

MARKET REVIEW & OUTLOOK



3Q 2025

Rationalization is coming for AI

Artificial Intelligence (AI) has sparked massive investment and excitement, but like all technologies, it will mature and consolidate before normalizing. While large players are likely to keep dominating given the capital intensity, we are watching for the first signs of rationalization—marked by the end of “capacity complaints.”

Sustainability goes “Dark Mode”

Sustainable investing follows a similar cycle but has already reached normalization. After an initial surge and subsequent cooling, interest has stabilized. Though politicized at its peak and slowed by federal pushbacks after the election, activity is returning but more discretely. We believe it is time to increase allocations once again.

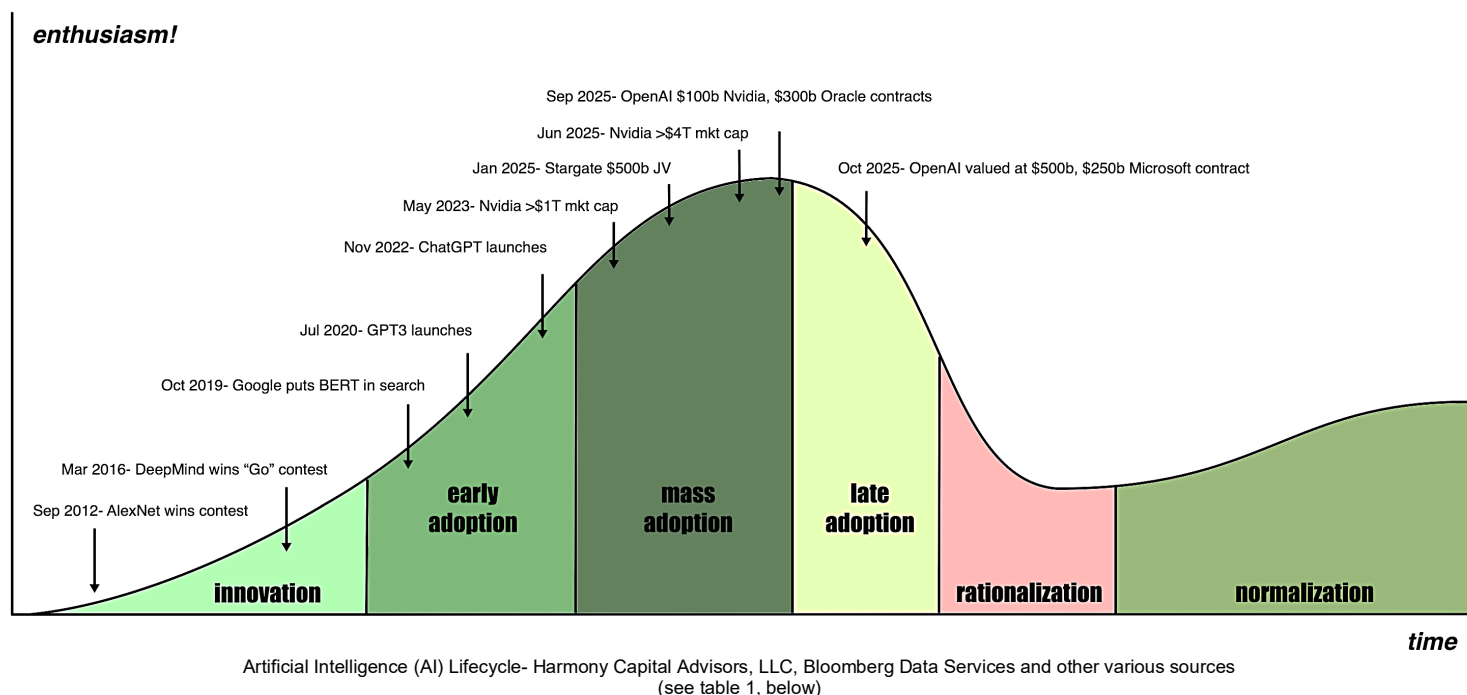
After all, sustainability implies you're working towards insulating your company from risks of all kinds, present and future.

AI is so HOT right now...

Amidst the wild ride that has been equity markets lately, it's good to step back to try to sort out a road map. After a punishing drawdown on the back of "Liberation Day" (4/2/25) earlier this year, tariff fears have given way to Artificial Intelligence (AI) euphoria. At the time of this writing, Nvidia has now become the first company to reach \$5 trillion in market capitalization!

We are enthusiastic fans of what AI can do for our economy. Still, we are also pragmatic in that all new technologies move through a lifecycle that ebbs and flows with enthusiasm. So, where are we in the current AI cycle? What comes next?

Exhibit 1 – Artificial Intelligence (AI) Lifecycle



We would argue, based on historical examples from past technology cycles, that we are likely in the "late adoption" phase of the cycle and that "rationalization" is on the horizon. However, we also see quite a bit of distance till that horizon manifests. Indeed, we are starting to see signs of limitations and competition, but these remain nascent compared to the hype still fueling investment in technology.

The reason for this potentially long "late adoption" phase is the data-hungry nature of the technology itself. If we look back to the beginning of the cycle, when AlexNet won a contest using software to categorize and label images, we can see at the core what neural networks are and what they need to power AI—vast amounts of data. Networks stacked on top of each other rely on enormous amounts of data to "train" the models for appropriate outcomes.

The challenge lies in generating or acquiring vast amounts of data—a build versus buy situation of epic proportions. Companies can either deploy enormous sums of capital to acquire data or they can generate it by deploying models and products for commercial use. Those "free apps" are using consumers to generate data.

So, unless you have an enormous stockpile of cash to pay for the data or AI-adjacent products to deploy to the market, catching up will be incredibly difficult.

The large companies dominating the AI landscape today are likely to remain in their current positions for some time. It is hard to know or see threats emerging, but they will likely look like either increased awareness of limitations or legitimate competition from multiple players and substitute technologies. While we see emergent signs of those, as we noted earlier, they are absolutely dwarfed at present by the mainstays.

To navigate this market dynamic, where the big get bigger but inevitably edge towards the “rationalization” phase, we would reiterate our approach of identifying AI beneficiaries or utilizers of the technology. These currently resemble software and service companies that have been early adopters of the technology, learning to leverage it to their advantage rather than being supplanted.

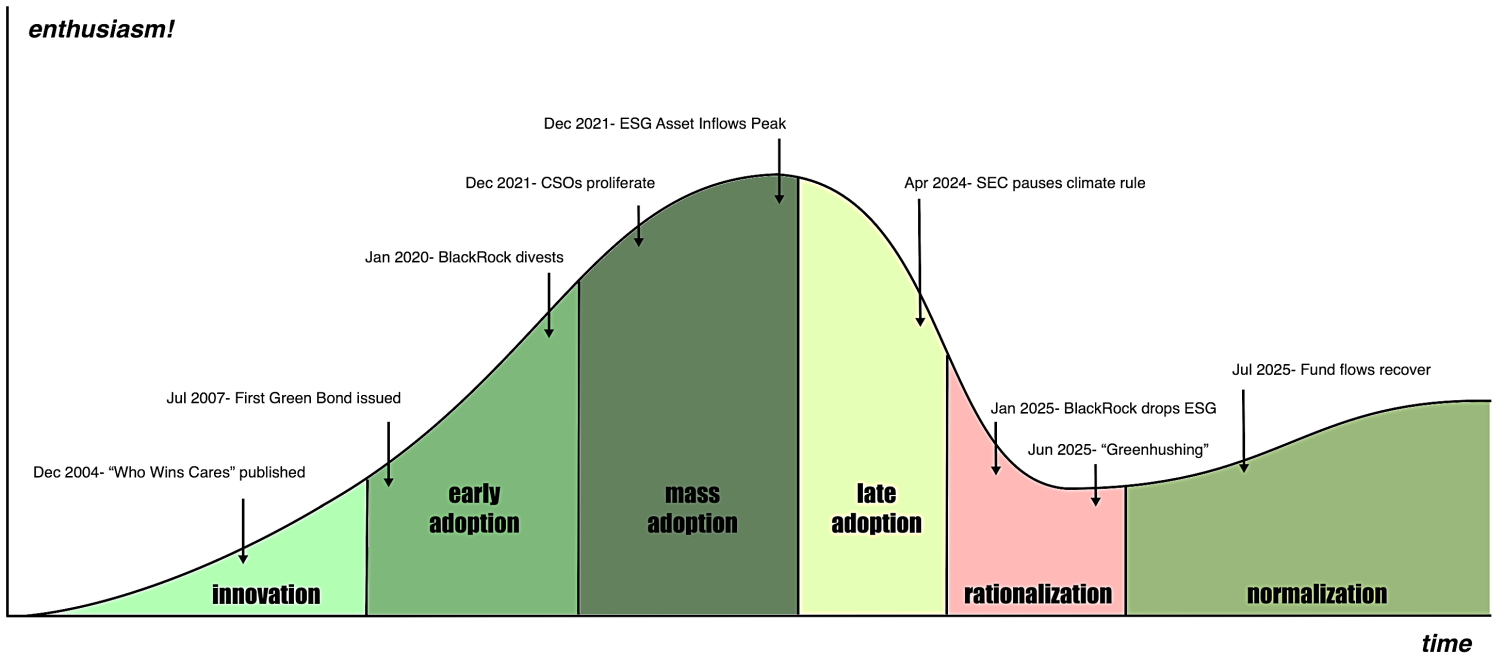
Sustainability Sneaking Back to Relevance

Another lifecycle that warrants a closer look is Sustainable Investing, as the rumors of its demise have been greatly exaggerated. Certainly, the headlines have clearly delineated the cycle illustrated below, but the “normalization” phase that we are now embarking on is far less obvious (at least to skeptics). Those close to this space are aware of the reality.

Frustratingly, the current administration has lit a fire underneath ESG and DEI pushback. If we are honest, while a challenge to navigate, this may be a necessary evil to assure the quality and ultimate future of the movement. There was a lot of froth surrounding the investing approach before this administration, which created inefficiencies and dubious products. Intense headwinds narrow the focus, streamline solutions, and generate better resiliency.

For those who have been watching sustainable investing before this administration, it may have felt like the enthusiasm for environmental and social health would never recede. However, the current US administration has clearly instigated and defined the “rationalization” phase. So where are we now in the lifecycle?

Exhibit 2 – Sustainable Investing Lifecycle



(Sustainable Investing Lifecycle- Harmony Capital Advisors, LLC, Bloomberg Data Services and other various sources (see table 2, below.)

There are clear signs that we have entered “normalization” for sustainable investing. For one, it is hard to imagine the headwinds getting any more severe with the repeal of nearly all federal support and potentially negative legal consequences for sustainable practices (DEI leads to reverse racism, and ESG flaunts fiduciary responsibility —would

be the arguments, as misdirected as they are). If it can't get worse, then rationalization is nearing an end, and normalization is next.

Secondly, we are seeing investors and corporations continue to pursue sustainability (which we would include in DEI), albeit more discreetly. "Greenhushing" has been coined for this activity, which suggests that the activities are worth pursuing, even if the macro-environment is unfavorable. However, this data is much harder to come by, since it is being hushed! However, many management teams discuss the importance of resiliency and diversity for their assets and workforce.

As such, we envision a future where sustainability is less politicized and discussed, alongside leverage, quality, and growth. After all, sustainability just means you're working towards insulating your company from risks of all kinds, present and future. Sustainability metrics will be used to gauge an entity's ability to sustain itself.

Outlook

As we look to year-end and ahead to 2026, we see economic challenges to the business cycle, but long-term promise in AI productivity, supporting higher growth. Rates are moving lower again as the Fed considers employment weakening; however, inflation remains persistent. This split is the result of AI driving the allocations of resources to new areas while simultaneously disrupting labor markets. Some places are overwhelmed by demand for AI spending, while other areas are suffering from a weakening consumer base.

The market is clearly drawing a line between companies that benefit from, or are adjacent to, AI investments versus classical software, or more broadly, any business that is directly exposed to consumers. While this makes some sense at a surface level, not all software is replaceable by AI (yet), and some will benefit. Consumers will also benefit, as their service providers utilize AI to enhance capacity and boost productivity. However, as we continue to aggressively ramp up investments, large companies with deep pockets and a head start in AI will likely continue to dominate.

Sustainability continues to see its drivers, even if they are, as we noted, less featured and sensational. Ensuring that a company can consistently deliver on its mission into the future is a key aspect of sustainable investing and a driver of value. Some are choosing to "green-hush" while accomplishing these goals, while others are braver and share their intentions more vocally.

We remain invested in AI but look for ways to diversify into the beneficiaries of the technology, as we are mindful that we are in the late stages of the industry's blind enthusiasm. For sustainability, we continue to find compelling individual ideas, but also now see benefits from lower rates, bringing life back to renewable energy. The combination of power demand for data centers, related to AI, and lower borrowing rates for capital-intensive businesses suggests an opportunity is at hand.

Signals for AI "rationalization" phase?

As we noted earlier, we are clearly in the "late adoption" phase of AI's lifecycle with eye-watering large capital spending announcements daily. The big get bigger and early adopters are extending their lead but this will inevitably hit a bump in the road. "Rationalization" comes for every technology, and we must be on the lookout for early signs.

The first sign we are on the look at for, is the end of capacity concerns from the hyper-scalers. Those companies that are now complaining about not being able to get enough chips, or whatever else they may require, will eventually solve the problem. When we hear "capacity is no longer an issue," that will likely be the first hint of oversupply and inflection towards rationalization.

Races to spend and build capacity ahead of competition will inevitably lead to companies overshooting. This excess capacity will crush margins and sap cashflow which could be devastating for those companies trading with lofty valuations.

Another sign to watch for is capital spending and the rate at which it increases. Or rather, when it increases more slowly. Currently, investment plans are racing higher and before they contract, there will be a more measured phase of growth. At some point, management teams and their boards will ask hard questions about Returns on Investments (ROIs) and margins. These are always the right questions but are often ignored when enthusiasm and competition are developing rapidly. Thus, any cooling of that dynamic may be a fleeting clue that negative corrections are on the horizon.

How do we know Sustainability isn't dead?

As we noted, sustainable investing is always a good idea (builds and protects long-term value) despite its seemingly out-of-favor moment politically, with a combo of lower rates and massive demand for power and water is driving interest again. Management teams learned hard lessons about resiliency after supply chain, labor, and tariff challenges. They are responding with thoughtful investments that appear to prioritize sustainability, even as many are shying away from “green,” “diversity,” and “ESG” labeling.

Renewable energy is of particular interest given the massive demand for power that data centers are creating. We need far more generation and transmission, both of which are expensive and challenging for the environment. Having gone through a “rationalization” phase now, the cost of building renewables is far cheaper; they can often be built on or near the location (requiring less transmission infrastructure), and they have no fuel logistics or costs!

Bottom Line

We continue to seek sustainable investments that can withstand an entire business cycle and have begun allocating again to Renewable Energy. We are also focused on power solutions that provide independence and resiliency, freeing companies from an aging national electric grid and volatile fuel costs.

Our cyclical adjustment has primarily focused on Financial Inclusion, as markets are rapidly repricing credit, particularly at the riskier end. Some of our companies have exposure to this theme, and while we are not exiting it entirely, we are pulling back a bit. These proceeds have been used to fund the increases in power investments we have made on themes highlighted here.

Lifecycle Data Sources:

Table 1 – Artificial Intelligence (AI) Lifecycle Sources

Date Sourced	Event	Detail	Link
Sep 2012	AlexNet wins contest	ImageNet contest won with a "deep learning" process that kicks of AI	https://pmc.ncbi.nlm.nih.gov/articles/PMC10049745/?utm_source=chatgpt.com
Mar 2016	DeepMind wins Go contest	AlphaGo AI beats human 4-1 in South Korea competition	https://www.wired.com/story/alphago-deepmind-google-wins-lee-sedol/?utm_source=chatgpt.com
Oct 2019	Google puts BERT into search	Opensourced neural network for Natural Language Processing (NLP)	https://blog.google/products/search/search-language-understanding-bert/?utm_source=chatgpt.com
Jul 2020	GPT-3 launch		https://en.wikipedia.org/wiki/GPT-3
Nov 2022	ChatGPT launches		https://en.wikipedia.org/wiki/ChatGPT
May 2023	NVDA >\$1T mkt cap		https://www.forbes.com/sites/dereksaul/2023/05/30/nvidia-hits-1-trillion-market-value/
Jan 2025	\$500b Stargate JV	JV Open AI, Oracle, Softbank, MGX for \$500b of AI	https://en.wikipedia.org/wiki/Stargate_LL_C
Jun 2025	NVDA >\$4T mkt cap		https://www.nbcnews.com/business/business-news/nvidia-becomes-first-company-worth-4-trillion-what-to-know-r_cna217721
Sep 2025	OpenAI \$100b Nvidia contract		https://www.forbes.com/sites/antoniopequenoiv/2025/09/22/nvidiaopenai-deal-chipmaker-investing-100-billion-in-chatgpt-maker/
Sep 2025	OpenAI \$300b Oracle contract	Three year contract for computing power, part of Stargate	https://www.techradar.com/pro/openai-bets-usd300-billion-on-oracle-contract-to-power-artificial-intelligence-expansion-despite-ongoing-losses
Oct 2025	OpenAI \$250b Microsoft contract	Secures model access for Microsoft through 2032, and preserves their 27% equity stake	https://www.geekwire.com/2025/microsoft-secures-27-stake-in-openai-in-new-deal-with-commitment-for-250b-in-azure-usage/
Oct 2025	OpenAI valued at \$500b	Valuation as part of Microsoft deal; 2025 revs est \$12.7b, \$27b net loss	https://sacra.com/c/openai/#:~:text=The%20company's%20model%20development%20and, and%20transparency%20in%20AI%20outputs.

Table 2 – Sustainable Investing Lifecycle Sources

Date	Event	Detail	Link
Dec 2024	"Who Care Wins"	Worldbank response to UN request published	https://documents1.worldbank.org/curated/en/280911488968799581/pdf/113237-WP-WhoCaresWins-2004.pdf?utm_source=chatgpt.com
Jul 2007	First Green Bond	European Investment Bank issues first climate awareness bond	https://www.eib.org/en/press/all/2022-308-15-years-of-eib-green-bonds-leading-sustainable-investment-from-niche-to-mainstream#:~:text=On%20July%205th%202007,of%20social%20and%20sustainability%20bonds.
Jan 2020	BlackRock divests	Investment policy targeting thermal coal producers exclusion	https://electrek.co/2020/01/16/blackrock-worlds-largest-investment-manager-drops-thermal-coal/#:~:text=As%20a%20result%2C%20we%20are,an%20annual%20letter%20to%20CEOs:
Dec 2021	CSOs Proliferate	PwC estimates that more CSO's hired in 2021 than prior 5yrs combined	https://www.pwc.com/mt/en/publications/sustainability/the-rise-of-chief-sustainability-officers.html
Dec 2021	Asset Inflows Peak	Morningstar 2025 report on ESG fund flows	https://www.morningstar.com/sustainable-investing/global-esg-fund-flows-increase-q4?utm_source=chatgpt.com
Apr 2024	SEC pauses climate rule	Several states push back on overreach	https://apnews.com/article/sec-climate-disclosure-rule-climate-change-lawsuits-35f464a554a5173e76c279e6ce399592
Jan 2025	BlackRock drops ESG	BlackRock withddraws from UN net zero initiative, drops ESG fund labels	https://www.wsj.com/business/blackrock-withdraws-from-climate-coalition-backpedaling-again-on-esg-0e9ad0f8
Jun 2025	Greenhushing	US coroproations drop ESG/green labeling	https://www.ft.com/content/f6b5084a-243a-406a-a8ff-089bbcacd2fc?utm_source=chatgpt.com
Jul 2025	Fund flows recover	Morningstar 2025 report on ESG fund flows recover	https://assets.contentstack.io/v3/assets/blt9415ea4cc4157833/blt7da172c52590cb03/Global_ESG_Flows_Q2_2025_Report.pdf

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