

Investment Report – 2<sup>nd</sup> Semester 2025

## The Market Pendulum Swings, Our Course Remains



The year 2025 was a test of patience for the long-term investor. In the US, diversification was penalized as a few large technology stocks continued to dominate performance. Europe witnessed a renaissance in sectors that structurally generate lower long-term performance than the broader market. Additionally, the weakness of the US dollar weighed on returns for international investors, a sharp reversal from its surge the previous year. Media coverage shifted just as rapidly: while "King Dollar" was the measure of all things at the end of 2024, concerns over the US deficit and tariff policies dominated the headlines by the end of 2025.

**Are We in an AI Bubble?**

The dominant theme was undoubtedly Artificial Intelligence (AI). The question of whether a bubble is forming requires a nuanced view. The global AI market is supported by genuine applications: millions of people use AI daily, autonomous vehicles are already on the roads, and productivity gains are tangible. Nevertheless, fundamental risks for investors revealed themselves over the course of 2025.

Rapid technological development reduces predictability. In January, the release of the Chinese open-source model Deepseek challenged the market dominance of US giants, demonstrating impressive capabilities with

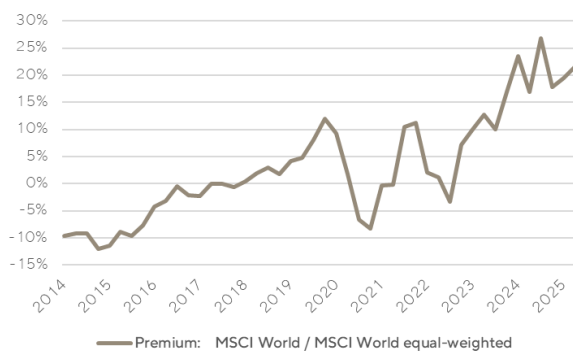
minimal capital. By year-end, Alphabet overtook the previous leader, ChatGPT, with the release of Gemini 3.0. This, in turn, had knock-on effects on the hardware side: Nvidia's dominance was challenged by custom-designed chips from Alphabet and its suppliers (such as Broadcom).

Data center expenditures are straining the resources of even the most financially robust companies. While giants like Microsoft or Meta cover their AI investments with stable cash flows, pure AI companies (like OpenAI) face enormous computing costs against comparatively low revenues. Before the rise of AI, tech giants had low capital expenditure and personnel costs. The AI arms race now forces them to invest significantly more in both, markedly changing their financial profiles and risk levels. As the recipients of these massive investments, hardware producers like Nvidia are particularly exposed.

AI is a disruptive trend with far-reaching consequences. However, a technology that changes the world can still jeopardize investors' wealth if valuations are too high, if capital is allocated to the wrong companies, or if their weighting in the index becomes excessive. Historically, early market leaders are not always the long-term winners (consider Kodak, Yahoo, Nokia, or Netscape).

## Valuation: The Optical Illusion

Stock market valuation remains a central topic of discussion. At first glance, the overall market appears expensive. However, this is because the eight dominating US companies account for roughly 25% of the global market value (which consists of around 1,300 stocks in total) and trade at massive premiums. This distorts the index. Conversely, if one looks at equal-weight indices (where every stock has the same weight), valuations sit within the long-term average.



Statistics show that the weight of individual stocks in a passive index is often highest precisely when valuation—and thus risk—is at its peak. Equal-weight portfolios therefore tend to perform better over the long term, as they avoid concentration risks during phases of euphoria.

This is exactly where opportunities arise. While the world focuses on the primary AI actors, many first-class quality companies have experienced corrections and are trading at discounts that do not reflect their solid earnings situation. In the technology sector, beyond the AI giants, one can find many established software companies whose valuations seem to price in a far-reaching disruption of their business models that has not yet occurred.

The market currently sees only opportunities in the contemporary AI winners, while seeing predominantly risks in the perceived losers. For long-term investors, this asymmetry offers attractive entry points into quality stocks.

## Quality vs. the "Junk Rally" in Europe

In Europe, the technology sector plays a subordinate role; instead, financial stocks (banks, insurance companies) dominate, accounting for around a quarter of the total market. This sector recorded strong performance in 2025, favored by higher interest rates and low valuations. However, a low valuation is often structurally

justified: for financials, low capitalization leads to increased fragility and volatile earnings. In other sectors, low valuations indicate cyclical earnings, thin margins, and high recurring capital expenditures. These attributes apply to most stocks belonging to the "Value" category, which staged a strong rally in 2025.

In contrast stands the performance of the "Quality" category: companies with high returns on equity, low debt, and stable margins. In the short term, quality stocks were penalized because their constant earnings profiles — their long-term strength — showed less growth dynamism in the post-Covid period compared to cyclical companies.

In the long run, stock prices always follow earnings growth. Since pure "Value" stocks cannot be held carelessly throughout the entire economic cycle due to their characteristics, the probability of generating excess returns with them over the long term is low. The same applies to switching between different investment styles (e.g., Value to Quality or active to passive). The reason is that one must always be right twice: when exiting and when re-entering. The probability that a portfolio of quality stocks will outperform cyclical bets over a full economic cycle is significantly higher—and historically proven through the quantification of the "Quality Factor".

## Fundamental Investing in Times of Exuberance

We do not know if the AI euphoria will continue in 2026. What we do know is that valuation mathematics acts like gravity in the long run. The higher the expectations, the harder they are to fulfill, and the less buffer there is to absorb external shocks. Currently, valuation in some areas has run ahead of fundamental development.

In other areas, the opposite is true: Medical technology combines the trend of demographic aging with technological progress and trades at a discount. In the software sector, outside of AI models, there are firms whose valuations price in almost exclusively negative scenarios due to disruption fears. And "Quality", the most successful factor over the long term, is trading at a significant discount to its long-term average. We are convinced that companies with an excellent track record are best positioned to survive profound changes and even use them to their advantage. It is quite possible that the next beneficiaries of AI development will be found away from the headlines, improving products,

increasing productivity, and thereby creating shareholder value.

The market pendulum swings between euphoria and depression. A high-quality stock portfolio is comparable to prime real estate: if you own a house in a prime location, you don't sell it just because the real estate market corrects briefly or because prices in another part of town happen to be rising faster. Great assets remain great, regardless of the cycle we are in.

Doing nothing is often psychologically harder than taking action. Yet, activism is the enemy of returns. The best protection against wanting to "time" the market is a long-term strategy and owning companies whose quality facilitates this time horizon. We recommend holding stocks and sectors that offer the best track record over the entire economic cycle and are exposed to structural megatrends.

Zurich, End of December 2025