

The Charter Group Monthly Letter

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Economic & Market Update

Bubble Talk at the Seminar

On October 1st & 2nd, The Charter Group hosted its traditional Fall Economic & Market Update.

The first part of the agenda focused on the tariffs. But most of that had been covered in previous issues of *The Monthly Letter*. The presentation then shifted to my concerns of a potential bubble forming in the markets, a topic I hadn't written about in recent years.

The reason I allude to a "potential" bubble is that they are almost impossible to confirm until after the fact. The time factor presents a conundrum when navigating a bubble. Does a portfolio manager keep dancing while the music keeps playing?¹ Or is it time to build in more defensive or contrarian strategies? Or how about shorting stocks (directly betting against the market)? Sometimes a bold bet against can feel good. But shorting carries the potential of painful losses if things continue to go up. As the old John Maynard Keynes

Our fall seminar covered the tariffs as well as a potential bubble forming in AI-related stocks.

It is difficult to know whether or not there is a bubble until it pops. Often there are clues if there are similarities to historical bubbles. But, the timing is tricky.

¹ Paraphrasing ex-Citigroup CEO Chuck Prince when, in 2007, he said "As long as the music is playing, you've got to keep dancing." A couple of years later, Citigroup, along with a number of other U.S. banks, proceeded headlong into the Subprime Mortgage Crisis, resulting in a \$476 billion bailout.



TD Wealth

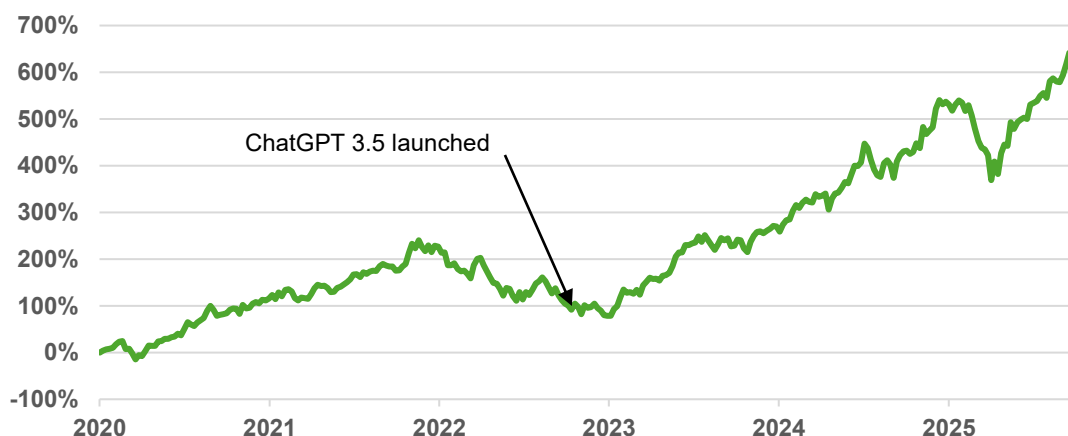


adage warns: "Markets can remain irrational longer than you can remain solvent."²

Artificial Intelligence (AI) is at the heart of the bubble concerns. Beginning almost three years ago with the release of ChatGPT 3.5 (**Chart 1**), Wall Street has been very effective at driving a narrative that suggests AI will be like what the steam engine was to the Industrial Revolution. ChatGPT 3.5 was so compelling in its novel capabilities that it captured the imagination of the public. With the markets at the time losing faith in the "metaverse" fad and with higher interest rates hammering many stocks and most bonds, ChatGPT3.5 appeared at just the right time.

The current ascent of these stocks began with the launch of ChatGPT 3.5.

Chart 1:
Bloomberg Magnificent 7 Total Return Index (AI-Related Stocks)



Source: Bloomberg Finance L.P. as of October 9, 2025

Often my tone on the subject of AI makes it seem that I am bearish on the theme. I have no doubt that the application of AI will be a net positive in the pursuit of finding new and better ways of doing things. The questions I have at this point, and what heightens my concern about a bubble, are: "How lucrative will it be for the providers (semiconductor firms, data centre firms, AI research & development firms, and so on)?" "What will be the value of the increased productivity for consumers and businesses?" And, "Can AI-related stocks be bought at a price low enough to provide a return on investment that is commensurate with the risk taken?" If AI moves towards general profitability and there are related portfolio opportunities that can be captured with a long-term investment strategy (as opposed to speculation or market-timing), I might start talking like one of the converted faithful. But I am not sounding like that yet. So, what's the problem. Or, as some of the advocates might suggest: "What's my problem?" 😊

This debate is not about AI's likely contribution to productivity.

It is about whether it will be profitable in general after the required massive spending is considered.

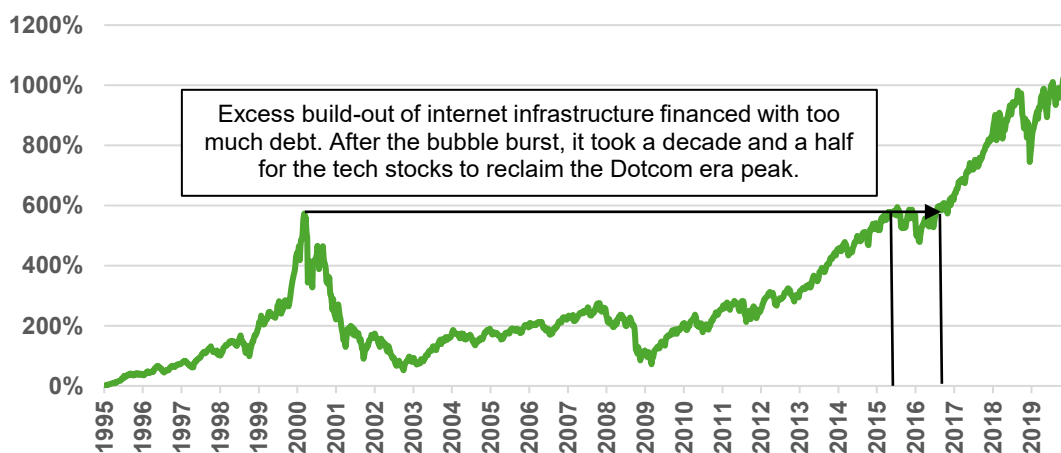
² John Maynard Keynes was an English economist and investment luminary who was at his most prominent from the 1920's to the 1940's.

At this point, the AI sector no longer has the luxury of not living up to its fullest. The capital expenditures that have taken place and that are budgeted to continue, combined with the eye-watering market value of many of the companies in the sector, make it imperative that it *has* to work as promised. In my opinion, AI's impact on the investment market is priced for perfection. Which brings us to one of the parallels with the Dotcom bubble of the late 1990s. It had better be as wondrous as the faithful are proclaiming. If share prices continue to advance significantly from here, the consolation prize of not meeting expectations might resemble the financial wreckage that followed the Dotcom bust in 2000

It may be that AI needs to live up to all its promises to justify the amount of capital it needs.

Anything less could cause considerable heartache for investors.

Chart 2:
The Nasdaq Index (Heavily Weighted with Technology Stocks)



Source: Bloomberg Finance L.P. as of October 9, 2025

(Chart 2).

One frustration at this stage is a lack of specifics. How is my day going to be significantly better five to ten years from now? And, as a general consumer, am I going to pay considerable money in order to seize these benefits? At this point, the novelties of ChatGPT (and other large language AI models) have provided very compelling solutions to rather narrow problems like coding, descriptive composition/documentation, and diagnostics (in medicine and general industry). Other applications are "promising" but often get bogged down in implementation costs, complexities, and corporate politics.

When searching for specifics, investors are often encouraged to just believe.

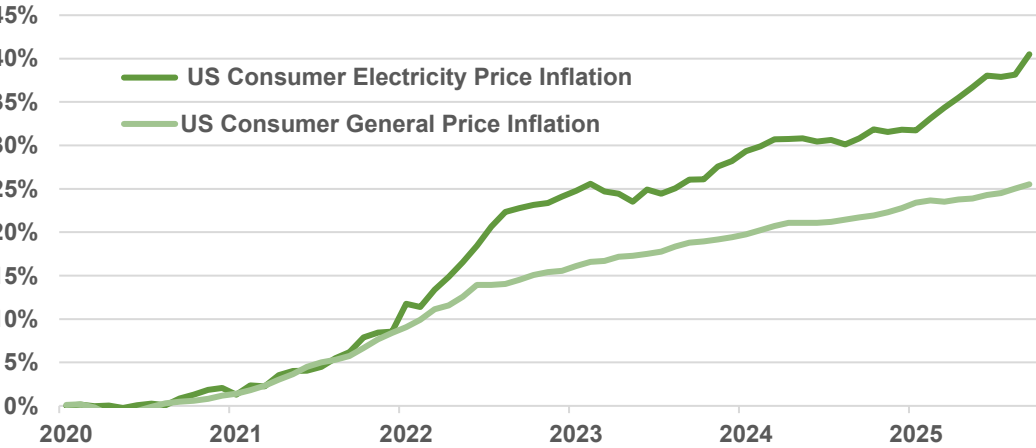
The benefits of AI are going to need to be much more entrenched and transformative to justify the trillions invested and spent. I think that would mean saving life-changing amounts of time and effort to do the things that currently fill our schedules. Over the last half century, computers, software, smartphones, and instant digital communications have done that. The day in the life of a consumer is functionally different in most respects compared to the 1970s. That is why those technologies consume a significant portion of

household and corporate budgets. And, despite the ups and downs that the tech sector has had over that time, it has rewarded enough investors general to compensate for the risk.³

In addition to the absence of specifics of how an AI future would look, there are still considerable roadblocks that are being tossed aside as concerns for another day. Unfortunately, some of those roadblocks are dead-ahead. The main one is energy. Many recent deals in the AI sector measure the size of the deal in gigawatts of energy consumption. Some conservative estimates point to a need for 200 to 300 gigawatts of additional energy output globally to power the data centres required by AI by the end of this decade. To provide some context, a larger nuclear reactor with a massive cooling tower tends to be in the one gigawatt range. The Three Gorges Dam in China puts out about 22 gigawatts. It took 18 years to become fully operational, drastically altered the surrounding topography, and displaced 300,000 people. We would need the equivalent of at least 10 of those just to meet AI's 2030 forecasted infrastructure! And 2030 wouldn't come close to the final build-out.

Watch for this to become much more political as consumers in many U.S. states that get their power from unregulated power utilities have been paying considerably more to cover their utility bills (**Chart 3**). I seriously doubt that they will be placated when told that energy prices are higher as a result of the added demand from AI.

Chart 3:
Cumulative General vs Electricity Inflation in the U.S.



Source: Bloomberg Finance L.P. as of October 9, 2025

Often the rebuttal to this involves new breakthroughs in energy (fusion), computing

³ Obviously not all investors. Some, but virtue of bad choices or too much speculation, got wiped out.

There is still no convincing answer for producing the energy that is expected to be needed.

The commercial demand for energy is increasing costs for consumers which might be setting up a political clash.

(quantum), semiconductor efficiencies. However, all of that would require significant financial write-downs and a need for even more capital to build the replacement infrastructure.

And while on the topic of capital, it appears that we have entered a new era where capital has become relatively less abundant and more costly. That has certainly been the case since the Pandemic as evidenced by higher interest rates. Investors may be expecting higher rates of return on their invested risk capital since they have higher yielding alternatives for their cash which didn't exist a decade ago. At a minimum, the full promise of AI will likely need to be imminent. If investors don't part easily with their capital, financing the AI infrastructure may become much more complicated or even possibly unviable.

Still on the topic of capital: lately a growing number of AI infrastructure deals have been financed with debt. It is one thing to finance things out of cash flow generated by ongoing business. But when borrowing becomes fashionable, analogies with the late 1990s begin to emerge.

Also, in a growing number of AI infrastructure deals, arrangements are becoming circular where a customer agrees to buy components in exchange for the component provider making an investment (Nvidia and OpenAI/ChatGPT for example). Plus, the U.S. federal government is exhibiting signs of state capitalism with its eagerness to provide capital in exchange for a say in things. The best-case scenario when analyzing companies for viability is when they are able to cover investments and expenses out of internally generated cash flow. What is trending in the AI sector is *not* that!

Finally, there have been multiple articles over the last month on what would happen if AI was just a continuation of normal technological progress and not some parabolic acceleration towards a Star Trek future. The progress over the last two decades has provided undeniable improvements. Processing speeds, memory storage, and speed of digital communications allow all of us to do more and to find new uses for technology that came of age prior to that. I think that if AI continues this pace of progress, it would qualify as a great future. However, that future would likely be unacceptable to the trillions of dollars of wagers expecting much more. If that becomes evident, it could be a day of reckoning, one that will tell us once and for all whether or not we are currently in a bubble.

AI needs capital, but capital is more expensive that it was pre-Pandemic.

A growing use of debt echoes the Dotcom bubble in the 1990s.

Creative financing schemes bring their own type of risk.

If AI ends up continuing the impressive pace of technological progress of the last few decades, the future will be bright for users of AI. But that pace could spell trouble for investors who were hoping for much more.



Model Portfolio Update⁴

The Charter Group Balanced Portfolio (A Pension-Style Portfolio)		
	Target Allocation %	Change
Equities:		
Canadian Equities	12.0	None
U.S. Equities	38.0	None
International Equities	8.0	None
Fixed Income:		
Canadian Bonds	22.0	None
U.S. Bonds	6.0	None
Alternative Investments:		
Gold	8.0	None
Silver	1.0	None
Commodities & Agriculture	3.0	None
Cash	2.0	None

No changes were made to the model portfolios in terms of the asset allocations or the investment holdings during September.

September was another spectacular month for gold, rising over 9% in Canadian dollar terms. And the gains continued into October with the price up over \$4,000 USD for the first time ever. If central banks are feeling confident about putting a lid on inflation while at the same time cutting short-term interest rates, gold investors' actions are a vote of non-confidence. It may be that all the tariff news of the past few months as well as a constant stream of other policy announcements have shifted news media attention away from the precarious state of government fiscal finances (including the U.S., Canada, Great Britain, and Japan), but it appears that the gold market has not forgotten. However, after gold's torrid 52% gain over the last year, it wouldn't be too surprising to see a bit of a pullback.

No changes in the model portfolios in September.

Gold had another fantastic month as it appears to be doubting the state of current fiscal and monetary policies throughout the developed world.

⁴ The asset allocation represents the current *target* asset allocation of the Balanced Model Portfolio as of October 9, 2025. The asset allocations of individual clients invested in this Portfolio may differ because of the relative performance of the asset classes since the last rebalancing and because of differences in the timing of deposits and withdrawals. The Balanced Model Portfolio is part of a sequence of five portfolios ranging from conservative to aggressive: Conservative, Balanced Income, Balanced, Balanced Growth, and Growth.

The stock market seems to be looking the other way, hoping for the telegraphed interest rate cuts to materialize. Equities in the U.S., Canada, and internationally were up significantly as a whole during September.

As discussed in the previous section of the newsletter, there are concerns about a bubble forming in stocks, primarily in AI-related sectors. However, the timing of when a bubble pops is very difficult to predict. From my perspective there currently aren't any clear catalysts on the horizon that could set off the herd towards selling *en masse*. Something would have to come out of left field, such as a surprising spike in inflation which could halt the talk of rate cuts and force investors to re-examine things.

So far the U.S. federal government shutdown which is now in its second week has not had a visible impact on the markets. The shutdown might have to drag on for a while to precipitate enough economic disorder to bother investors. There isn't much upside for either of the main U.S. parties to see this continue for long. As a result, I would expect that after each side has gotten enough publicity, they will then likely inch toward an agreement.

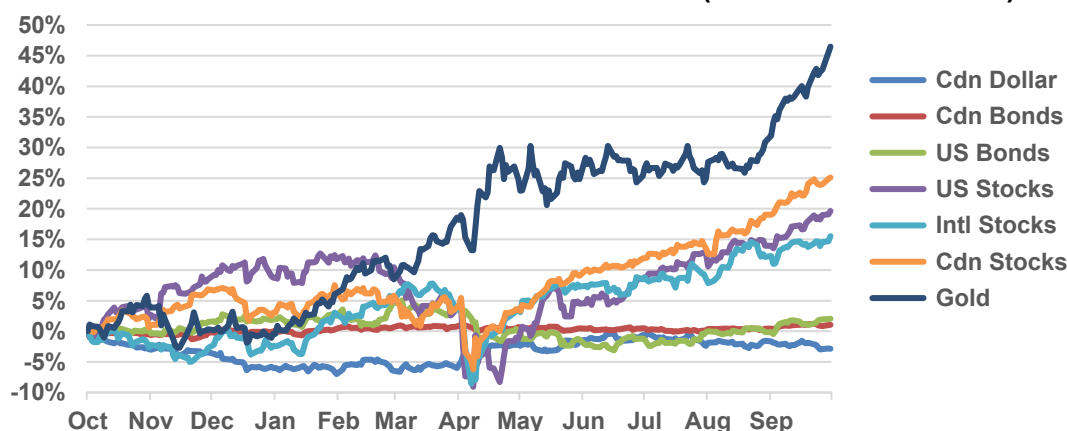
Below is the 12-month performance of the asset classes that we have used in the construction of The Charter Group's model portfolios. (Chart 4).⁵

Stock markets appear to be taking a view that is the opposite of gold investors.

No apparent catalyst for a selloff. That catalyst would need to be an unexpected surprise. Perhaps we get a "melt-up" in stocks until there is something.

The current U.S. government shutdown would have to continue for a while to cause problems for the markets.

Chart 4:
12-Month Performance of the Asset Classes (in Canadian dollars)



Source: Bloomberg Finance L.P. for the interval from October 1, 2024 to September 30, 2025

⁵ Source: Bloomberg Finance L.P. – The Canadian dollar rate is the CAD/USD cross rate which is the amount of Canadian dollars per one U.S. dollar; Canadian bonds are represented by the current 3-year Government of Canada Bond; US bonds are represented by Barclays US Aggregate Bond Index; U.S. stocks are represented by the S&P 500 Index; International stocks are represented by the MSCI EAFE Index; Canadian stocks are represented by the S&P/TSX 60 Composite Index; Gold is represented by the Gold to US Dollar spot price.

Top Investment Issues⁶

Issue	Importance	Portfolio Impact
1. Global Geopolitics	Significant	Negative
2. Global Trade Wars & Alliances	Moderate	Negative
3. Inflation from Tariffs (Portfolio Impact)	Moderate	Positive
4. Canadian Federal Economic Policy	Moderate	Negative
5. Tariffs: Slowing Economic Growth	Moderate	Negative
6. Canadian Dollar Decline	Medium	Positive
7. China's Economic Growth	Light	Negative
8. Long-term U.S. Interest Rates	Light	Positive
9. Short-term U.S. Interest Rates	Light	Positive
10. U.S. Fiscal Spending Stimulus	Light	Positive

⁶ This is a list of the issues that we currently deem to be the ten most important with respect to the potential impact on our model portfolios over the next 12 months. This is only a ranking of importance and potential impact and *not* an explicit forecast. The list is to illustrate where our attention is focused at the present time. If you would like an in-depth discussion as to the potential magnitude and direction of the issues potentially affecting the model portfolios, I encourage you to email me at mark.jasayko@td.com or call me directly on my mobile at 778-995-8872.



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Accountability is further enhanced by the fact that we commit our own investable wealth to the same model portfolios in which our clients are invested.





The information contained herein is current as of October 9, 2025.

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