

Holowesko Partners Ltd.

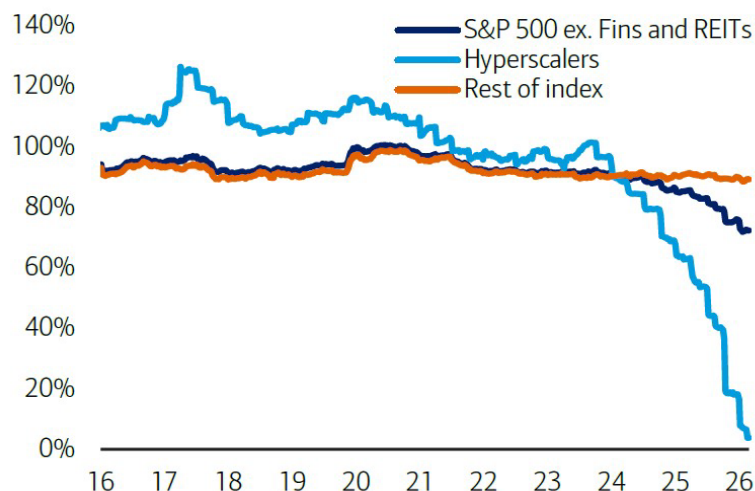
June 2026

"Doubt is not a pleasant condition, but certainty is absurd" - Voltaire

Since Liberation Day a little over a year ago, equity prices in the US have increased a remarkable 50%. The past quarter alone saw an 18% rise from the Iran War lows. Most of this increase has been concentrated in AI related investments. According to Empirical Research, AI Plays now account for 42% of the overall US market cap and have produced 84% of the market's return this year. These companies have now outperformed the market by over 65 percentage points over the last 12 months. While hyperscalers previously led the charge, the baton has passed to chipmakers whose share prices have taken off in dramatic fashion. The Philadelphia Semiconductor index, which includes the likes of Nvidia and memory maker Micron, has *tripled* since the post-tariff lows last year and increased 88% in the past quarter alone. That's heady stuff!

Fueling this rise has been a parabolic increase in spending on compute. Since 2023, capital expenditure by the large hyperscalers has risen nearly 5-fold to over \$750bn expected this year. That spending now exceeds cash flows making the group in aggregate free cash flow negative for the first time ever. Google, which had been buying back over \$60bn a year in 2023 and 2024, last month announced plans to issue \$80bn in new equity to help fund its exploding capital expenditure budget.

NTM FREE CASH FLOW AS A PERCENTAGE OF NET INCOME
Weekly, as of 6/22/2026



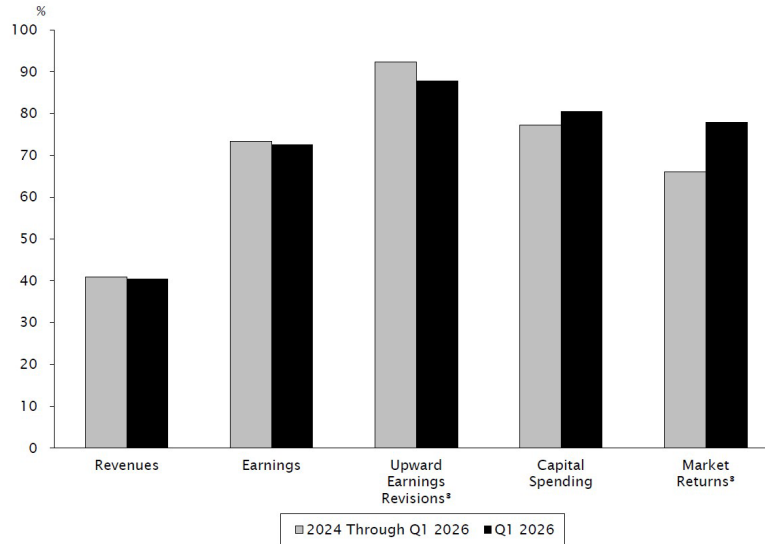
Source: FactSet, BofA US Equity & US Quant Strategy

In addition to their own requirements, hyperscaler spending (along with neocloud providers) is being driven by demands from standalone LLMs like Open AI and Anthropic. In aggregate, the standalone large language models (LLMs) are burning through an estimated \$20-30bn a year, with Open AI alone indicating negative cash flow totaling over \$100bn by the end of the decade. Investor capital and vendor financing are filling this gap, not improving profitability.

This massive infrastructure buildout is driving the market's earnings growth which in turn is propelling the US index higher. AI Plays have accounted for nearly three quarters of overall profit increases since 2024 and a similar amount year-to-date, according to Empirical. In the second quarter, two semiconductor companies alone – Micron and Nvidia – accounted for 40% of all S&P 500 earnings growth.

THE AI PLAYS¹

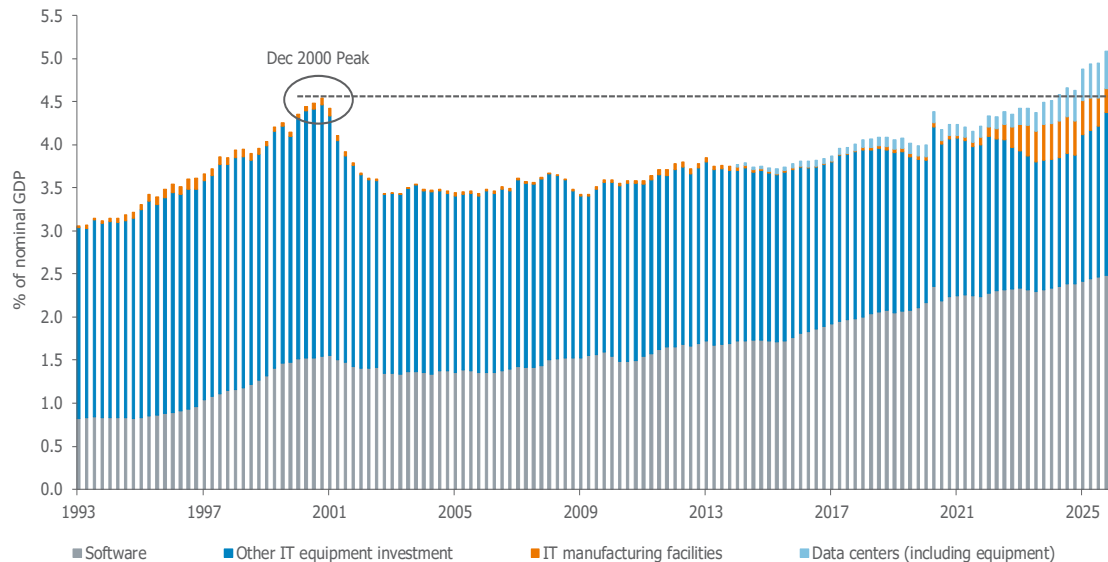
Select Metrics: Shares of Market-Wide Growth²
2024 Through Q1 2026



Note: ¹ 68 stocks, the ten largest are Nvidia, Alphabet, Microsoft, Amazon, Taiwan Semiconductor, Meta, Broadcom, Tesla, ASML and Micron. ² Measured as aggregates. ³ Through Late -June 2026
Source: Empirical Research Partners

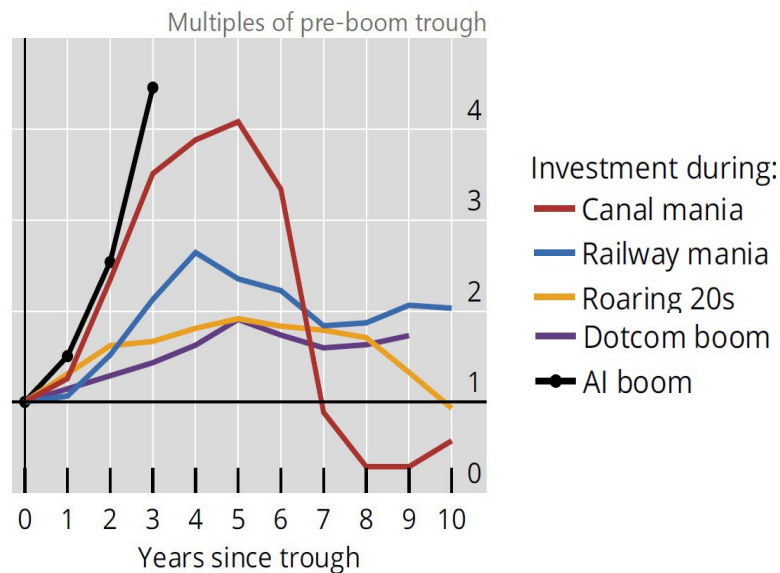
Technology related investment has now reached over 5% of GDP, surpassing the IT buildout at the peak of the dotcom boom. According to the Bank of International Settlements (BIS), the ramp in AI related investment has now exceeded all other expenditure booms which accompanied transformative technological innovations.

INVESTMENTS IN TECH HARDWARE, SOFTWARE AND CONSTRUCTION STRUCTURES



Source: BIS methodology, Census Bureau, BEA, Kepler Cheuvreux

BOOM – BUST CYCLES ARE A REGULAR FEATURE OF PAST MAJOR INNOVATIONS



Source: Cranmer (1960); Rungcharoenkitkul (2026b); Bank of England; Federal Reserve Bank of St Louis; Bank of America; S&P Global Market Intelligence; companies' communications; national data; BIS.

This may all sound like a naysayer's view of AI. It's not. We have seen firsthand from our internal use of AI platforms its transformative potential. AI is a powerful technology with implications for virtually every business and for society as a whole. There is the potential for tremendous value creation, even though returns on investment to date remains illusive. The challenging part as an investor is identifying where and to whom the value that is created will actually accrue. Each of the booms the BIS highlights above represented in their words "a genuine technological breakthrough which attracted capital in excess of what returns could ultimately justify." Over time, winners eventually emerge from this excess. What we take issue with is the degree of certainty reflected in today's markets as to who those future winners will be.

To understand the conviction investors have today, start by looking at how they have concentrated their bets. The top 10% of companies by capitalization (dominated by AI-related technology companies) now account for nearly 80% of the entire US market, the most ever according to Deutsche Bank. Technology, media and telecom companies (TMT - again mostly AI related today) account for half of the market, the most ever and well above the dotcom peak.

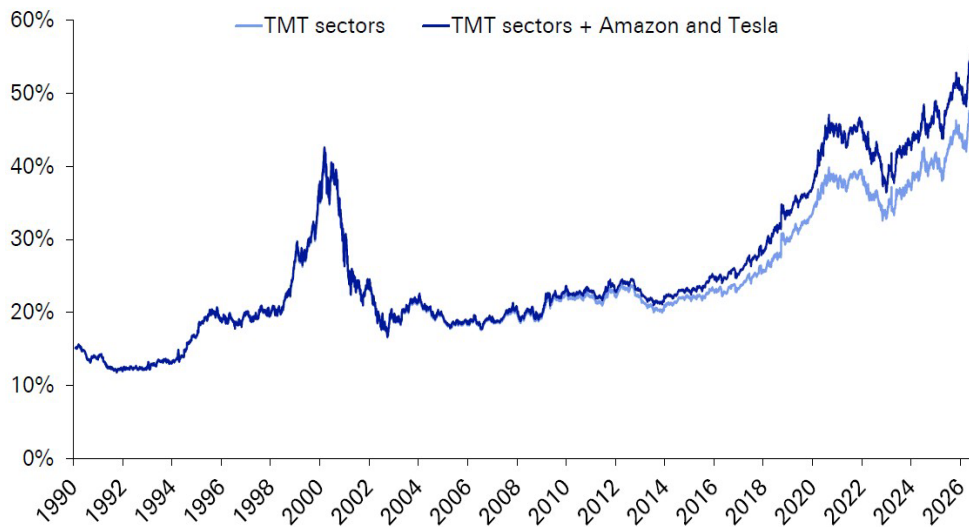
TOP 10% OF STOCK BY SIZE VERSUS THE ENTIRE US STOCK MARKET



Note: as of May 2026.

Source: Kenneth R. French database, Deutsche Bank

TECH AS A SHARE OF S&P 500 MARKET CAP



Source: Bloomberg Finance LP, Deutsche Bank

Certitude is also evident in the degree of leverage being employed in the market. As of May 2026, margin debt according to the Financial Industry Regulatory Authority (FINRA) is 54% higher than a year ago, now at 4.4% of GDP, far above previous peaks. In addition to this \$1.4tn retail borrowing, there is another \$3.2tn in hedge fund leverage based on Carlyle estimates. The Federal Reserve's May 2026 Financial Stability Report notes that leverage for hedge funds is at record levels (including positions in the bonds market). Not captured in these figures is the embedded leverage in ETF or options. Leveraged ETF exposure has increased 6-fold in the past 3 years, according to The High Tech Strategist. Zero-day options which have embedded leverage of 50x or more and barely existed a decade ago' now account for 50% of all SPX option volume.

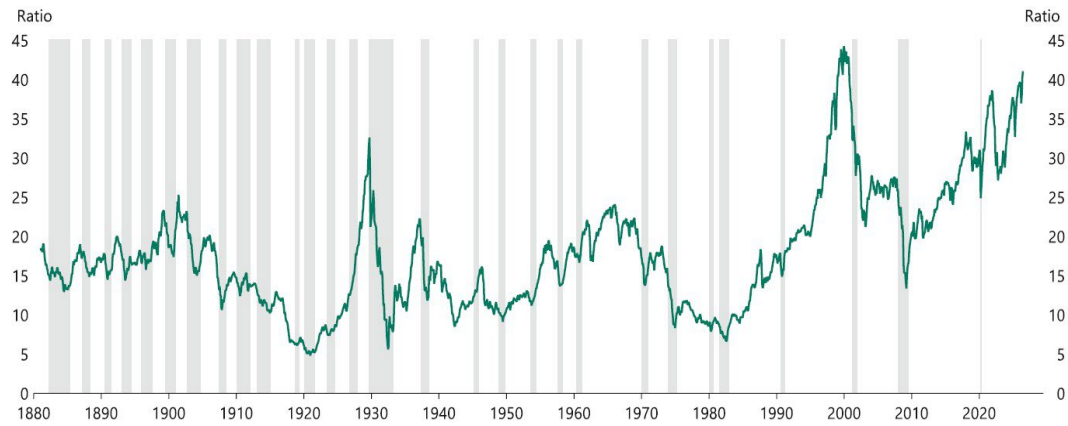
FINRA INVESTOR MARGIN DEBT RELATIVE TO GDP: 4.44



Source: GuruFocus, FINRA

Conviction has driven valuations in the US market to historic extremes. In the past quarter, the cyclically adjusted Shiller PE ratio reached 42x, a level it has exceeded only 14 months in the past 145 years (0.8% of the time), all of which occurred from April 1999 through the dotcom decline into September 2000.

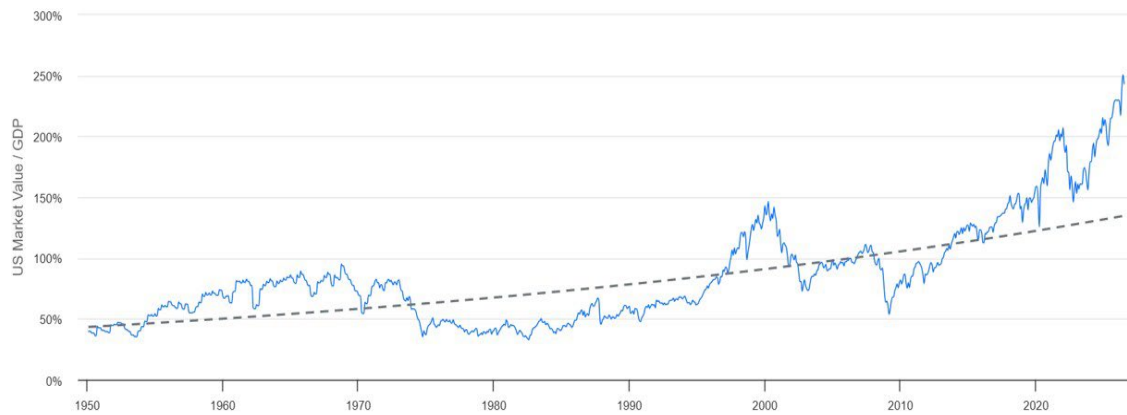
US MARKET CYCLICALLY ADJUSTED PRICE TO EARNINGS RATIO



Source: Robert Shiller, Macrobond, Apollo Chief Economist

The value of the US stock market relative to GDP has now reached an unprecedented 250%.

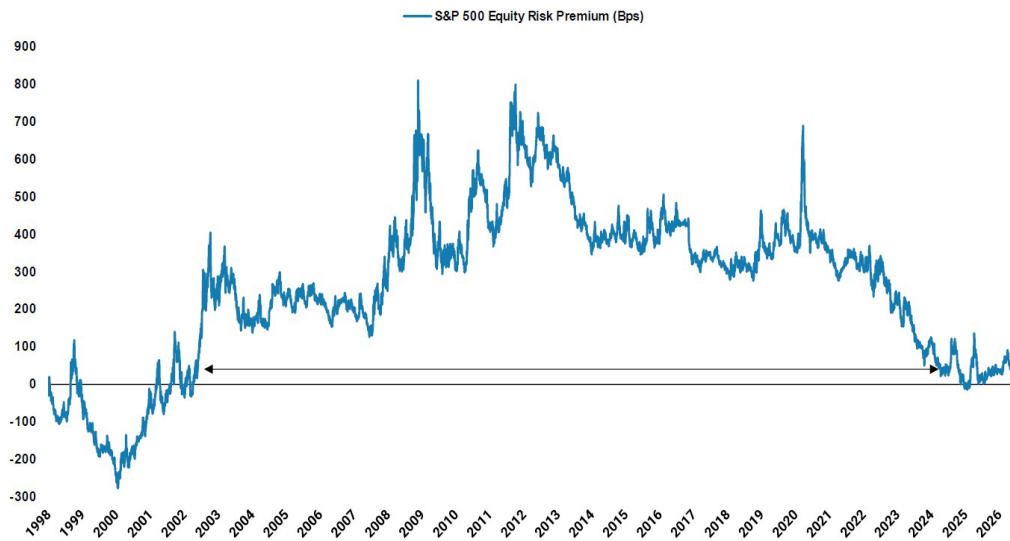
US MARKET Buffett Indicator Ratio



Source: www.currentmarketvaluation.com

The equity risk premium has collapsed. Shareholders are willing to accept the slimmest margin of safety since early 2000.

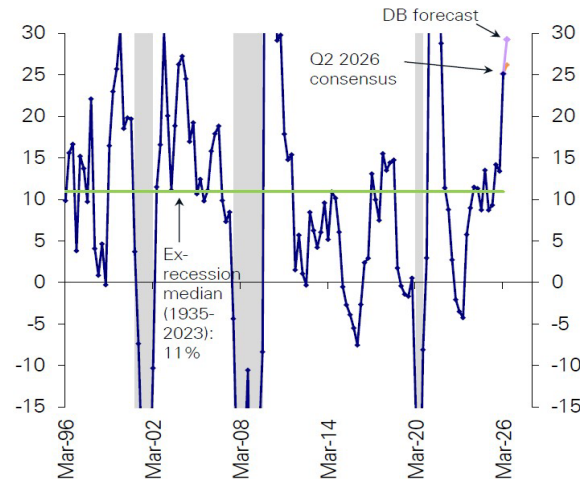
US MARKET EQUITY RISK PREMIUM



Note: ERP based on forward earnings yield and 10-year Treasury Yield.
Source: FactSet, Bloomberg, Morgan Stanley Research

Current share price valuations are often justified by pointing to the strong underlying profit increases seen in recent years, growth which has accelerated in 2026. EPS for the S&P 500 rose 29% in the first quarter and the consensus expects 27% growth for the full year. Deutsche Bank points out below that is arguably the highest profit growth for a “non-recessionary bounce back” period in the past 30 years.

S&P 500 QUARTERLY EARNINGS GROWTH (Percentage, YoY)



Note: *Excluding 2018 tax cut.
Source: Bloomberg Finance LP, Deutsche Bank Asset Allocation

However, nearly a third of the earnings increase in the past quarter were due to one-off items. Roughly a quarter of the Mag 7's earnings increase came from abnormal income, mainly gains on holdings in Anthropic, OpenAI and SpaceX. In other words, optimism about AI lifted asset values, those higher asset values flowed through earnings, and the resulting earnings growth was then used to support further optimism about AI-related equities. But leave this aside for a moment and instead look closely again at the chart above. The last time you had similar earnings growth outside of a recession rebound was in March 2000 when profits rose 33%. From that peak, the index fell 50% over the next two years. Even as late as September 2000, six months after the top with the market down 12% from its peak, earnings were still growing 22% yoy.

This is not intended to be predictive. What matters going forward is whether earnings growth can be sustained far enough into the future to generate the cash flows needed to compensate for today's extraordinary valuations. In the chart below, Bank of America calculates the implied duration risk for the US market. This embeds a continuation of current high growth estimates particularly in the IT sector shown in the second chart. It shows investors are willing to wait a near record high length of time to earn a return on their investment even if that historically high growth is sustained. Think of the certitude embedded in that roughly 35-year duration relative to the pace of change we are witnessing today.

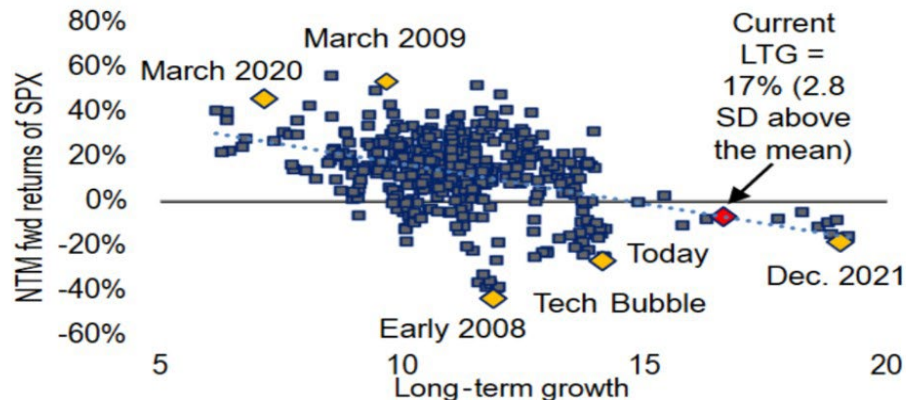
S&P 500 DURATION BASED ON DIVIDEND DISCOUNT MODEL
2001- 05/26



Source: BofA US Equity and Quant Strategy

US LONG TERM GROWTH EXPECTATIONS

Long Term Growth Rates vs Forward 12 month S&P 500 Returns
1986 – 5/2026



Source: Bank of America

The sustainability of earnings growth comes back to the earlier observations about the increasing need for outside capital investment to sustain the AI infrastructure buildout driving earnings. Ultimately that capital relies on continued investor conviction. There are a myriad of risks we can envision which might shake confidence. Three are worth highlighting.

Start with the semiconductor sector. This notoriously cyclical industry now accounts for 20% of the market, four times the weighting six years ago and twice where it reached at the peak in the dotcom bubble, according to Citadel.

SEMICONDUCTORS AS A PERCENTAGE OF S&P 500



Source: Bloomberg, Macrobond, Apollo Chief Economist

The sector's rise this past year has been mostly due to memory chip makers where AI related demand has exceeded capacity resulting in massive product price increases. Prices for DRAM have tripled in the past year leading to similar increases in revenue which get amplified at the net income level by the high operating leverage in these heavy fixed cost businesses. As the old market saying goes, the best cure for high prices is high prices. Traditional non-AI buyers find ways of reducing memory costs through re-engineering. Marginal production becomes more viable or acceptable. Firms are incentivized to find new ways of using AI with less memory usage. And to the extent higher prices must be passed on to consumers, demand destruction kicks in helping bring the market back into balance. According to Nikkei Asia, as noted by David Scott, China's three largest Android smartphone makers are cutting shipment targets by 30% for 2026. These adjustments likely bring memory prices back down, along with them cyclically inflated revenues and profits, even before new capacity has a chance to catch up with demand, as it inevitably does. SK Hynix recently completed the largest US equity listing ever by a foreign company to help fund a planned doubling of wafer capacity over 5 years. ChangXin Memory Technologies, the 4th largest player which has doubled its share of the DRAM market this year, is also raising \$9bn in China with plans to boost its capacity 32%.

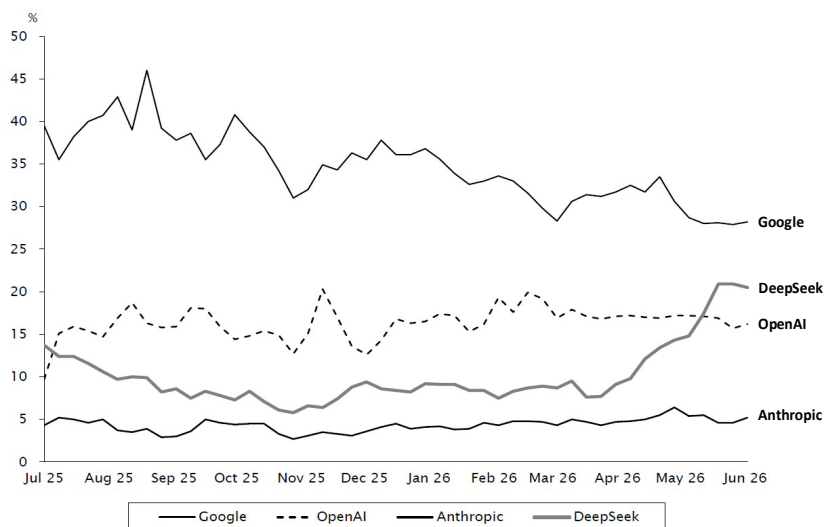
FOMO is a second risk to consider. Hyperscalers ramp in spending is rooted in the belief that the as-yet-unknown value creation coming from AI will be captured largely by a few dominant firms. That's what happened in the internet era, and it's driving the capex arms race today. But it's unclear whether AI will bring the same scale effects. Internet platforms near zero marginal cost allowed them to scale with "free" product offerings to end consumers (social media, search, etc.), which was largely monetized through advertising. For AI LLMs, the marginal cost of a token is well above what customers have been charged to date.¹ By one estimate, users on a \$200/month plan can consume \$8,000-\$14,000 worth of tokens. Capital is being used to subsidize users in a race to capture share. When costs have risen for end users, whether because of higher usage or less favorable pricing, greater scrutiny on the returns from AI spend has led companies to re-evaluate usage. Gartner calculates that only 28% of AI use cases fully met ROI expectations and predict that over 40% of AI projects to be cancelled by 2027 because of unclear business value and escalating costs. To reduce costs, enterprise users are moving to open-source models for tasks that don't require the highest performing models. These LLMs are available at a fraction of the cost. Chinese models such as DeepSeek, for example, are 10-20x cheaper than proprietary models with the capability of running 80-90% of requests. Core high-volume AI inference workloads also are increasingly being run on in-house hardware rather than hosted on hyperscaler clouds, again reducing cost. These shifts reflect managements' questioning the wisdom of transferring intellectual capital onto LLMs run by firms that subsequently offer competing platforms. All of this challenges the winner-takes-all mentality driving the large hyperscalers massive capital outlays that is underpinning much of the market's earnings growth.

¹ Tokens are the small pieces of text (words, parts of words, punctuation, or symbols) that an AI model breaks language into so it can process and generate text.

GOOGLE, OPEN AI, ANTHROPIC AND DEEPSEEK¹

Market Share on OpenRouter²

July 2025 Through June 2026



Note: ¹Data includes text generation models only. ² Market share is defined as the proportion of tokens routed through models from each provider within OpenRouter's platform.
Source: OpenRouter

A final risk is increasing competition for capital, one which extends beyond the AI boom. As noted above, AI infrastructure spend has surpassed cash flow generation and Carlyle estimates that 80% of planned expenditure over the next few years will now need to be funded externally. The past two months saw the two largest equity issuances in history with SpaceX raising over \$85bn and SK Hynix issuing \$27bn worth of ADRs. As Russell Napier points out, since 1996, \$8.5tn worth of US equity has been retired through net buybacks and M&A (mainly private equity purchases). Only 8 of the 116 quarters over that timeframe saw net equity issuance, which we are again seeing today and which appears likely to continue given the scale of funding needed. What has been a structural force supporting share prices appears to be shifting to a headwind at a time when valuations are at all-time highs.

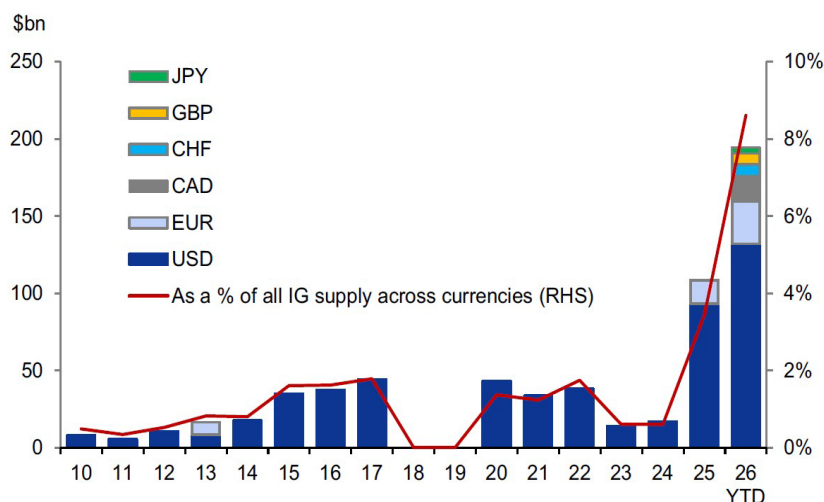
US IPO GROSS PROCEEDS



Note: Universe consists of US deals greater than \$25 Million in Value.
Source: FacSet, Goldman Sachs Global Investment Research

In addition to equity, firms are increasingly taking on debt to support spending. On top of this, additional funding is coming from private equity and private debt funding.

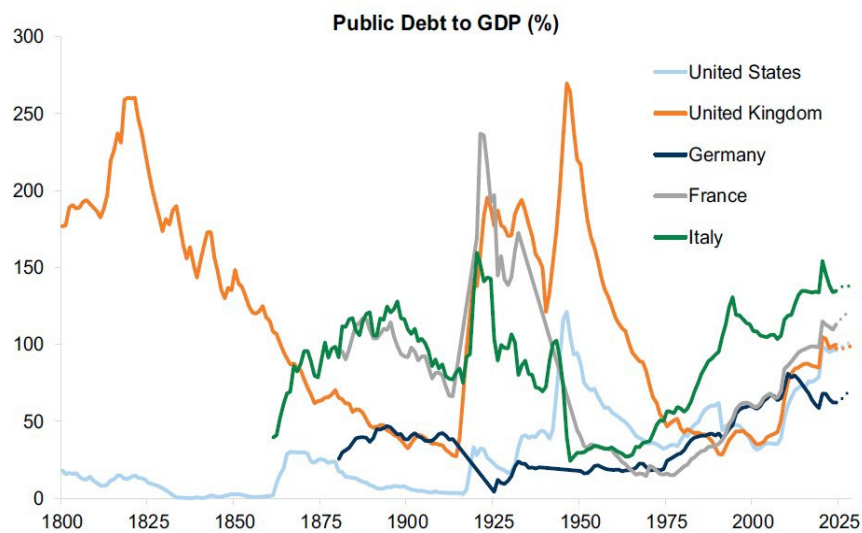
HYPERSCALER DEBT ISSUANCE ACROSS CURRENCIES USD Equivalent



Note: As of July 9, 2026. Captures debt issued by the following companies: Alphabet, Amazon, Microsoft, Meta, and Oracle.
Source: Dealogic (ION Analytics), Goldman Sachs Global Investment Research

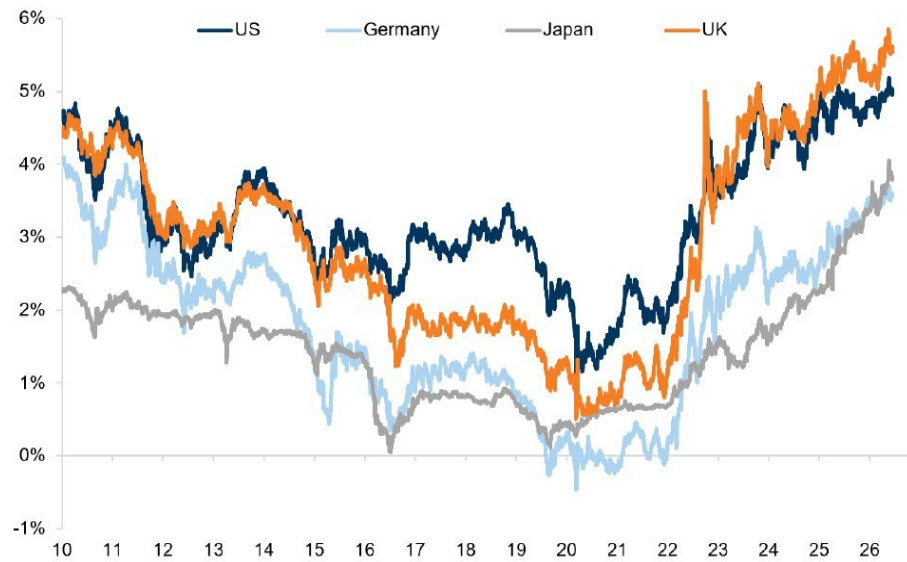
More broadly, funding demands are also increasing in the public sector with government borrowing in developed countries at the highest levels outside of wartime. Goldman Sachs points out that since the start of the century, government debt to GDP has risen from 55% to 124% in the US, from 22% to 102% in China, from 69% to 95% in the Euro zone and 37% to 95% in the UK. Much of this debt was accumulated in the years following the GFC and pandemic when interest rates were near zero. Now, the cost of that financing is steadily marching back toward historic norms.

GOVERNMENT DEBT AS A PERCENTAGE OF GDP



Note: Dotted lines are GIR Economics forecasts.
Source: IMF, Haver Analytics, Goldman Sachs Global Investment Research

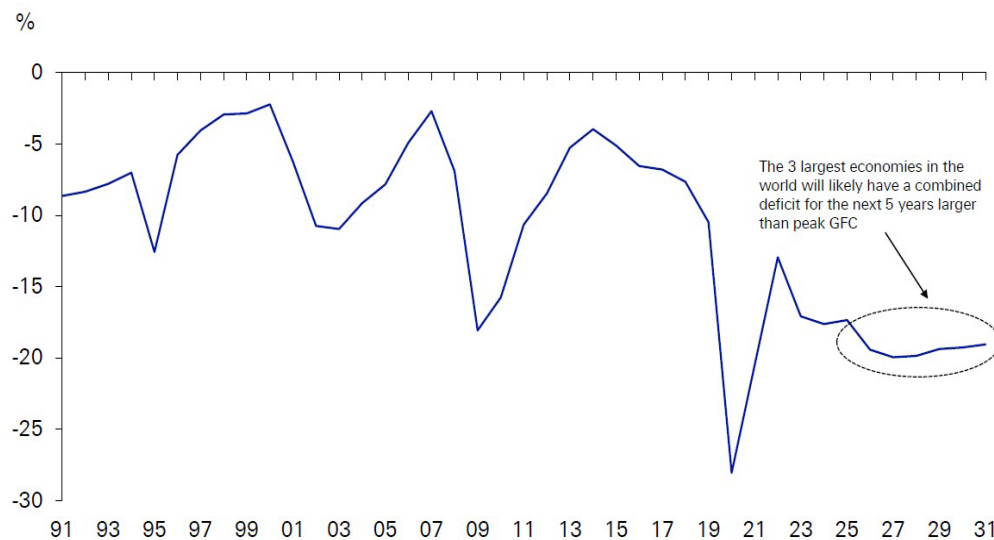
30-YEAR GOVERNMENT BOND BENCHMARK YIELDS



Source: Datastream, Goldman Sachs Global Investment Research

Compounding this are fiscal deficits running at levels historically seen only during economic crisis, as Deutsche Bank shows below. Based on the International Monetary Fund (IMF) numbers, fiscal deficits represent an additional \$5-6tn draw on savings.

BIG THREE: COMBINED FISCAL DEFICITS AS A PERCENTAGE OF GDP OF US, CHINA and GERMANY



Source: IMF, Haver, Deutsche Bank

Competition for capital pushes up the cost of that capital for businesses. Since the near zero interest rate era five years ago, the average cost of capital for a US company has moved up from around 5% to nearer 8% today. Most of this has been higher borrowing costs since equity risk premiums have actually compressed as shown earlier. All else equal, a rising discount rate means the value of future cash flows are worth less today, especially for businesses where cash returns lie far into an uncertain future.

AI Infrastructure – Benefiting from the Buildout

In sum, the US market is at valuation levels we feel do not adequately compensate for risk. But remember when we say “the market” today we are talking about a handful of highly valued companies because of the extreme concentration. Beyond these firms and especially overseas, there are companies that are benefiting from the AI infrastructure buildout which do have attractive valuations and solid fundamentals.

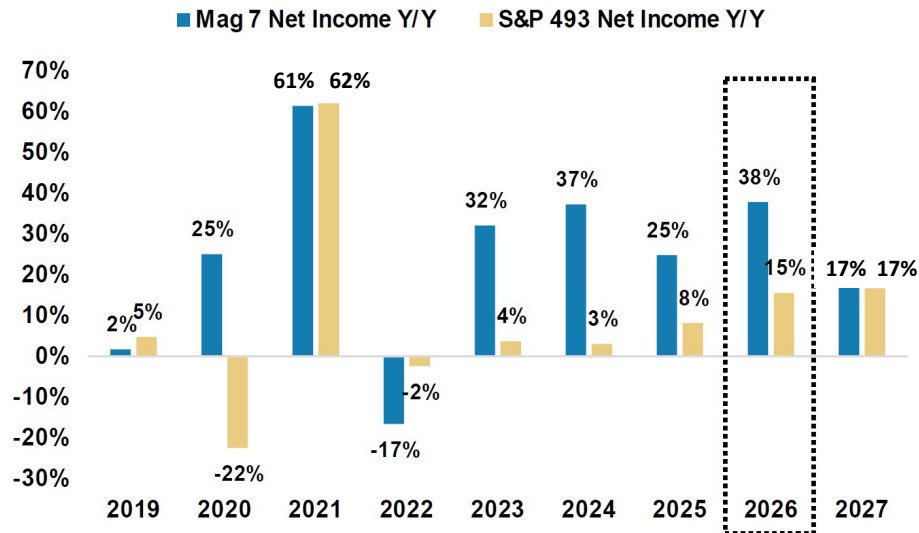
US Market Exposure – Opportunities Arise

Back in the late 1990s, at the height of the dotcom boom, we were able to find a number of fundamentally strong businesses at attractive valuations even in a market which itself was expensive. The singular focus on all things tech-related back then sucked capital away from the other sectors, depressing share prices in spite of strong fundamentals and attractive outlooks. A similar phenomenon is happening today in the US market, reflected in the more reasonable valuations of the average company as opposed to the market overall. The chart below shows that the typical stock in America has a PE ratio in line with its historic average at 17x. This is why our exposure to the US has increased despite the issues discussed above.



It's notable that earnings growth within the S&P500 is expected to broaden out from the Mag 7 dominance of the past 3 years. That should bring more attention to some of these forlorn businesses.

US EARNINGS GROWTH BROADENING



Source: FactSet, Bloomberg, Morgan Stanley Research.

Staples – An Anchor to Windward

Companies offering stable mid-to-high single-digit earnings growth attracts less attention these days than tech investments compounding growth far more rapidly. Consumer staples business also face challenges from pricing fatigue, with the hikes that drove earnings growth post-Covid now experiencing consumer pushback. That's especially true for lower- and middle-income households being squeezed in the current "K-shaped" economic environment. Compounding these pressures is the impact GLP-1 drugs are having on food and beverage businesses. So what's to like?

First, these defensive companies now represent the lowest portion of the overall market on record and sell at near their lowest relative valuations in 50 years. A huge amount of pessimism is priced in.

CONSUMER STAPLES PERCENTAGE WEIGHT IN S&P 500

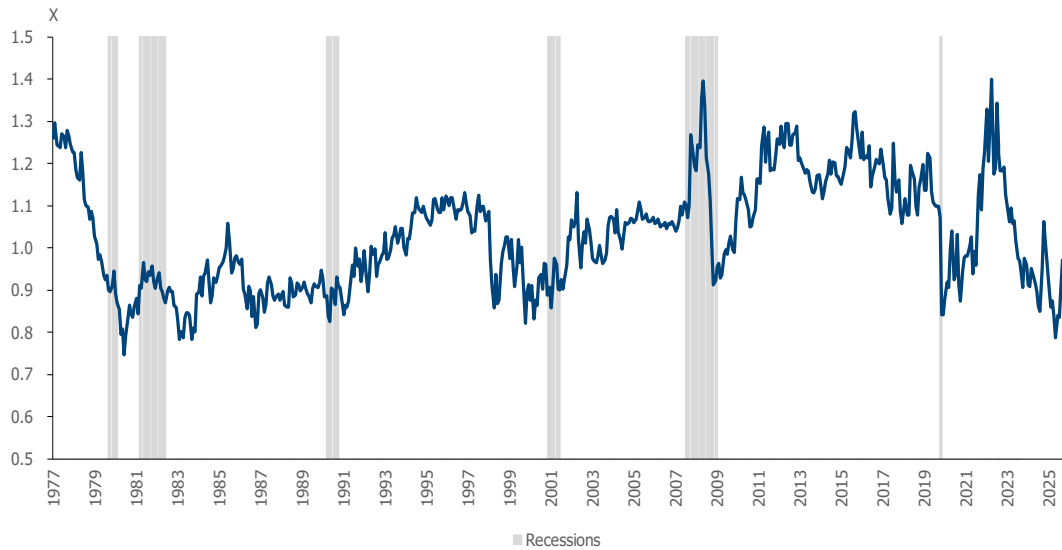


Note: Data at 7-16-2026
Source: Bloomberg, Strategas Research

MEGA CAP US CONSUMER STAPLES STOCKS

Relative Forward Price to Earnings Ratios

1977 Through Mid-July 2026

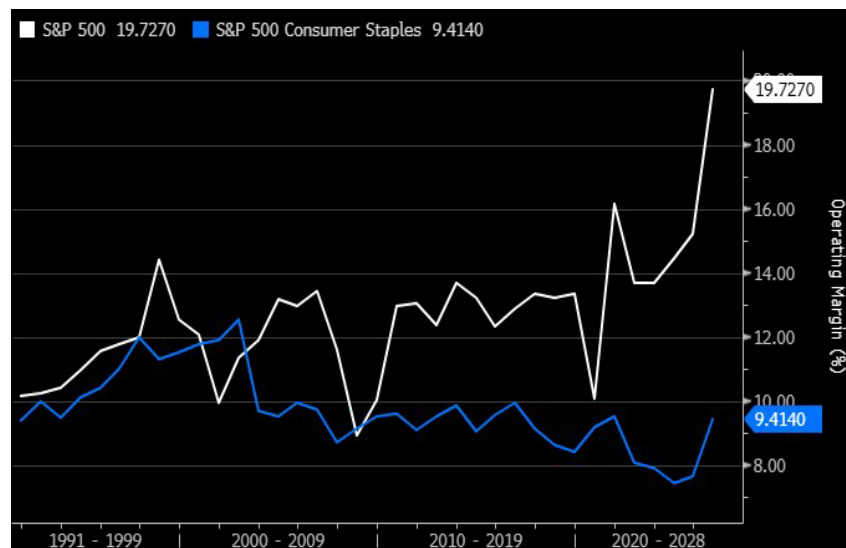


Note: The top 13 companies by market cap. Cap-weighted data relative to the S&P 500.

Source: National Bureau of Economic Research, Empirical Research Partners

These lower valuations are on earnings that appear depressed. Operating margins for the sector as measured by the S&P Consumer Staples Index reached 25-year lows in 2024, a notable contrast to the market overall where margins are at all time highs. Interestingly, 2025 saw an improvement in profitability that is expected to continue in 2026 as the chart below shows. Part of that improvement is from lower commodity inputs which have been a significant headwind. Managements are also reacting to consumer pressures by improving cost efficiency.

OPERATING MARGINS



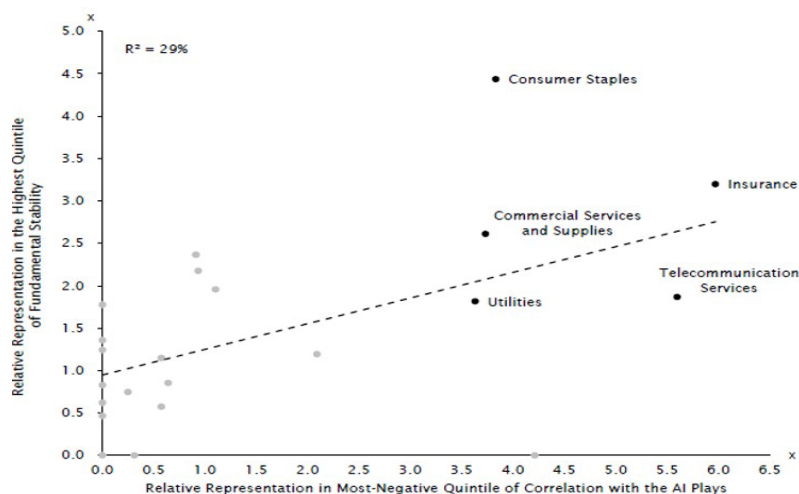
Source: Bloomberg

Beyond these fundamental attractions, staples also offer an interesting hedge against a sell-off in AI related plays, as noted by Empirical Research. The chart below shows that staples businesses rank among the highest in fundamental stability while having one of the largest representations among stocks most negatively correlated with AI Plays. This explains the mixed investment performance this past quarter for these holdings but also shows why they serve as an important anchor to windward for the Fund.

AI HEDGE

Large - Capitalization Stocks Relative Representation of Sectors in the Highest Quintile of Fundamental Stability vs the Most - Negative Quintile of AI Play Correlation¹

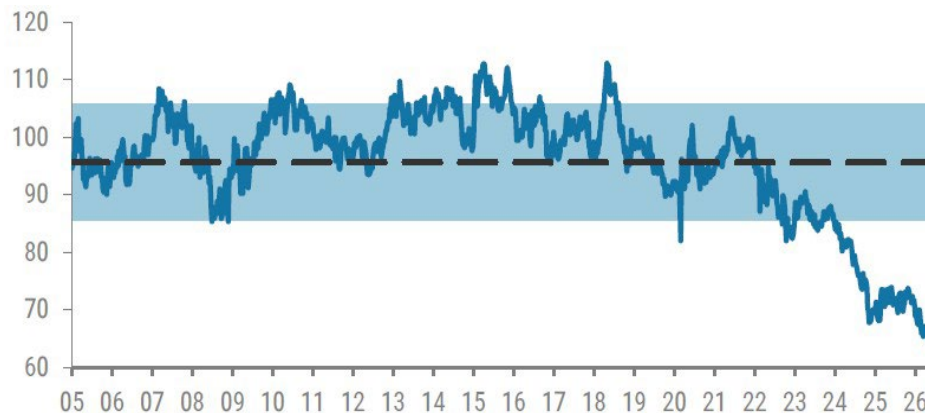
As of Late - June 2026



Note: ¹ Relative representation is a sector's share of the cohort divided by its share of the whole universe. Correlation based on daily relative returns over the prior six months.
Source: Empirical Research Partners Analysis

European staples trade at even deeper discounts than their American peers.

EU STAPLES NTM PRICE TO EARNINGS VALUATION VERSUS US STAPLES



Source: Thomson Reuters, Morgan Stanley Research

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