

October 6th, 2025

Fall Quarterly Commentary



"When bubbles happen, smart people get overexcited about a kernel of truth. Are we in a phase where investors as a whole are overexcited about AI? My opinion is yes."

Sam Altman, 1985-
CEO, OpenAI

OpenAI is changing the world. It has quickly amassed 700 million weekly users and is building out \$1 trillion dollars of infrastructure to power ChatGPT. Currently, annual losses exceed revenue, and the company is valued at \$500 billion. Jensen Huang, CEO of Nvidia, says OpenAI will ultimately be worth trillions. Sam Altman just promised to pay Oracle \$300 billion for cloud computing facilities, which will require power generation equivalent to two Hoover Dams or four nuclear power plants.

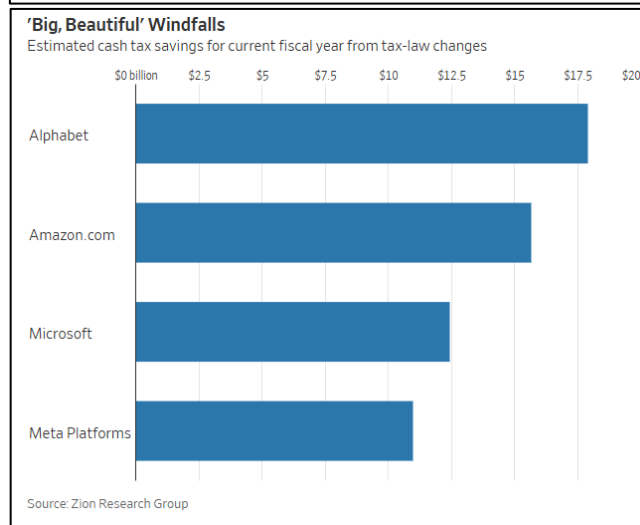
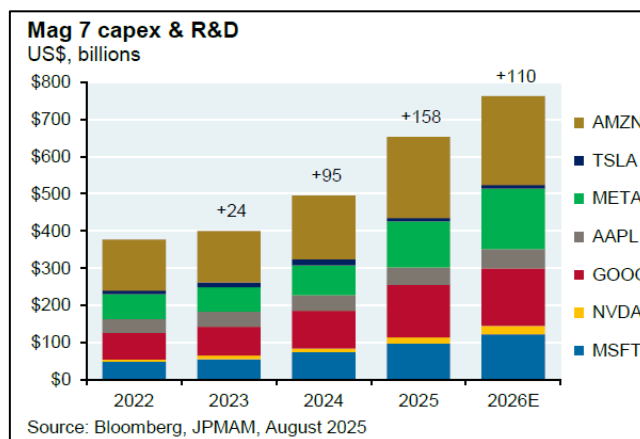
Oracle, already highly indebted, plans to borrow more for this project. Doug O’Laughlin in *Fabricated Knowledge* best explains how the landscape for big tech companies is being radically altered:

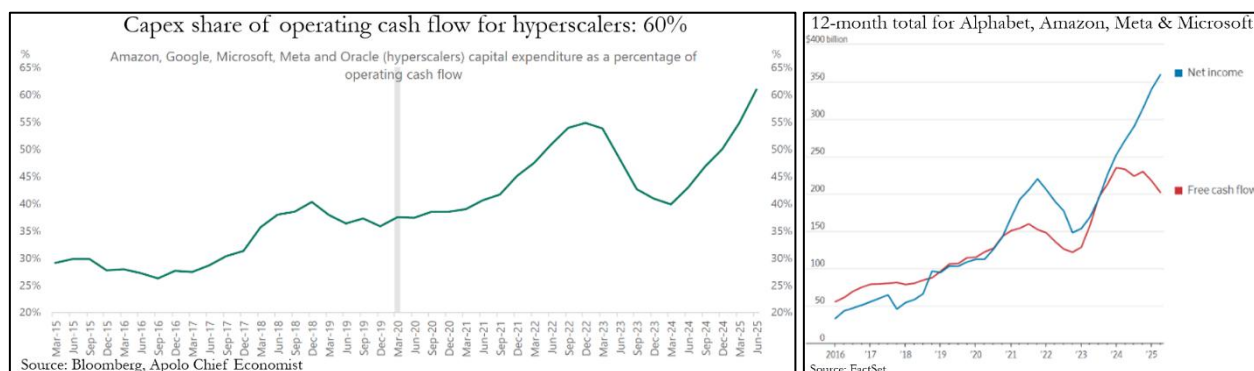
"There is no way for Oracle to pay for this with cash flow. They must raise equity or debt to fund their ambitions. Until now, the AI infrastructure boom has been almost entirely self-funded by the cash flows of a select few hyperscalers. Oracle has broken the pattern. It is willing to leverage up to hundreds of billions to seize a share. The stable oligopoly is cracking... the implications are profound. Amazon, Microsoft and Google can no longer treat AI infrastructure as a discretionary investment. They must defend their turf. What had been a disciplined, cash-flow-funded race may now turn into a debt-fueled arms race."

The 'Magnificent 7' tech companies will spend an extraordinary \$650 billion on capital expenditure (CAPEX) and research & development (R&D) this year, representing more than 30% of all the CAPEX across all S&P 500 companies.

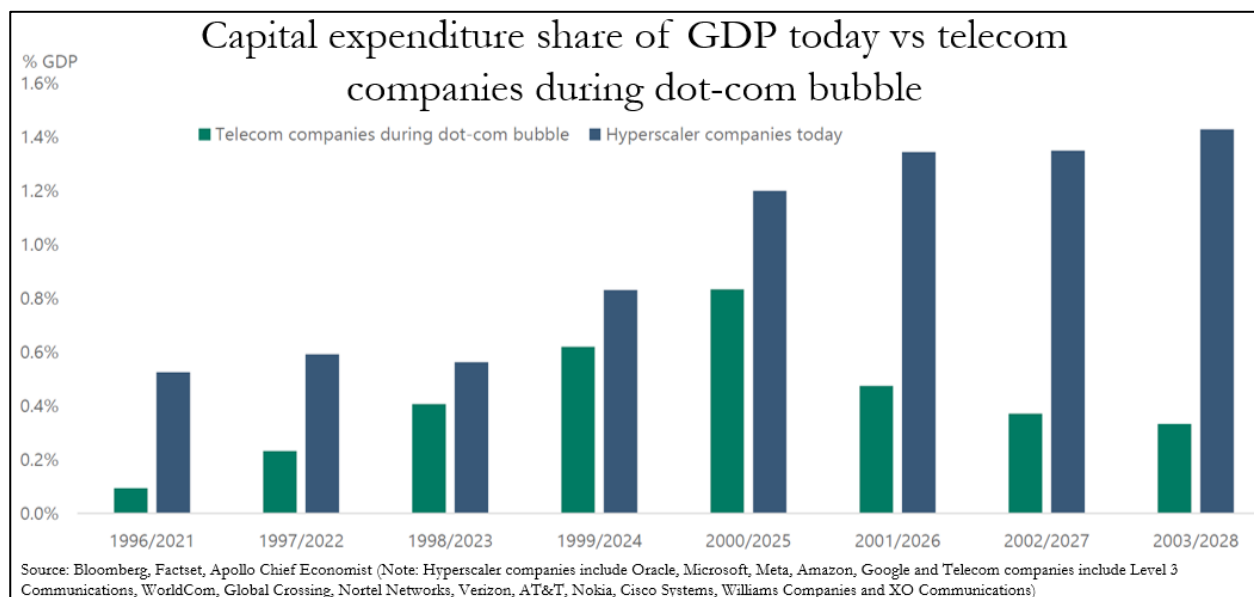
For context, the above represents 20% of revenue for these companies, an investment rate more than double that of other large U.S. companies relative to operating income. Recently enacted profit-enhancing tax law accelerates depreciation and R&D deductions. This is expected to save S&P 500 companies an estimated \$150 billion in cash taxes annually, equivalent to 8.5% of annual free cash flow. Just four of the above big-spending companies represent a whopping 40% of the total expected tax windfall.

Big tech companies are now in a capital spending arms race on commodity-like AI capacity, which is crowding out the R&D spending that drives innovation while eroding the free cash flow available to investors.

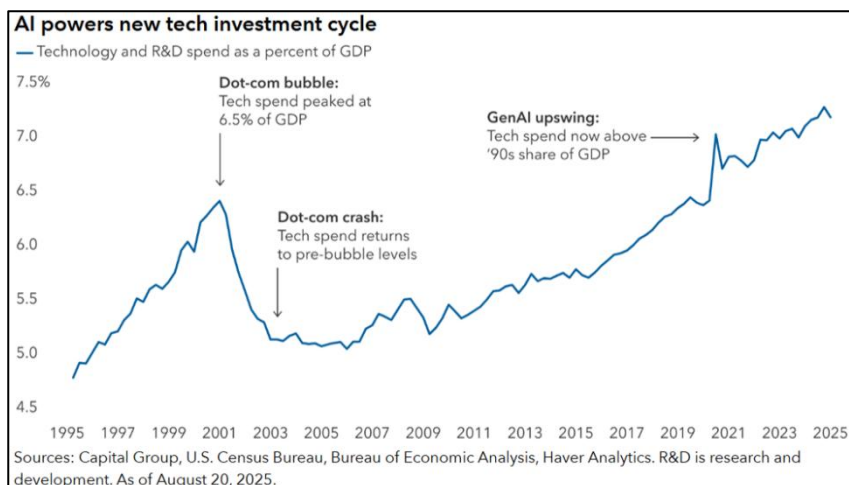




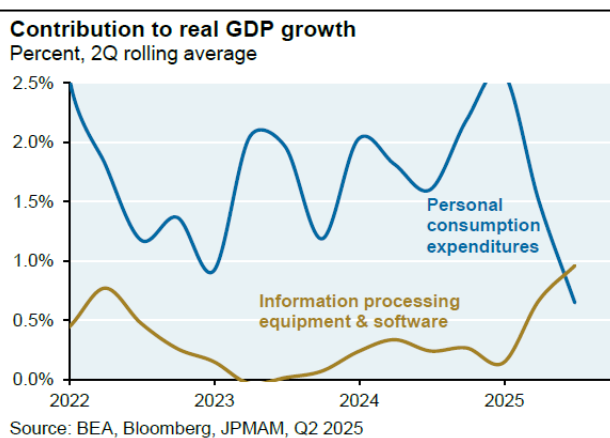
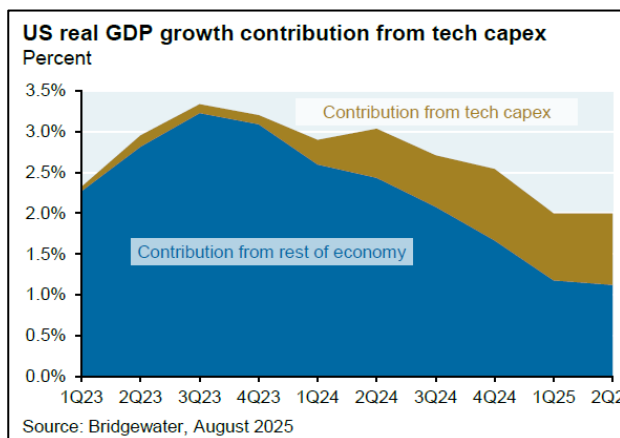
Companies choosing to increase capital spending isn't inherently good or bad - what ultimately matters is whether the returns on that incremental capital exceed its cost of capital. History offers several examples of the largest companies of their era dramatically accelerating capital spending, much like today's big tech leaders. AT&T was all-in on the internet in 1998, and the stock trades at a lower price today. Exxon Mobil decided to aggressively pursue shale extraction in 2014, yet its stock price was no higher eight years later. Just as the internet and shale have been totally transformative to the U.S. economy, we will all benefit from AI technological advancement. Less clear is which companies will emerge as winners and which will be left behind.



Although this surge in spending may put the dominance of today's largest tech companies and their outsized profits in doubt, it is providing meaningful support for the U.S. economy. Spending on technology and R&D represents over 7% of U.S. GDP.

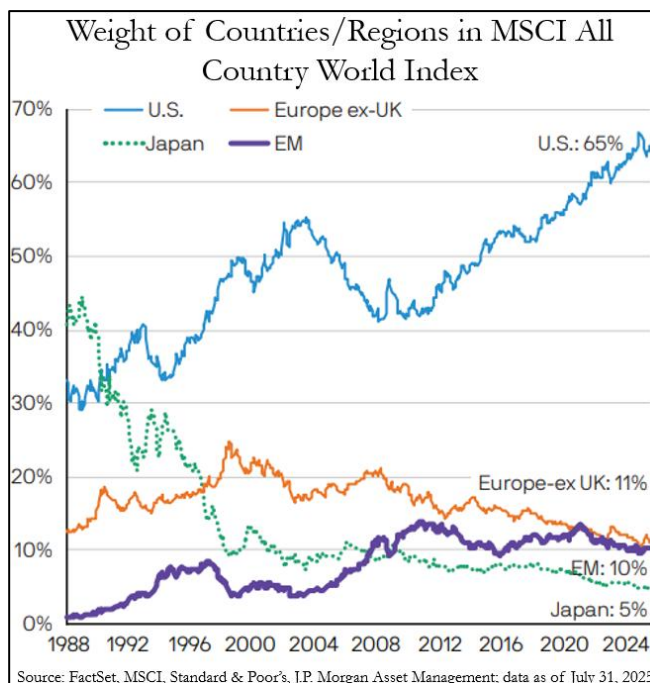


Consumption typically drives two-thirds or more of our annual economic growth. Recent softness in consumer spending has been offset by tech capex - serving as a buoy for otherwise declining growth and helping to plug the economic gap.

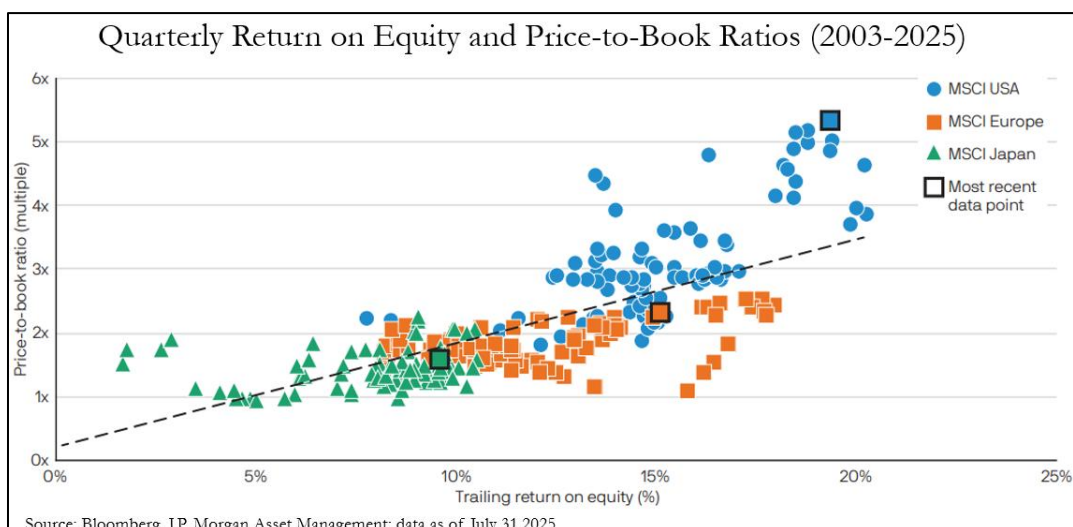


In addition to serving as an economic driver, the ascendance of the tech sector has driven U.S. equities relentlessly higher vs. other markets over the past fifteen years. The U.S. now represents 65% of world stock market value, up from 30% in 1990. When comparing traditional valuation measures based on metrics like revenue, earnings, and cash flow, U.S. stocks appear significantly more expensive. This is especially true given our high-flying technology sector represents 35% of the S&P 500 Index.

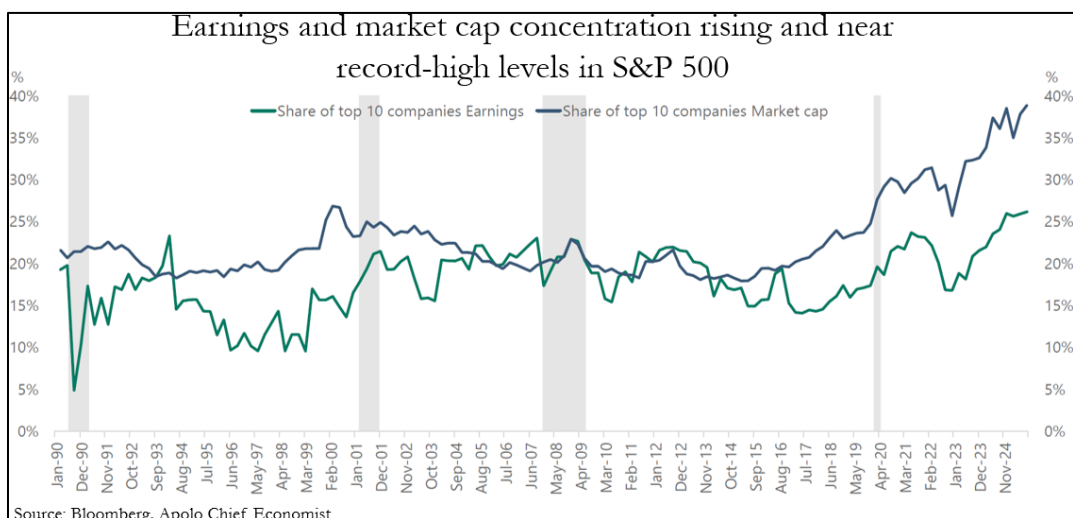
However, the U.S. has delivered superior growth in corporate revenue and profits, leading to and justifying its premium equity market valuation. One good way to encapsulate how stocks get valued is to compare price-to-book value and return on equity, as the two are directly



related. Investors will pay larger premiums if that business is more profitable. As you can see below, over the past 20+ years the U.S. (in blue) has led the world in returns on equity, thus trading at the richest stock market valuation.



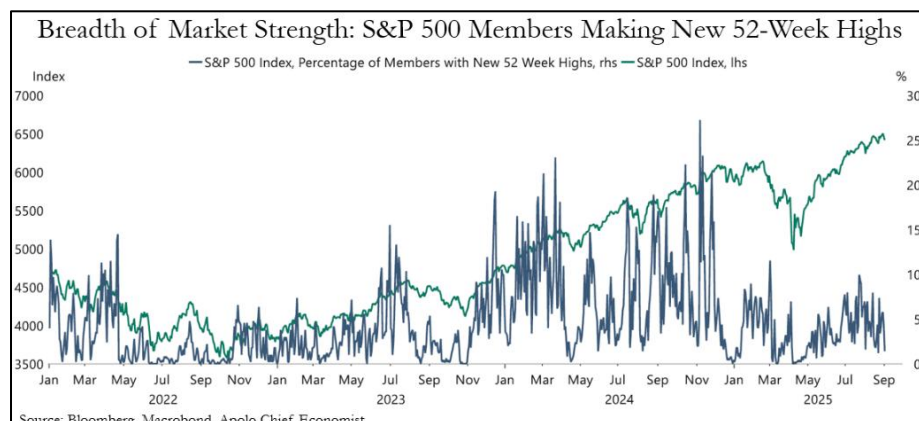
The majority (55%) of the S&P 500 Index's return since January 1st, 2021 has been concentrated among its ten largest companies (NVIDIA, Microsoft, Apple, Google, Amazon, Meta, Broadcom, Tesla, Berkshire Hathaway, JP Morgan). Popularity has its price, as these ten companies represent a 40% weighting in the S&P 500 Index while earning 25% of index profits. More broadly, a quarter of the largest 100 U.S. companies trade at a forward P/E above 30x, which is beyond our comfort zone. The onslaught of big AI spending may dent profits and push the largest tech stocks off their premium-valuation perch.



Signs of investment speculation are bubbling up, particularly around cryptocurrencies and all things AI.

- The largest leveraged buy-out (LBO) of all time was just announced, a \$55 billion deal to take Electronic Arts (EA) private, surpassing the size of the 2007 buyout of Texas utilities (TXU), a year in which the stock market peaked.
- AI-related stocks have accounted for 75% of S&P 500 returns, 80% of earnings growth, and 90% of capital spending growth since ChatGPT launched in November 2022.¹
- 35% of S&P 500 market capitalization trades at more than 10x trailing revenue, higher than the previous peak of 25% in the dot.com year 2000 and far beyond historical norms.
- Leveraged exchange-traded fund (ETF) assets have increased 350% over the past five years, reaching \$135 billion.
- Many 'crypto-treasury' stocks are trading at multiples of their underlying cryptocurrency value.
- Companies with a business plan to 'buy cryptocurrencies' have raised twice as much capital as that raised in IPOs this year. Since June 1st, more than 100 companies have raised over \$45 billion to buy cryptocurrencies.
- Thinking Machines, an AI startup, raised \$2 billion at a \$12 billion valuation despite having no revenue and a secret business plan.
- Bitmine Immersion Technologies, backed by prominent VC investors, announced plans to spend \$250 million on Ether,² boosting the company's value from \$26 million to over \$2 billion overnight.
- An electric bike maker recently raised \$500 million to hold cryptocurrencies, with its stock price jumping from \$9 to \$44 the day of announcement.

Meanwhile, less than 10% of S&P 500 Index stocks have joined the index in hitting all-time highs in recent months. This lack of market 'breadth' is an unhealthy market indicator.



¹ According to J.P. Morgan and its universe of 41 AI-related stocks.

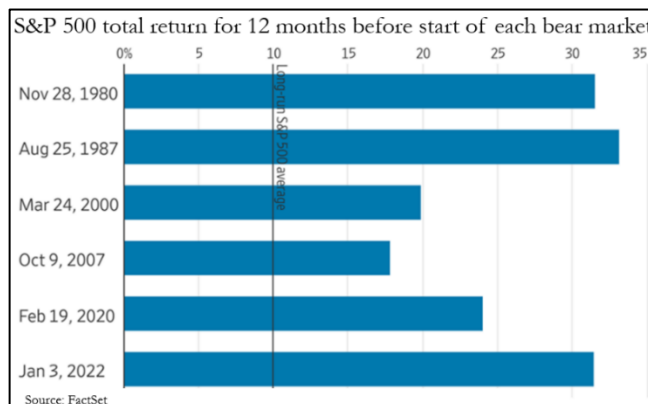
² Ether, the second largest digital asset by market capitalization, underpins the Ethereum blockchain platform.

The market's speculative tone and its narrow leadership are starting to remind us of the late 1990s, when we wrote how expensive and irrational the stock market environment looked amid great excitement over nascent internet and 3G wireless technologies. While those advancements were indeed world-changing, the stock market craziness ultimately met an ignominious end. We see similarities coalescing around AI, which is changing the world and fueling stocks in its orbit.

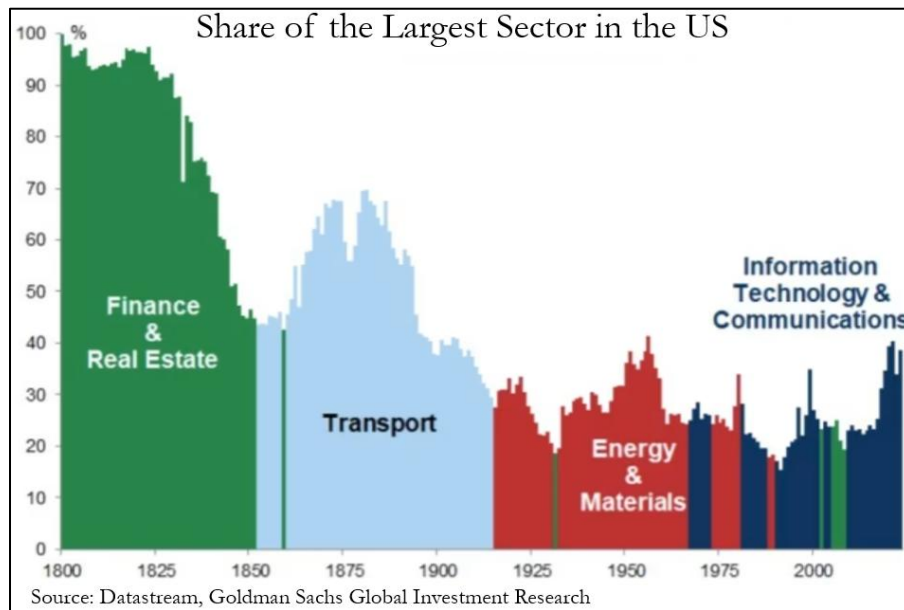
Retail investors are all-in, with stocks representing a larger share of household financial assets than seen in the year 2000 at the dot.com peak.

We worry the above is being ignored, as only 4% of today's active equity fund managers were around back when the dot-com boom gave way to a three-year bear market.

We know exciting growth opportunities can propel stocks further than we expect. It is possible to be 'right' on an overvaluation call and still end up with less money by staying away than if we had held on for the full ride up, and all the way back down. Prior to each of the major bear markets over the past 40 years, stocks leaped 15% to 30% in the final year of their rise, cushioning the subsequent downturn.



We feel fortunate to be living at a time of significant technological advancement, which will continue to make our lives easier and more productive. AI is a total game-changer that will boost economic growth. It has already contributed to some good returns in our portfolios. As always, it is our job to distinguish between good businesses and good stocks. No matter how exciting a business, at some point excessive valuation can make it a bad investment. We are ever-mindful of the disruptive force of competition that companies and industries eventually run into.



We find it fascinating that financial and real estate stocks made up the entirety of the U.S. stock market in the 1800s only to give way to the dominance of the railroad industry. The latter ended up bankrupt after spending massively to build out the transcontinental railroad, which gave birth to the transformative industrial age and radically improved living standards.

We appreciate your trust and support as we guide your investment portfolios through a future filled with inevitable economic progress.

Sincerely,

John Prichard
John G. Prichard

Kurt Beimfohr
Kurt Beimfohr

Miles E. Yourman
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