Vancity Investment Management

Q3 2025 Supplemental market commentary.

Market concentration hits record levels as investors shrug off tariff concerns and focus on the AI trade.

This year has been a tumultuous one for investors. It started with the U.S. imposing extreme global tariff policies, which led to a sharp fall in equity markets, followed by a quick reversal in the second and third quarters as investors brushed off earlier concerns and once again become enamored by the artificial intelligence (AI) trade. This sharp reversal in sentiment has fueled a staggering 30 per cent plus move in the Morgan Stanley Capital International (MSCI) World Index from April lows.

Since bottoming in April, a large driver of the market has been a mix of momentum and short-term speculation around a narrow segment of the market, particularly AI related names. The potential of AI has excited the investment community and massive amounts of capital have flowed into the space. This has led to a small group of companies contributing the lion's share of the market's performance, resulting in a record high level of market concentration. Goldman Sachs noted that companies which fall within its "non-profitable tech," "most-short"[1] and "meme stocks" categories have been among the best performers since the April lows, indicating a high level of market speculation.

History shows that bubbles form when too much money is chasing the next big thing. Whether it's the internet, autonomous driving or, going back much further, railroads. Right now, the big thing is AI. And while capital is chasing a handful of names, many quality companies with proven and resilient business models and demonstrated histories of growing earnings are being ignored. In times like this it's especially important to remain disciplined in one's approach to investing. Over the years the market has shown time and again that bubbles burst and long-term earnings growth

---

[1]Companies that have been most shorted by investors, indicating that investors expect share prices to decline. This is generally a sign that the company is of lower quality company and/or have serious issues.

matter. We can't change how many companies chase AI and how much they spend, but we can decide where to put our money, and what risks to take or noise to ignore. In markets such as this discipline matters more than predictions. In bubbles, outsized returns will be made and lost, but lasting wealth is built by patient investors.

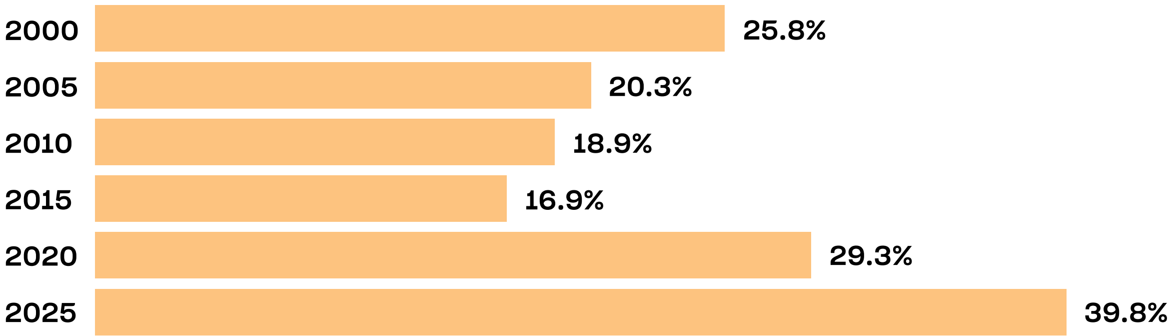
At Vancity Investment Management we follow a socially responsible investing (SRI) focused investment philosophy that identifies companies with strong balance sheets, quality management teams, and high recurring revenue streams. This process resulted in solid downside protection during the market drawdown at the beginning of the year, showcasing the defensive attributes of our funds. The flip side, however, was lagging performance as the market rebounded, especially in our Global Equity Fund. When investors become laser focused on a concentrated area of the market and direct capital towards it, other segments often lag. This underperformance can happen regardless of the sound investment opportunities that are available in other market segments—a trend we've been experiencing in our Global Equity Fund. While the market is focused on a few AI names, the companies in the Fund continue to generate strong earnings growth rates but have been largely overlooked by the market. This presents an opportunity for long-term investors to buy great companies at very attractive valuations.

Market gains have been concentrated.

As headlines talk of the S&P 500 hitting all-time highs, what's missing from the conversation is how a handful of companies are responsible for most of the year-to-date returns leading to extreme levels of market concentration.

The Magnificent Seven, a term given to the megacap companies Alphabet®, Amazon®, Apple®, Meta®, Microsoft®, NVIDIA®, and Tesla®, now have a combined market value of more than $20 trillion, equal to ~33 per cent of the S&P 500 index. If we expand out to the top 10 companies, the concentration is ~40 per cent of the index, meaning the remaining ~490 companies account for only 60 Per cent. There's no historical precedent for such extreme concentration.

Share of top 10 companies in S&P 500.



Source: **Bloomberg**

When only a handful of stocks are driving a market rally, if a reversal in those names occurs, we'd expect capital to flow out to the broader market. In such an environment, while market-cap weighted indices may struggle given the high concentration risk in AI names, the broader equally weighted market should fare better and could get a boost as investors recognize the forgotten opportunities.

AI spending bonanza.

There is little doubt that AI is a transformational technology that will impact society in innumerable ways. The question nobody has an answer for, however, is when will the AI spending stall out and which companies will be the eventual winners.

Tech companies are currently in an arms race as demand for AI services, which requires both massive computing capacity and energy, is rising at a rapid clip and nobody will know how much is too much until after the fact. This spending has already reached a staggering scale. According to one estimate, American tech companies are expected to spend $300-400 billion on AI this year alone. It's been calculated that roughly half of last quarter's GDP growth came from just AI infrastructure spending.[2] The issue these companies now face is how to find enough revenue or cost efficiencies to offset this spending. According to Bain & Co., they'll need $2 trillion in combined annual revenue by 2030 to fund computing power, but revenue is likely to fall $800 billion short.

Every industrial revolution passes through a bubble phase, including railroads in the 19th century, which went through three different bubbles, and broadband in the 1990s and early 2000s. Nortel anyone? Big infrastructure buildouts that change the world often pass through a bubble phase so it's very much in-line with historical trends to expect the same of this one.

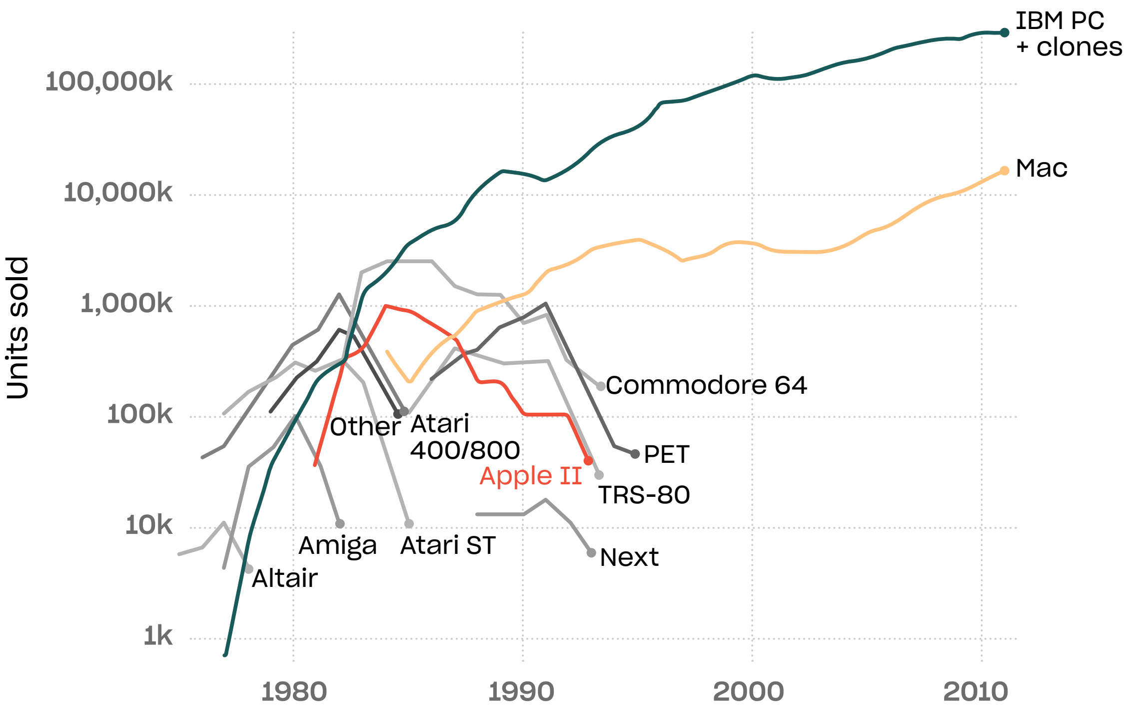
All of this is to say that the spending on AI will at some point slow dramatically and at present it's difficult to say who the winners will be. Personal computers transformed our entire world, but only two companies, MacIntosh and IBM, were able to survive.

It's because of these issues that we've been very cautious in predicting winners and blindly investing in the AI trade. However, what we do know is that the demand for energy for cooling is going to increase dramatically which will only increase the need for renewable energy companies such as Boralex® (Canadian Equity Fund holding) as well as HVAC companies like Trane Technologies (Global Equity Fund). We're also invested in some of the Magnificent Seven, as we believe they're best positioned to continue their market dominance while utilizing AI to produce further sources of revenue and efficiencies.

---

[2]The majority of this spend is going towards the building of data centers, which are massive buildings full of GPUs and servers that are used by large AI firms to generate responses and train models. Almost half of the cost goes towards energy and cooling.

IBM and Apple were the only two survivors in the personal computer space.



Source: **Data from Dediu, H., "The Next 40", Asymco, March 2016.**

Tariff policy impact.

While markets have shrugged off the initial implementation of tariffs, the era of trade uncertainty is just beginning. The average effective U.S. tariff rate has surged from ~2.5 per cent at the start of the year to ~18 per cent. The World Trade Organization has already lowered its forecast for global trade growth in 2026 from 2.5 per cent to 1.8 per cent, directly citing these new U.S. policies as a primary driver of the downgrade.

The uncertainty extends beyond the current rates to their ultimate levels, duration, and the potential for sudden escalations or reversals. This complicates long-term investment and hiring decisions. Companies are in a costly race to adapt, realigning supply chains through nearshoring, reshoring, and diversification. These are complex, expensive maneuvers that can take years. We feel comfortable that over time companies will adapt to this new world order, but we remain laser-focused on ensuring our holdings are prepared for what lies ahead and have had many conversations with management teams for those that are most vulnerable. Even though Wall Street has moved on from 'Liberation Day', Main Street hasn't.

Understanding our investment philosophy and approach.

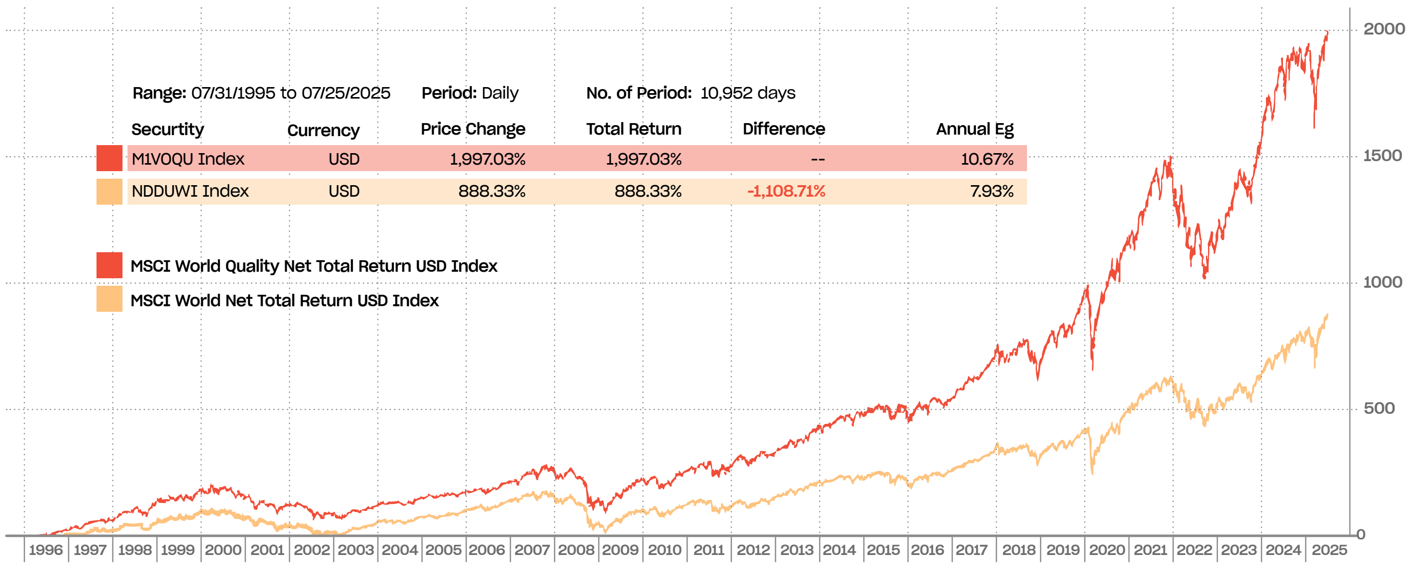
We follow a bottom up, growth at a reasonable price investment philosophy with a focus on quality companies. We bring together in-house environmental, social, and governance (ESG) analysis and detailed financial analysis to identify opportunities that can deliver long-term growth with sustainable value.

What do we mean by quality? Quality investing is a strategy focused on identifying and purchasing securities of companies with durable business models and sustainable competitive advantages. These advantages, whether it's a dominant brand or proprietary technology, shield companies from competition and allow them to maintain high levels of profitability over extended periods. This durability allows businesses to consistently generate high returns on invested capital and reinvest their earnings at these high rates to keep growing, effectively turning them into a powerful compounding machine. Such companies often pair financial strength with capable leadership, giving them the flexibility to navigate challenges, adapt to change, and continue growing. For our clients, that means a more reliable path to long-term wealth creation.

Unlike pure growth strategies that may encompass a wide spectrum of companies, including speculative ones, our approach focuses on investing in durable businesses at a fair or rational price. We see heightened levels of investment risk in companies promising explosive growth, especially when market excitement pushes valuations to levels reliant on a continuation of this outsized growth. Rather than ignoring these opportunities, we take a measured approach, analyzing them closely and investing only when the potential rewards justify the risks.

We believe quality endures. While no investment strategy outperforms in every market environment, the quality factor has proven to be one of the most persistent and reliable sources of excess returns over the long run. History backs this up: over the long run, the MSCI World Quality Index has consistently outperformed its parent index, the MSCI World Index.

Outperformance over time: MSCI World Quality Index surpasses MSCI World Index.



Source: **Bloomberg**

Defensive power of quality.

Quality investing tends to do best, relative to the market, in downturns as it targets companies with inherently defensive business characteristics. These companies possess strong balance sheets with low debt, which provides a crucial buffer when credit tightens, and the economy slows. Many also generate stable earnings from essential goods and services, making them less vulnerable to economic swings. In times of market stress, investors frequently seek safety by moving out of riskier assets and into durable, financially sound companies like these.

We saw a clear example of this in early 2025. During the first four months, market volatility was significantly heightened as a dramatic shift in U.S. trade policy unsettled investors. The VIX index, a key gauge of market volatility, spiked to its highest levels since the COVID-19 pandemic. Despite this turbulence, the Global Equity Fund's quality-focused strategy proved its resilience in this challenging environment, delivering substantial outperformance against the benchmark.

Quality is on sale.

As investors focus on the AI trade, a large portion of the market is being ignored, providing a rare opportunity for us to buy quality companies at attractive valuations. Most of these companies won't have the same explosive near-term growth rates or exciting narratives, but this is more than made up for in their recurring revenues, long-term growth runway, and defensible business models.

Below are just a couple of examples of companies that have underperformed year-to-date but continue to post strong results and should do so for many years to come.

> **Waste Connections—**Along with Waste Management and Republic Services, Waste Connections controls more than 50 per cent of the North American waste industry. Over the last 10 years, it's grown revenue at a compounded rate of almost 16 per cent. The result for shareholders has been fantastic as shares have compounded at a rate of 18 per cent plus per annum over this timeframe. As long as there's a need for waste and recycling collection, Waste Connections will have a very bright future.
>
> **Visa—**A global household name that dominates the credit card space alongside Mastercard. The move to a cashless society has greatly benefited the company as earnings have consistently grown at a high teens pace since it went public in 2008, with no end in sight. Both Visa and Mastercard have been excellent investments for investors as shares have compounded at a rate of ~20 per cent per annum since 2008.

These are just two examples of the opportunities the market's emotional swings are currently providing. Exciting short-term narratives that drive investor sentiment and fear of missing out mind-sets are what create outstanding opportunities for investors with a patient, disciplined approach.

Why we remain confident in our approach.

Our investment approach is defined by our core philosophy: identifying high-quality growth companies at reasonable prices, fully integrated with a rigorous ESG framework. This disciplined process results in a distinct portfolio profile that will not always be in sync with short-term market trends. Periods of divergence are not a weakness but a testament to the consistency of our strategy through short-term market oscillations.

The resilience demonstrated during the volatility of early 2025 affirms our conviction that focusing on financially sound, "steady compounders" provides downside protection and is a prudent path to navigating uncertainty. While market leadership will inevitably rotate, the fundamental principles of quality have proven to be a reliable source of excess returns over the long term.

Appendix.

In a market landscape dominated by the performance of a few megacap technology stocks, it can be tempting to simply follow the herd. The Magnificent Seven has delivered extraordinary returns, single-handedly driving index performance and capturing investor attention. However, our commitment to a disciplined investment process, rooted in both rigorous ESG and fundamental analysis, compels us to look beyond momentum. This disciplined approach is why our Global Equity Fund differs from the MSCI World benchmark, leading us to exclude Tesla and Meta for ESG-related risks and to maintain a cautious underweight position in NVIDIA due to valuation and competitive concerns.

Why our ESG screens exclude certain Magnificent Seven stocks.

- Our proprietary ESG screening process is designed to identify companies with strong governance, sustainable business practices, and a positive societal impact. This disciplined framework requires us to look beyond market leadership and financial performance to assess the fundamental risks and opportunities embedded in a company's operations.
- Tesla and Meta platforms have been prominent drivers of innovation and market returns but are both excluded from our portfolios as they don't meet our stringent ESG criteria. Our analysis has identified persistent and material concerns ranging from governance issues and workplace safety at Tesla, to data privacy and content moderation challenges at Meta that we believe pose significant long-term risks to shareholder value.

Why we remain underweight NVIDIA.

- Nvidia's performance in 2024 (+179 per cent) and large weight in the index meant its performance had an outsized impact on major indices.
- We didn't own NVIDIA for the most part of 2024 for several reasons. Foremost among these were concerns about the company's valuation, making the stock susceptible to a significant correction. The semiconductor industry is cyclical, and the current AI-driven boom has drawn comparisons to past tech bubbles, leading to worries about the sustainability of NVIDIA's meteoric growth.
- The competitive landscape is also intensifying. Established rivals like Advanced Micro Devices® and Intel® are aggressively developing their own AI-focused chips, while some of NVIDIA's largest customers, including Google®, Amazon, and Microsoft, are increasingly designing their own custom silicon to reduce their reliance on a single supplier. This trend toward in-house chip development, coupled with NVIDIA's revenue concentrated among a small number of large clients, presents a significant risk.

- The Fund did initiate a position in late 2024 to capture some of NVIDIA's long-term growth drivers, but we believe these risks warrant a measured approach, resulting in the fund maintaining a strategic underweight position relative to the benchmark.
- We recognize that our underweight in NVIDIA was a significant detractor from the fund's relative performance in 2024, and so far in 2025. However, this position is a direct result of our disciplined, risk-managed approach. Given our persistent concerns about its valuation and competitive landscape, we believe maintaining a measured exposure is the most prudent path for delivering sustainable long-term returns.

Vancity Investment Management is located on the unceded territories of the Coast Salish territory, represented today by the Musqueam, Squamish and Tsleil-Waututh Nations. They have been custodians of this land for thousands of years and we would like to pay our respect to the elders both past and present.