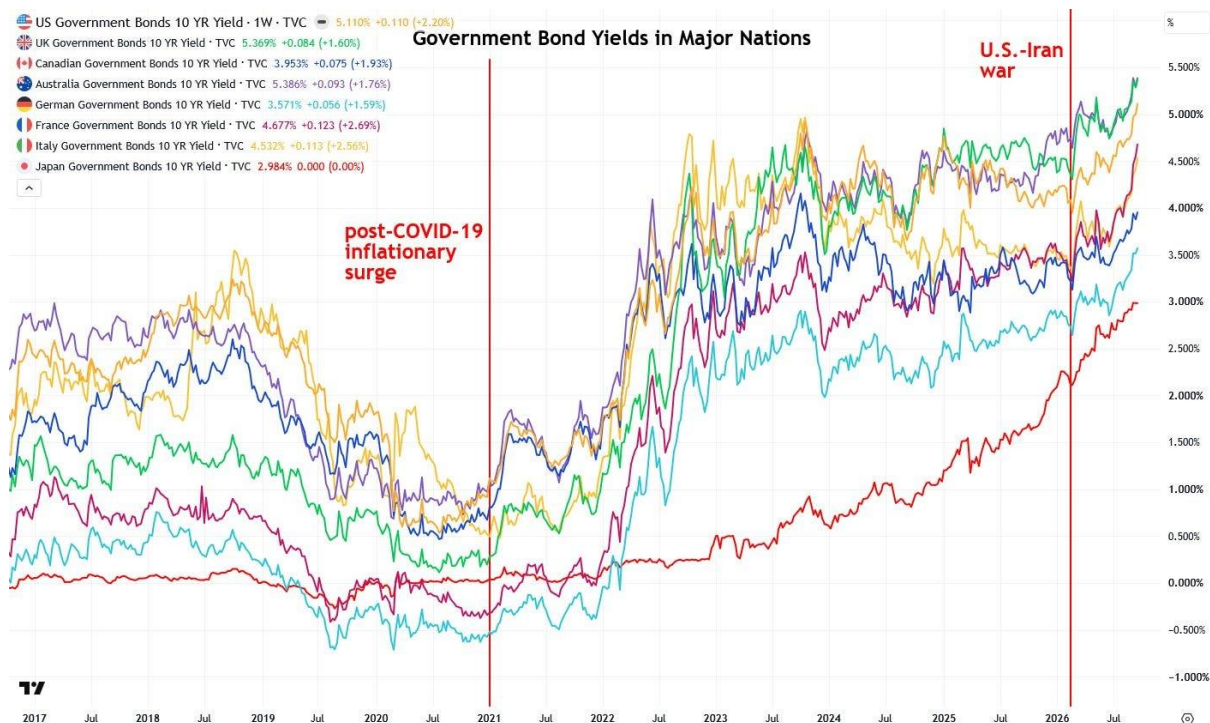


October 2026

Dear Clients and Friends,

For a long 40-year period ending in 2020 global interest rates gradually decreased. With interest rates approaching zero, many governments, consumers and economies piled on debt. Since COVID, however, interest rates have surged upward accompanied by a substantial increase in the cost of global natural resources such as oil and copper. This trend accelerated in recent months.



In the third quarter, the U.S. Treasury market suffered its worst quarterly performance since 1994. The benchmark 10-year Treasury yield surged by almost 20% during the quarter ending at 5.29%. It was the sharpest quarterly rise in interest rates in over 32 years. Because bond yields move inversely to prices, this dramatic spike triggered a historic selloff across global fixed-income markets.

These interest rate increases have dramatically changed the economics of any business decision, theoretically reducing the attractiveness of investment as the cost of money (investing) is now sharply higher. The increasing cost of money has also sent interest expense for governments and other major debt issuers shooting higher. Again, in theory, this would normally hamstring investment and slow economic growth.

However, that has not been the result ... yet. The emergence of AI has overwhelmed typical economic and investment patterns in the U.S. We have seen a massive INCREASE in investment despite the higher interest costs. This increase in investment (e.g. data center building, et al) has fueled historically high growth rates in corporate earnings. Those strong earnings have kept the stock market supported despite the sharp acceleration in interest rates this past quarter.

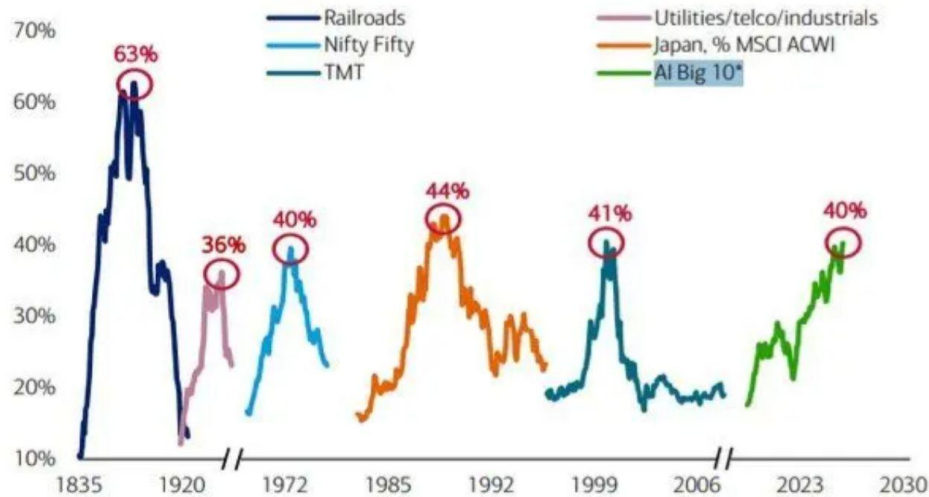
But AI has been the only thing working in this market. A very large swath of stocks have fallen in recent weeks as interest rates have risen. The September 2026 sector performance shown below tells the tale: the most interest rate sensitive parts of the market fell while technology shares with strong cash flows and little debt rose.



As a result, there is a raging debate about whether we are in an AI-driven stock market bubble. For its part, Goldman Sachs very recently issued a report in which they declare “not yet.” The most common rebuttal to bubble talk is the magnitude and strength of stock earnings for the largest companies. While share prices relative to sales are very high, share prices relative to earnings are running at average levels. However, the chart below provides further evidence for the possible stock market bubble talk. The chart shows previous ebullient periods in the stock market where the market became very focused with a small group of companies responsible for almost all the market’s gains. If past patterns hold, the current stock market concentration of the 10 big AI stocks is consistent with prior market peaks. We can see in this chart that the subsequent adjustment is swift and harsh as the “bubble” unwinds.

Chart 2: The history of stock market bubble concentration

The bubble history of stock market concentration measured as % of US market cap

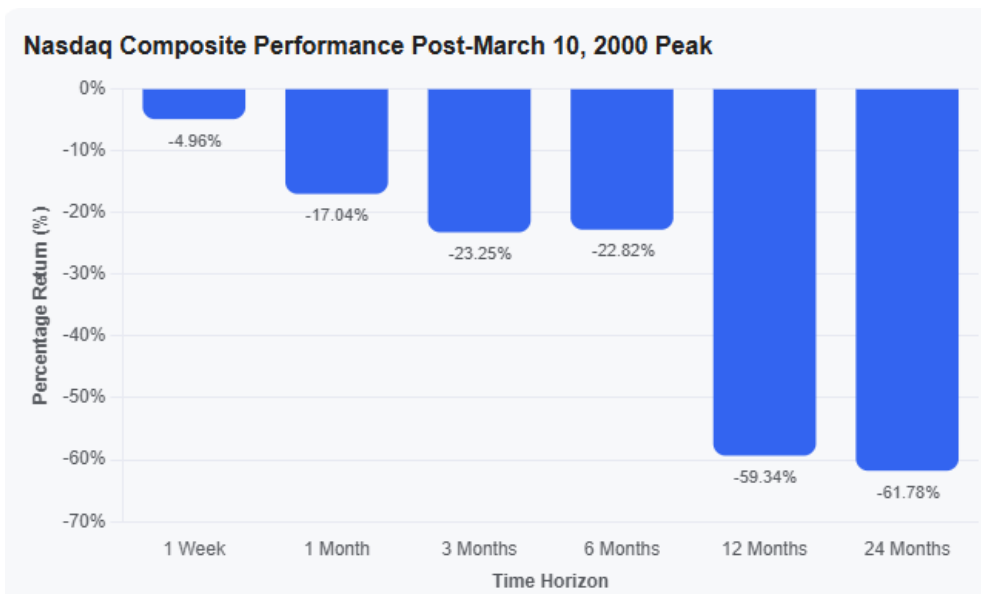


Source: BofA Global Investment Strategy, GFD Finaeon, Bloomberg. Note: Japan is measured as % of MSCI ACWI, all others as % of US stock market. *AI Big 10* = Magnificent 7 + Broadcom, AMD, Micron.

BofA GLOBAL RESEARCH

At the end of the day, investors must have confidence that all the money being borrowed and spent to fund AI will have a payoff; that there will be a return on investment in a knowable time frame that makes economic sense. When investors lose confidence in that premise, things go bad very, very quickly.

Below are the returns for the NASDAQ starting from the March 10, 2000 dot.com peak when investors determined that the economics of the internet would, in fact, NOT support the stock market valuations of those companies.



Stock market crashes are a danger that most investors are not built for. When the dot.com crash happened, investors actually rushed back in to buy in the summer of 2000 after stocks had fallen 23% from their spring peak. Investors thought they were buying the previous high-fliers at bargain prices. However, those investors saw their portfolios get completely obliterated in the next six months.

While all boom cycles seem different, they do share similar behavioral characteristics. With each passing day, we get closer to a make-or-break moment for AI and a likely market top. Are we calling a market top now? No, we are not. It's an impossible task and, to some extent, it's not necessary. Employing investing strategies that shelter clients from market volatility is what we do and will continue to do. That approach steers us clear of the worst of the stock market's downfalls so that we have the funds to move into the market when it turns around.

For now, that has led us to be somewhat cautious to see how this surge in interest rates plays out. We are keeping a keen eye on the market reactions of the semiconductor sector. That group has been the epicenter of the AI trade. When that sector breaks, we expect the broader market will eventually follow. Of course, that downdraft will set up the next market opportunity also.

To future profits,


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