



The Essence

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The Day That Harriet Went Missing

IT was September 24, 1966. The wealthy and well-connected Vanger family hosted a party at their home which took up much of Hedeby Island in northern Sweden. When it came time for dinner, the Patriarch of the family, Henrik Vanger, noticed an empty chair, that of his grandniece, 16-year-old Harriet. The next morning she was still missing at breakfast.

Frantic, the family literally called out the dogs and a massive search of the island ensued. She was not to be found. *“No, she would not have just run off like that. We were too close; how shameful I was for not taking those few seconds to speak with her that day when she asked to see me. She must have been in trouble, and I could have protected her. No, it’s foul play for certain. ALL her belongings were still in her room, surrounding her bed, unslept in.”*

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Fast forward to the year 2005, Stockholm, Sweden. It was a typically cold and frosty winter. Henrik Vanger never lost his devotion to finding out what happened to (likely who killed) Harriet on that day she went missing. He noticed on the evening news one day a report that Swedish journalist – and part owner of the small, but acclaimed, *Millennium Magazine* – Mikael Blomkvist, had lost a libel suit, not being able to sufficiently prove allegations made against a local businessman. *“This is going to bankrupt the Millennium,”* said Henrik to his friend, confidante and legal counsel, standing by his side. *“Go hire that Blomkvist. He’s one helluva good investigative journalist. Perhaps he can figure out whatever happened to Harriet.”*

Blomkvist accepted, with pay and the promise that Vanger would turn over some damaging materials he had against the businessman who had successfully sued him for libel. He moved into a small cottage on Hedeby Island, in what was a brilliantly beautiful snow-covered village. Replete with frozen lakes, winter-bare trees covered in white, yet still filled with singing birds, small dirt roads barely able to pass, yet much fun to do so, plus a small black cat needing of Blomkvist’s attention ... and milk!

Mikael found some old photos of a parade held earlier in the day and a car accident on a bridge to the island on that fateful September 24th. From them, unnoticed by others, including the year-long police investigation at the time, he pieced together a scenario of the day from the very frightened face of the 16-year-old Harriet. Needing more help to quicken his research, Blomkvist was introduced to Lisbeth Salander, a pierced anti-social brilliant freelance investigator of her own right. They made the perfect investigative team.

Tyranny reigned in the Vanger family (with the seemingly singular exception of Henrik), with one member worse than the next, committing unthinkable atrocities through the



decades, some to their dying days. Blomkvist and Salander spent months, as winter turned to spring, putting together the (oh, so tiny) pieces of the puzzle until they deduced that Harriet was still alive, in hiding from her past (and brother Martin Vanger) in London.

At the end, Martin is killed in a car crash; Harriet then feels safe to return to Hedeby Island and is tearfully reunited with her granduncle Henrik. As Henrik's "intel" on the businessman (Wennerström) who had successfully sued Blomkvist was not revealing enough, Salander embarks to uncover additional crimes he committed, while she also hacked into and stole billions of Euros from his secret bank accounts.

The End.

Some may recognize this story, fictional but based on a few incidents in the life of Swedish author Stieg Larsson. "*The Girl with the Dragon Tattoo*" was the first of a trilogy of crime novels, written by Larsson, which were published posthumously, starting in 2005, after he died of a sudden heart attack.

The success of the book led to a Sony Pictures movie, released in 2011. It was a critical and financial success, grossing over \$230 million at the box office, more than double its cost to produce. One of our Portfolio Managers [PMs], having recently returned from a trip to Northern Europe (Norway, not Sweden), was reminded of the book, not due to its content, but because of the beautiful and serene surroundings in these two Northern European countries. The PM also later saw the movie.

While we typically avoid commenting on "news of the day," at this time we cannot help but give a glimpse into our thoughts regarding **Artificial Intelligence [A.I.]** We do so by comparing the experience of the book, "*The Girl with the Dragon Tattoo*," to that of its movie.

Create vs. Transform

Countless times we have read a book and thought "*oh, the movie will be wonderful*," only to be disappointed that the movie (while perhaps exhilarating on its own) cannot capture the vivid nuances of one's imagination conjuring up the details of the story as it is told in words. The brilliant snowscape in one's mind can rarely be fully captured, even with the finest cameras. "Aha," we now think, a book represents what the human brain can **create** – imagination leads to creativity – while a movie represents others' re-imagination of what the book represents to them. Even "generative" A.I. does not portend to create anew. Rather, it uses existing algorithms to **transform**.

Christopher Plummer – a prolific actor originally gaining fame as Captain Georg von Trapp in the film version of "*The Sound of Music*" (1965) alongside Julie Andrews – played

the role of Henrik Vanger while Daniel Craig – perhaps best known for his roles as James Bond 007 – played Blomkvist. Rooney Mara – whose ancestors founded the N.Y. (football) Giants in 1925 – played Lisbeth Salander, earning her a nomination for the Academy Award for Best Actress. While these outstanding actors brought Stieg Larsson's characters to life, even with a 2½ hour running time, they could not compete with the (average reader) ten hours immersed in these characters with the book. One's own imagination will always be deeper, more detailed and more finely tailored to one's own personality than any A.I. (at least ones known today).

Generative A.I. (genAI) is a broad label describing any type of Artificial Intelligence that can produce new text, images, video or audio clips. Technically, this type of A.I. learns patterns from training data and generates new, unique outputs with the same properties. For instance, the word "c-a-t" is transformed to the image of a feline.

Our point is to differentiate between "**creation**" and "**transformation**." Stieg Larsson **created** Blomkvist and Salander (they are fictional characters) while Sony's film director David Fincher **transformed** the book into a movie. Why is this difference important to investing?

In our estimation, the most important lesson is that, as opposed to changing society the way we know it, as many would have you believe A.I. may do, instead, A.I. may, over time, serve to **augment** society, assuredly in countless ways. It may augment human creativity, yet not replace it. It may augment learning, yet not create something heretofore unknown. It may augment science, yet not create that which is not modelled today.

Two brief differentiating examples:

➤ What's the **next** big thing? Electric vehicles (E.V.s) have been around since the beginning of the automobile. But, largely due to government prodding (and perhaps a man with the initials "E.M."), E.V.s have only recently begun to take off. Would A.I. be able to predict the next popular engine technology? Will that be natural gas, hydrogen fuel cells, something completely different or back to "plain old" internal combustion engines that do not emit carbon? Ask an A.I. engine that question and it may pontificate, or just say something akin to "*that is still to be determined ... by people*." What's the **next** big food, drink, cologne or handbag? We believe A.I. could assist our process of identifying **existing** trends/products that are destined to further succeed. But, as we see it today, we are loathe to believe that A.I. could look into future products, not yet invented, that which may displace those of today.

➤ As we have discussed in prior editions of *The Essence*, demographics are a known and intractable trend. The world's population growth has slowed, and many societies will age out of their capability to provide their citizens with

their requisite services. Only advances in technology (aided by Artificial Intelligence) will be able to help our aging societies cope. We will need A.I. (and robotics and other efficiencies) to assist the transformation of services so that fewer people may produce the services that more of society will need. But humans will have to **create** how those services will be provided. Then A.I. can kick in to implement those human creations.

So, just as a movie can **augment** a book, so too can A.I. **augment** human ingenuity. Almost without doubt, we will have more to say on this subject in future editions of *The Essence* – still created by humans – no ChatGPT here!

EQUITIES STRATEGY

Following on the preceding A.I. discussion, from a near-term investment standpoint, there has been little differentiation in the U.S. (and some global) equity markets of late. If one's portfolio did not have meaningful exposure to A.I.-related investments, then one's portfolio underperformed ... fill in the blank. While A.I. is not new, it is believed by some to be at the core of a new level of productivity growth the world has not witnessed. Therefore, it seems like there is no price too high to pay for this new trend. While we will not dispute this newfound optimism, we remain, at our core, investors in proven companies that have withstood the test of time. Some of the current investments in Aristotle Capital portfolios have exposure to this trend, but most are not wholly reliant upon it. We shall continue to monitor, learn, extrapolate (where appropriate) and *invest* selectively, but always with an eye on quality, predictability and a touch of warranted skepticism, just in case the consensus view is wrong or delayed.

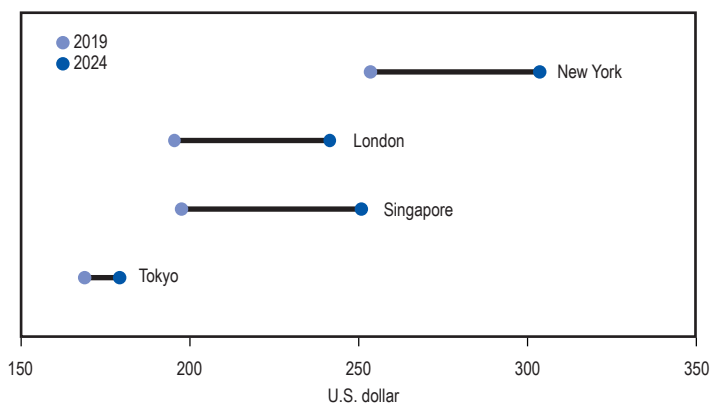
Reiterating that one of our PMs recently spent two weeks getting to know Norway, the PM was surprised that the group was not nearly alone in early June. It is more popular to travel to that part of the world during winters, as that's when the unique beauty of the Northern Lights may be seen, and spectacular winter activities (including dog sledding) may be enjoyed – though Norway is not often seen as a skiing destination, the 1994 Winter Olympics in Lillehammer notwithstanding.

Another country where tourism demand is literally exploding all year-round is Japan. In 2012, the Japanese government, under then Prime Minister Shinzo Abe, set out to become a global tourism destination. The country was already struggling with the prospect of a declining and aging population, while immigration is viewed cautiously by most Japanese. Thus, as part of his "Three Arrows" Structural Reform, Abe said (we paraphrase) "*if we cannot entice the growth of the permanent Japanese population, we can encourage the number of persons in the country to increase via foreign workers and tourists.*"

Albeit starting from a small base, the plans have been quite successful to date. Of course interrupted during the Covid period, according to the Japan National Tourism Organization, the country went from ~8 million visitors in 2012 to greater than 30 million expected this year. That means ~7% of its population as visitors in 2012 (not all at the same time) to, now, ~25% of its 123 million. By comparison, in 2024, 85 million tourists are expected to visit Spain, a country also with a declining population of currently ~47½ million. That's a 180% ratio! Thus, we believe that Japan could have plenty of room to expand tourism further.

Hotel Bargains

Average daily room rates in March 2024



Sources: CoStar; Bloomberg

Many plans were enacted to attract visitors. These included infrastructure improvements (trains and airports), better signage (including in the English language), and expansion of tourist destinations such as Tokyo Disneyland and its adjacent, unique in the world, DisneySea. The increase in tourism is also due to increasing affordability. Not only has inflation in Japan been far lower than most of the rest of the world, but interest rate differentials have resulted in a rapidly declining currency, so when measured in U.S. dollars, Japan is a unique bargain. The chart above highlights this, comparing hotel rates, pre-Covid and now, for the popular tourist hot spots of New York City, London and Singapore with Tokyo. Not only was Tokyo far less expensive previously, but its room rates have also increased amongst the least of the developed world.

So, tourism, coupled with a (slightly, not getting **too** excited) relaxed foreign worker allowance, may combine for good news for Japan's economy in the coming years. We shall continue to monitor these trends.

INVESTMENT ACTIVITY

NOT due to the above tourism discussion, but on its own merits, we would now like to highlight a recent Japanese addition to Aristotle Capital equity portfolios.

- Daikin Industries** (headquartered in Osaka, Japan), whose namesake brand is not well-known in the U.S., is one of the largest producers of Heating, Ventilation and Air Conditioning (HVAC) systems, both residential and commercial, in the world. In the U.S., its Goodman and Amana brands are popular in the mid-range segment, with Daikin soon to be rolled out at the higher end. We came to know the company as a competitor to Johnson Controls' HVAC business, when we previously had an investment in that company. It is a good example of the benefits of our global research process. The HVAC business is changing meaningfully worldwide with requirements for higher SEER (Seasonal Energy Efficiency Ratings), changing fluorocarbons (refrigerants), increasing use of heat pump technology (typically electricity-powered, not natural gas), etc. Further, developing countries' penetration rate of HVAC systems will, in our view, narrow the gap with developed countries. 88% of American households have air conditioning while ~9% of Indian households have the same – up from ~5% just seven years ago, according to Statista.

Daikin in particular, we believe, is extremely well-positioned due to its large, advanced manufacturing facilities, technological superiority (particularly in heat pumps) and a diverse geographic footprint spanning >150 countries, more so than its global peers. Always careful to monitor risk, we are mindful of Daikin's significant business in China – though it is differentiated in that market – generating enviable margins that would be important to be sustained.

STANDARDS OF LIVING COMMENT

We remain of the view that, oftentimes, reported economic statistics are backward looking and could change too slowly to reflect current – let alone future – conditions. For 2024 to-date, the Federal Reserve (Fed) has thus far kept short-term interest rates unchanged at 5¼-5½%. Long-term interest rates have meandered around, with the 10-year U.S. Treasury yield reversing some of its late 2023 plunge, ending on June 28 at 4.36%.

The world's central bankers are all struggling with if/when/how much to *lower* interest rates (except the Bank of Japan which is just beginning its *raising* process – the topic of future editions of *The Essence*). We are confident that they will mostly get it wrong (too much loosening or not quick enough), mostly fall into the same "traps" as they always

have, cause and/or watch as labor and economic uncertainty takes hold, and then go into a relatively long *pause* which is, as always, "data dependent." We are just as confident that, with a long-term perspective, even with all these Central Banks' "bumbling," over time, economic growth will persist the world over, living standards will improve and the cycles along the way will seem tiny when looked at in retrospect.

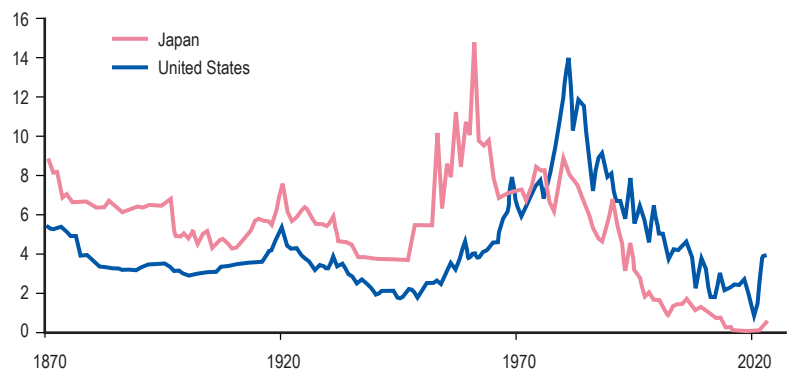
Crisis Following Hiking Cycles



Sources: Deutsche Bank Research; Bloomberg

The graph below shows longer-term interest rates for Japan and the U.S. dating back 150 years. Note that until the 1970s, Japanese interest rates were always higher than those in the U.S. Around that time, the Japanese "miracle" started to end, population growth slowed dramatically and inflation persistently undershot the Bank of Japan's targets. So, interest rates in Japan have remained far lower than in the U.S. (and hotel prices are cheap!). Note the slight upward kink in just the past year. For many of the same reasons as elsewhere in the world, inflation has finally ticked higher in Japan. This is exacerbated by a sharp rise in electricity prices caused by the still shuttered nuclear power plants as a result of the 2011 Tōhoku earthquake and tsunami. Japan now imports natural gas to make up the power shortfall, at prices needed to reflect liquefaction, transportation (much from the U.S.) and re-gasification.

10yr U.S. and Japanese Government Yields



Sources: Global Financial Data; DB Research

We believe it is likely that the very wide interest rate differential between Japan and the U.S. (and rest of the world) could, at least to some extent, narrow, reversing some of the damaging trends of the past several years.

CONCLUSION

The Day That Harriet Went Missing is the whodunit theme of a very well-written book by Stieg Larsson, largely set in magical Northern Europe. “*The Girl with the Dragon Tattoo*” was later made into a successful film; comparing the two may be analogous to how we view Artificial Intelligence versus reality.

We see human beings as able to **create** something new from a blank slate. A.I. can augment these creations and transform, for instance, words into pictures. We see **Books** as **Brains**

while their **movies** can be generated by **A.I.** A human brain can **imagine** and **CREATE anew** while generative A.I. (at least to our thinking at the current time) cannot.

In no way do we mean to minimize the extraordinary benefits possible from advancements in A.I. technology. Last December, one of our Team Members discussed A.I. and how it comes through our investment work on Aristotle’s podcast, *The Power of Patience*. [Please look up this discussion that may be found on our website or anywhere you may listen to Podcasts.] But we are reminded of many new technologies, holding great promise, that take years or decades to mature before providing the benefits imagined by their creators. We remain hopeful, yet wary of hype, and always measured in our estimation of how newness may translate into investments.

We wish you a very pleasant summer.

We acknowledge the retirement of Steve Borowski, co-founder of Aristotle and long-time partner, confidante and loyal friend of our other co-founders, all of whom remain. He’s not “leaving town” and Welcomes a continuing personal interaction with the business and all those associated with it.

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“The aim of argument, or of discussion, should not be victory, but progress.”

~ Joseph Joubert (1754 – 1824), a French philosopher and essayist, remembered largely for his thoughts, which were mostly published posthumously.

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