3rd Quarter 2025
Portfolio Management
Gill Wealth Group

Wealth Management
Dominion Securities

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RBC Dominion Securities Inc.

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Executive Summary

AI euphoria and the markets extended rally

The US and worldwide stock markets continued to rally in the third quarter from a steep decline in April 2025, caused by the tariff announcements. The major factor driving the rally has been AI related euphoria and talks of interest rate cuts, while inflation is still high and above the US Fed 2% target.

This remarkable rally in the third quarter however has been mostly concentrated in a few AI related company stocks. Several sectors such as oil and gas, healthcare and consumer staples have not participated in the ongoing stock market rally.

The current S&P 500 forward Price to Earnings (P/E) is 22.7x and well above its 5-year (19.9x) and 10-year (18.6x) averages. Even in the Russell 2000, the index for small cap US businesses, companies with negative earnings are outperforming those with positive earnings reflecting the intense speculation and optimism in the markets.

For a healthy market advance, the rally should be broad based, meaning several sectors or a majority of the economic sectors should be participating in the market rally.

The massive AI related capex spending, in trillions of dollars, will severely impact the cash rich balance sheets of the big tech companies, including Amazon, Meta, Microsoft and Google (“the hyperscalers”). The hyperscalers FCF (free cash flow) is predicted to drop by 43% through Q1 2006 (Exhibit 1).

Circular investments in each other by Nvidia, profitless Open AI, Oracle and the above-mentioned companies (Exhibit 2) raises the spectre of the failed vendor financing phenomenon of the late 1990s involving the telco equipment manufacturers, such as Northern Telecom, Lucent & Alcatel. The 2000 tech crash wiped out some of these well established leading global firms resulting in severe losses for investors. The outcome of the “promised” AI productivity boom in the short to medium term is questionable. Secondary rental or leasing rates for Nvidia GPUs have been on a steady declining trend for the past few months. Microsoft’s CEO mentioned that they have excess Nvidia GPUs that they cannot install because of a lack of adequate power, equipment and data centres, while Nvidia seems to promise insatiable demand for their latest chips.

Most likely, we are going to witness capital misallocation, destruction, overvaluation and irrational exuberance in the short term. The advent of railroads and electricity also had profound impacts over time and reshaped the economy, but it was very hard to predict winners at an early stage

We have been patient with the deployment of our clients’ hard-earned savings, especially in the overextended sectors (AI & Bitcoin) of the stock market. Risk management that involves protecting the previous period gains is key in overextended markets.

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Exhibit 1: Mega Cap Cash Flow Detioration Trend & Exhibit 2: The Circular Vendor Financing