to identify both these growth companies and these growth trends very early before they're really being talked about broadly in the marketplace, before they're necessarily on all growth investors' radar screens. We identify these growth trends within individual companies that may not be the names that you're hearing about every day in the financial press, names that are a little off the beaten path.

Think of us as, instead of being the prospector for the gold mine, we're the supplier. We all know about Levi Strauss, but there were a lot of other suppliers that people don't talk about: the people who made the pants, the people who sold the food, the people who provided the cleaning services.

That's what we like to find — the backdoor secondary plays into these really exciting growth trends that aren't fully reflecting those growth opportunities, and that perhaps have steadier growth prospects than some of the ones that, you know, if they hit a dry spell, like a pharmaceutical company that has a couple drugs that don't work, you can get a really sharp reaction. Our companies can move on to the next pharmaceutical company that's working on drug development and isn't solely dependent on that one drug.

We think that distinguishes us from many of our other growth competitors, and we think it makes it fun to look at the portfolios and see what's in them because you can learn about a lot of companies you might not know about.

TWST: Thank you. (NS)

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