

The Charter Group Monthly Letter

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Economic & Market Update

Capital Punishment

Imagine if you could borrow capital at no cost. Would it impact how we manage our finances? It probably would for many of us. A nice house with a cost-free mortgage. Sweet! We could buy more things and do more things.

The cost of capital for consumers was historically low in the decade prior to the pandemic. For many corporate borrowers, it was even lower. For some banks in Europe, they got *paid* to borrow (depositors paid the banks instead of the other way around). For the providers of capital back then there weren't alternatives offering better returns.

The cost of capital has been notably higher than it was in the decade before the pandemic. Providers of capital (lenders and investors) are now requiring higher interest payments and higher dividend yields. Much of this is because of rising demand for capital as well as higher inflation (lenders want an inflation premium in the hopes that their returns will maintain purchasing power).

Capital is becoming more costly as the demand for it has increased.

Will the AI infrastructure build-out lead to a global battle for capital, increasing its cost further?

And will this blowback onto the AI sector and eventually jeopardize the amount of required infrastructure?



TD Wealth



Not only is the cost of capital higher than it used to be, but we also might be in the early stages of an epic global battle for capital.

As we entered this decade, it was becoming apparent to me that promises to balance government budgets had been discarded. Voters (in the U.S., Canada, and the rest of the industrialized world) were voting for more government support and, implicitly, the deficits that came along with that. To finance those deficits, governments need to borrow increasing amounts of capital. This added demand increases the cost. And it "crowds out" private sector borrowing unless companies and consumers want to pay the higher cost of capital after governments have secured their financing.

In addition to more social services, it was also becoming apparent that decades-old national infrastructure were in serious need of upgrades and replacement. Add in population growth and we likely need much more infrastructure on top of costly improvements.

The other major fiscal challenge involves the need to establish a defense posture that addresses the current and future geopolitical challenges. The post-Cold War peace dividend is a thing of the past. Re-establishing and maintaining defense is capital-intensive and requires constant spending. Essentially, being able to perpetually outspend the Soviets was the decisive factor in determining the outcome of the Cold War (thankfully for mankind, the Cold War remained mostly a financial battle between different economic systems and never evolved into an all-out kinetic battle!).

I have written extensively about government spending and its increasing reliance on deficits that need to be financed with borrowed capital. So, nothing really new there. What is new is the capital-hungry, energy-hogging AI phenomenon in the private sector.

Just prior to the pandemic, there was already a jump in the demand for electrical power due to cryptocurrencies, data/software clouds, and electric vehicles (EVs). From my perspective, this was a bit of a surprise to many. These applications have a digital feel to them and the digital revolution of the 1990s didn't spawn a need for materials and energy. It was mostly better software and more efficient electronic communication leading to better productivity. In contrast, recent technological developments require much more power. And generating substantially more power requires an epochal shift in the allocation of material and financial capital resources.

The battle for capital starts with governments financing deficits.

Then corporations which need capital for operations or expansion.

Then consumers who take out mortgages or borrow to buy items.

If governments borrow a lot, they can end up "crowding out" business and consumers.

Will AI and its historic need for capital be able to "crowd out" other borrowers?

Scaling up the extraction and production of material resources is expensive enough. However, the newly preferred methods of power generation made things even more expensive. If we wanted to do it on the cheap, coal would have been the way to go. But, for obvious reasons, we wanted to move away from that and towards renewable energy as well as non-carbon-emitting sources like nuclear.

In 2019 I sensed that this expensive scaling up was going to add enough to the overall demand of capital that I didn't see the cost of capital falling back to where it was in the mid-2010s. This is what led me to keep bond maturities short and not get seduced by the talk of interest rates coming back down.

Then ChatGPT 3.5 happened in November 2022 which set off a wave of artificial intelligence (AI) fever. Cryptocurrencies, the cloud, and EVs are still with us. The AI demand for energy is simply stacked on top of it all!

The amount of capital needed is daunting and historic in its magnitude. This doesn't seem to be lost on those who are leading AI-related companies. Their charismatic and passionate pleas for capital to investors, potential corporate partners, and governments have made headlines recently.

McKinsey & Company, a global consulting firm, estimates that data centre processing dedicated solely to AI will require \$5.2 trillion in capital spending by the end of 2030.¹

That \$5.2 trillion in additional capital will need to either come from an increase in aggregate global wealth or it will need to require drawing capital away from other uses. Aggregate wealth moves slowly. It is relatively fixed over the short- to medium-term. So, much of the \$5.2 trillion will be re-directed from other current and potential uses. This is at the heart of the global battle for capital.

The primary combatant in this war for capital is the U.S. federal government. Between now and the end of 2030, the U.S. Congressional Budget Office estimates that the U.S. federal government will need to find almost \$7.5 trillion in capital to finance the forecasted deficits.²

The demand and cost of capital was rising post-pandemic.

Then the AI fever and related spending began in late 2022 adding to the demand for capital.

More than \$5 trillion of AI spending is expected to be necessary to realize AI's full potential.

¹ Jesse Noffsinger, Maria Goodpaster, Market Patel, Haley Chang, Pankaj Sachdeva, and Arjita Bhan, "The cost of compute: A \$7 trillion race to scale data centers." *McKinsey Quarterly*, April 28, 2025.

² 10-Year Budget Projections – Key Budget and Economic Data. The U.S. Congressional Budget Office, January 2025.

I don't think it is reasonable to expect that AI-related spending will "crowd out" U.S. federal government spending, or any other sovereign country borrowing and spending for that matter.

The battle may need to shift to competing among other corporate users of capital. And if that is not sufficient, the financing of AI-related spending may have to go up against consumer borrowing. How would that go over with the public? 😊

Bill Dudley, a former President of the New York Federal Reserve Bank, recently wrote "During the internet boom of the late 1990s, spending to build the national fiber optic network pushed real interest rates well above 3%."³ (That is how high rates were above the prevailing inflation rate). Adjusted for inflation, the late 1990s fiber optic build-out added up to a little over \$1 trillion.

The current real interest rate implied by the yield on the U.S. 10-Year Treasury bond less the current annual Consumer Price Index growth rate is 1.13%.⁴ If the fiber optic build-out was able to increase real rates to 3%, that would roughly be adding about 2% more interest for most borrowers from where we are currently. The AI build-out may require *five-times* more capital than the fiber optic build-out. The resulting increase in interest rates across the board, including things like mortgages, could be substantial.

What is my best guess for how this will play out? To begin with, I do not think the AI-related sector will be able to raise \$5.2 trillion in additional capital between now and the end of 2030. The sector should be able to get a portion of this capital and at a reasonable cost at first. But eventually I would expect these massive demands for capital to collide with the other participants in the market looking for financing: governments (at all levels, but primarily sovereign national governments), businesses, financial institutions, and consumers. Then it becomes a bidding war, and it is the cost of capital, including interest rates or dividend yields, that is being bid up.

Over the last couple of years, some of the large technology firms have financed the early stages of the AI build-out through internally-generated cash flows. There has been some optimistic thinking that this will be the source of most of the needed capital going forward. However, over the past 12 months ended September 30th, the Magnificent 7 tech stocks

The internet build-out in the late 1990s increased the demand and cost of capital. AI spending is by many measures much more expensive and will need to be financed with debt.

³ William C. Dudley, "Will AI Be an Economic Net Positive? Probably Not." Bloomberg Opinion, Bloomberg Finance L.P. November 17, 2025.

⁴ Source: Bloomberg Finance L.P. as of November 17, 2025.

only produced a little over \$380 billion in free cash flow.⁵ Over five years, that only gets us to \$1.9 trillion. Still \$3.3 trillion short. And that is assuming that all these companies would want to commit *all* of their resources to AI. Most of them have other significant lines of business that might also need capital going forward. In a sign that current free cash flow is insufficient, some of the larger companies, like Amazon, have announced plans to borrow in the bond market.

Other recent developments and proposals aimed at potentially circumventing the capital challenge include AI leaders engaging in charm offensives with the U.S. government and governments around the world hoping that they will facilitate and/or finance the build-out. However, much of this would involve additional government spending which will need to be financed in the capital markets. So not helping to alleviate the overall global demand for capital and the impact on the cost of that capital.

Or, how about some central banking gimmicks and creative government fiscal accounting in the hopes of lowering the cost of capital. You'll probably guess that I am too skeptical to give any of those ideas credence (and I've read about a number of schemes lately!).

Until the cost of capital becomes too expensive, I think we will see a tremendous amount of spending on AI infrastructure. However, it will likely be significantly less than what the leaders and advocates in the sector deem to be required. If the AI build-out had begun a dozen years ago, I think much more of the desired infrastructure would have been possible. But that was when capital was cheap and the opening salvos in the war for capital was still a ways off.

For our portfolio strategy, companies that have roles in energy production, those that engage in materials extraction and processing, and those which are not beholden to the cost of capital will all continue to feature prominently. Plus, I am still cautious on the bond markets, particularly in the medium to longer maturities with the possibility of an increasing cost of capital.



The result of the battle for capital could be persistently higher interest rates. Portfolio strategies should take this into consideration.

⁵ Source: Bloomberg Financial L.P. as of November 17, 2025.

Model Portfolio Update⁶

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 October.

Gold was up almost 4% for October in Canadian dollar terms. However, that masked a significant amount of volatility. Mid-month it was up about 13% before selling off. I wrote last month that its rise recently may have been too much, too fast and was ripe for a pullback. Now that we have had one, it helps to reduce some of the anxiety with respect to holding the position at its target weight. Global central bank buying and lingering inflation concerns should help to put a bit of a floor under its price.

Despite October's scary reputation among investors, other than the volatility in gold, it was a relatively sedate month with stocks in the U.S., Canada, and internationally generally rising.

No changes to the strategies or the holdings in the model portfolios during October.

Gold had a volatile month, its first in a while. But still ended the month higher.

Most reasons for holding gold in the model portfolios are still intact.

⁶ The asset allocation represents the current *target* asset allocation of the Balanced Model Portfolio as of November 17, 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.

Going forward, the one main concern for the markets is not getting the U.S. Federal Reserve rate cut it wants on December 10. As recently as October 24th there was a 100% implied probability that there would be one.⁷ Now, as of this writing, that has fallen to 41%.⁸ Policymakers have begun to place more importance on containing consumer price pressures than on bolstering employment. Rate cuts always carry the risk of stoking inflation. Apart from some challenges facing recent college graduates, the overall U.S. labour market still looks fairly robust by historical standards.

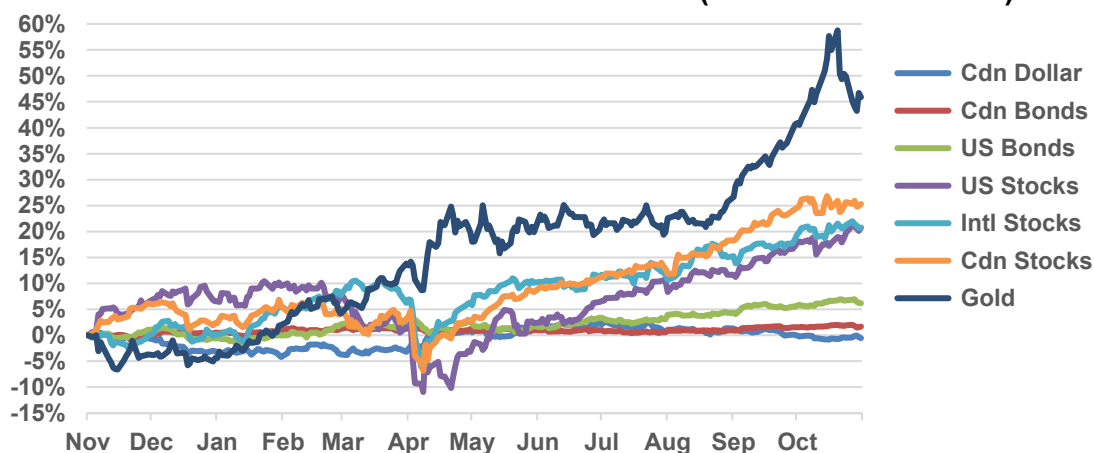
If we don't get that December rate cut, then we might see some vulnerability in sectors that were the beneficiaries of recent speculation, including companies in the artificial intelligence and cryptocurrency spheres. The risk of a general market selloff is not as likely this late into the cycle as it has been in the past. What we have seen over the last year is really a tale of different markets with only a few large companies helping the overall market hit recent highs. The rest of the market has been relatively quiet and better priced.

Seasonally, the last two months of the year tend to be better than average. So, if there is an adverse reaction to not getting a December rate cut, perhaps it will be muted with the presence of some festive cheer.

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 1).⁹

Chart 1:

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



Source: Bloomberg Finance L.P. for the interval from November 1, 2024 to October 31,

⁷ Source: Bloomberg Finance L.P. as of November 17, 2025.

⁸ Ibid.

⁹ 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.

The focus of investors is shifting to the probability of a December rate cut. That probability has declined in recent weeks.

Policymakers are becoming more concerned about inflation. A rate cut may increase the inflation risk.

The equity markets don't appear to be uniformly overvalued. As a result, any correction could be concentrated to a couple of sectors.

Top Investment Issues¹⁰

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

¹⁰ 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 November 17, 2025.

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