FORTIS FINANCIAL GROUP

October 22, 2025

Dear Clients and Partners:

After significant volatility throughout the first half of the year, Q3 came in very strong, once again led by Large Cap Growth. The YTD figures by size and type are shown below.

	Value	Blend	Growth
Large	11.7%	14.8%	17.2%
Mid	9.5%	10.4%	12.8%
Small	9.0%	10.4%	11.7%

The strength of Large Cap Growth is of course a reflection of the "AI trade". Rather than slowing down as many expected, AI investments are picking up significantly. We will address that in detail.

Across the rest of the market, mid and small caps did participate as did Value but to a lesser extent. Interestingly, Value is once again trading towards the lowest end of its recent range vs. Growth. A few notes related to the chart to the right:

Value vs. growth price-to-earnings discount
Russell 1000 Value vs. Growth, next 12 months

- Value will almost always trade at a lower multiple than Growth given the overall growth and margin profile of the businesses (think Proctor and Gamble vs. Microsoft)

- Historically the valuation discount is around 30% less vs. 44% today

- Both Value at 17x earnings and Growth at 31x earnings are above their long-term averages. Growth is significantly above, reflecting (i) the fact that the Growth businesses of today are far better than the historical average and (ii) significantly above average expected earnings growth from AI development

- We would note that towards the bottom of this range there is generally at least a period of Value outperformance

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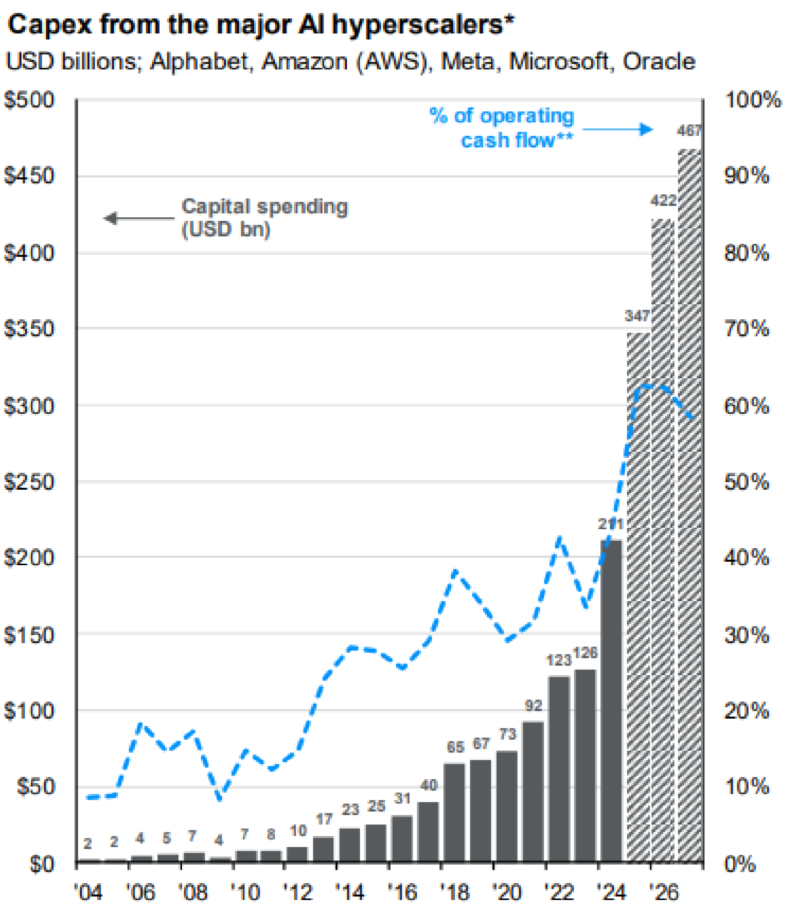
AI Trade

Q3 was the AI trade full stop. The hot question now is "are we in a bubble". It is a fun saying but what exactly are the characteristics of a bubble? First you need to have excessive valuations and second you generally need to see significant debt levels. These two components generally interplay with each other

- **Excessive valuations:** While the market is more expensive than typical, the companies that are considered in a bubble are nowhere near excessive valuations. For example, at the peak of the 2000 tech bubble, the most valuable company in the world, Cisco (CSCO), was valued at 131x the next twelve months' earnings and over 200x the prior twelve months' earnings. Today's most valuable company, Nvidia (NVDA) is valued at 31x next twelve months' earnings and 59x prior twelve months' earnings. In addition, Nvidia is a much higher quality business than Cisco ever was, which can be seen by Nvidia's 61% operating margins vs. Cisco's 22% operating margins at the peak of the bubble in 2000. Nvidia is also growing faster with 145% year over year profit growth vs. 59% for Cisco in 2000. Many people will point towards the quantum stocks, most of which are more research companies than businesses, as evidence of a bubble. We would note that there are always a few industries whereby investors get overly excited and build them up to extreme values. That does not create a market-wide bubble

- **Significant debt allowing for excessive spending:** The housing crisis and associated debt instruments of the early 2000s is a recent reminder of this. The numbers being thrown around on the AI CAPEX would make it seem like there must be significant debt being created. How can anyone spend $500B / year and not create a massive debt bubble.



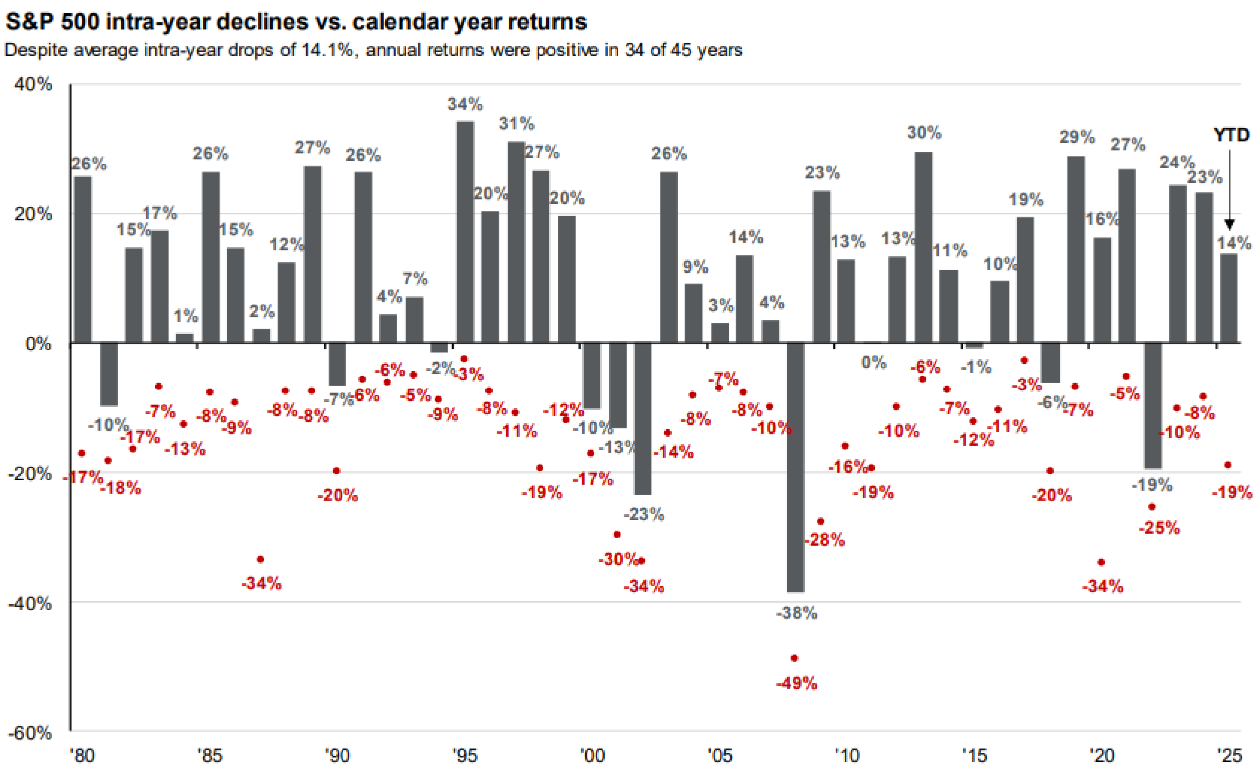
What is missing from the analysis is that the majority of the investments are being done by the hyper-scalers (GOOG, MSFT, AMZN, META, ORCL). This is very important because these companies generate even more in operating cash flow than the spending (i.e., 2025's expected $347B of CAPEX spending is only around 2/3 of their operating cash flow). The scale and cash flow from these companies is unprecedented. In other words, it sounds large, but it's funded with cash flows from the best businesses ever created.

That being said, individual companies will certainly be taking on debt to finance this because outside of CAPEX individual companies will also have other priorities (buybacks, etc.). Additionally, there are a lot of companies outside of the hyper-scalers that will be spending far in excess. We are certainly starting to enter the "debt phase" but it is only starting.

However, it's worth asking, what would the cash flow be used for otherwise? The hyper-scalers have a very interesting "problem". They generate hundreds of billions of dollars of excess cash / year. This can be used for buybacks, dividends or left on the balance sheet as excess cash. If instead of building excess cash on the balance sheet, this cash can be deployed at returns in excess of buybacks, cash holdings, etc. these companies will be worth substantially more. And what if they don't spend it? Mark Zuckerberg was recently quoted as saying if Meta overspends on AI by a couple hundred billion dollars it will be very unfortunate, but the risk is actually that they underspend and lose. Losing this race may create existential problems for some of these companies. Therefore, they have to spend it, and while it is currently unknown, they may end up getting very strong returns on that spend.

We have heard a lot of media commentary that these companies are shifting from being CAPEX light to CAPEX heavy. Generally, CAPEX light is better (that is why these are the best businesses ever) however (i) their CAPEX light businesses are not going away unless (ii) AI is real. If that is true then most likely they will end up with (i) a good portion of the CAPEX light businesses AND (ii) the ability to invest excess cash flow at strong returns that were previously not available. That would not create a bubble, that would create even stronger businesses making these companies actually under not over-valued. The best quote we have seen is from an analyst named Tae Kim *"The only bubble is in weekly AI bubble stories. A truly exponential curve".*

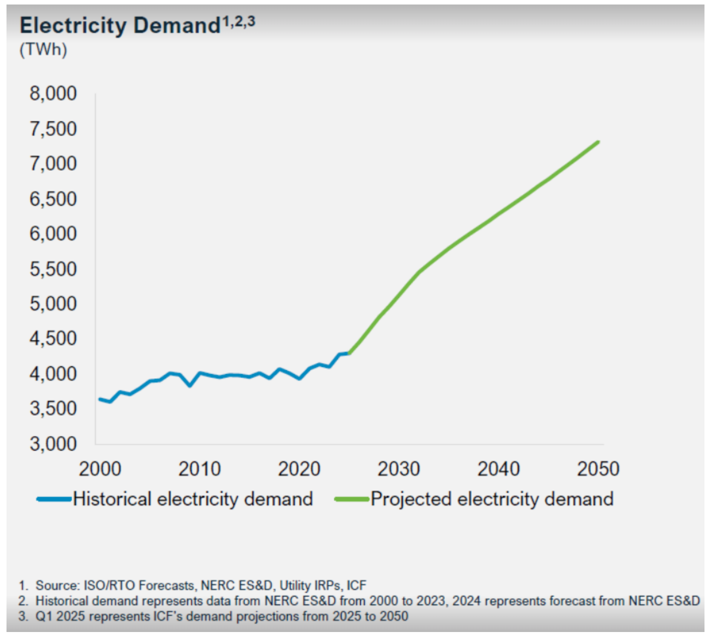
Our opinion on this has been made, repeatedly, we think the technology is very real. The timing and the magnitude are unknown, but it is coming. We would also note if we have a "bubble" the market is likely going significantly higher. That doesn't mean it is going to be a straight line however. The below shows annual returns (black line) and largest annual drawdown in red:



The only thing that we are 100% certain of is that we will see drawdowns, some small and some quite large throughout this entire process.

Power

If you listen to any of these hyperscalers' CEOs talk, you'll often hear them discussing compute per kilowatt-hour (kWh). Everyone building what Jensen Huang has termed "AI factories" is focused on compute per kWh because the limiting factor right now is energy, and specifically electricity. These datacenters gobble up massive amounts of electricity and there is only so much being produced. The expected increase in need for electricity by the end of the decade is staggering. As you can see in the chart below, the expected increase in demand in the next 4 years is more than the increase in demand we've seen over the last 25 years. So where does the supply come from to meet this demand? The answer: everywhere and anywhere it can.



We believe we are entering an energy renaissance here in the United States that will have bi-partisan support. Historically when you think of energy you think of oil and gas. However, oil does not easily convert to electricity. In this case, we are talking about natural gas, nuclear and solar as the primary vehicles to fulfill the demands of these data centers.

With the demand for all of these forms of energy increasing meaningfully, there is going to be a huge need to develop and expand the infrastructure that both produces them and distributes them. There are many different players in these value chains, some commoditized (like the silicon in solar panels) and some regulated (like many of the utility companies), so our team is diving deeper into this area to tease out where the best opportunities are for value creation. You will likely be hearing us talk about this more in coming months and quarters, but we wanted to bring it to your attention as an area of focus for our team as we look for new opportunities.

Conclusion

We may be just beginning the true bubble phase of this market cycle. While there will likely continue to be lots of volatility, particularly in certain sectors, we don't believe we are at a "bubble popping" point of concern yet in this cycle as valuations have not yet become extreme enough and there is not yet enough debt in the system to make us really concerned. We continue to favor companies that have exposure to the massive spending for data center infrastructure and the energy infrastructure that powers them.

As always we are available at your convenience.

Regards,
Your Fortis Team

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