

Invest Smarter. Live Better.

Not Our First Rodeo

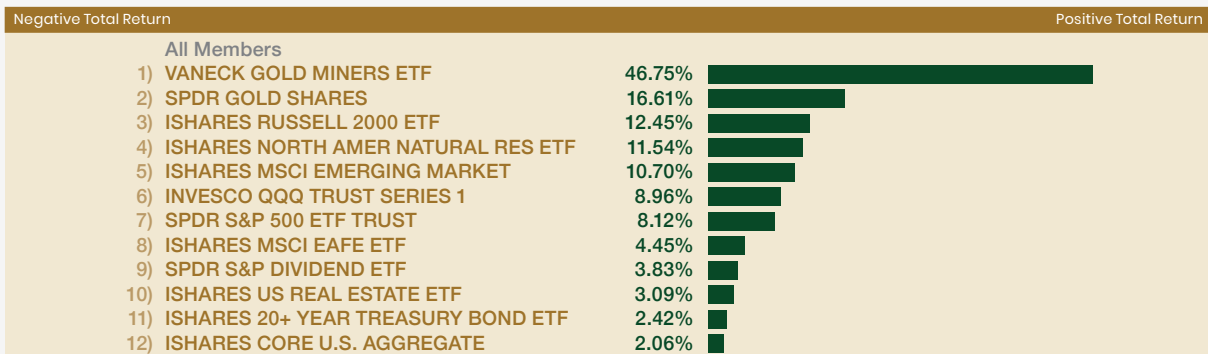
Introduction

Avalon portfolios had one of their strongest showings on record in the third quarter despite the ongoing uncertainty that has characterized markets in 2025. It was a perfect environment for our approach, which actively analyzes real assets like natural resources as a counterweight to the conventional stock/bond portfolio. Our current portfolio reflects a regime change underway since the pandemic inflation spike that favors a higher allocation to real assets.

That has played out well in the quarter and for much of the last two years. Our overweight positions in gold and gold stocks, as well as our decision to favor both U.S. and International equities over more defensive allocations to bonds and value stocks, drove portfolios higher amidst a broader rally in all assets.

We think this quarter supports our view that investing experience matters even more when markets are at their most uncertain.

Asset Class Returns for Q3 2025



Source: Bloomberg

Negative Sentiment Disbelief and Yet a Surprisingly Resilient Economy

This year's market strength comes amid a backdrop of unusual and increasingly interventionist government actions. Some measures, such as the federal government taking an equity stake in Intel (and coercing Nvidia to do the same), seem aimed at advancing national security objectives by strengthening domestic semiconductor capacity. Others, like the FCC's involvement in Disney's media content and President Trump's attempt to remove Federal Reserve Governor Lisa Cook, are unprecedented and have raised concerns about institutional credibility and the independence of key agencies. While interventions in the semiconductor industry may produce strategic benefits amidst a trade war with China, many decisions have introduced uncertainty into markets. Investors are left to consider the implications of policy actions that appear discretionary or politically driven.

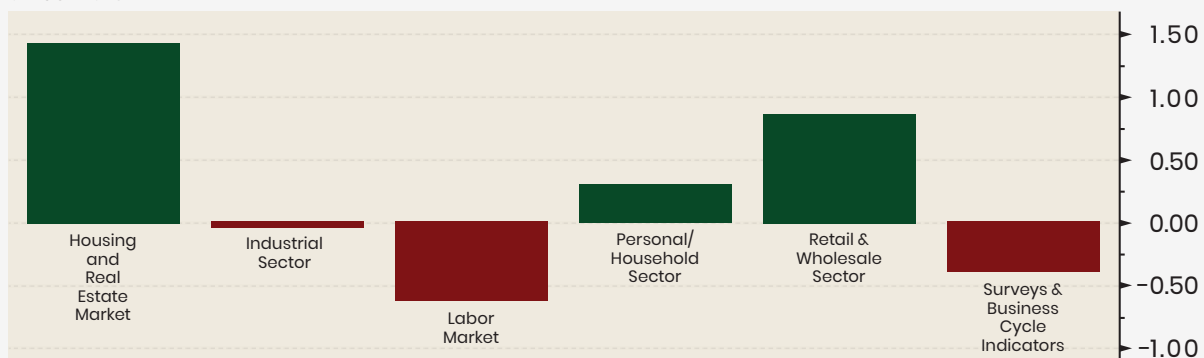
This political maneuvering has weighed on sentiment across businesses, consumers and investors. As the Economic Surprise Index Component chart below shows, negative sentiment and labor data (primarily the result of slowing immigration) are outliers amidst what has been surprisingly strong economic data. The forecast for the past nine months has been that the U.S. economy would slow down, though that has not happened yet. GDP growth in the second quarter was 3.8%, and the Atlanta Fed predicts that GDP in the third quarter will be 3.9%. Outside of some weakness from lower income consumers, hard economic data remains remarkably resilient considering the negative expectations from tariff and trade uncertainty.

Economic Surprise Index

Surprise Snapshot

02-Oct-2025

Surprise Sectors



Source: Bloomberg

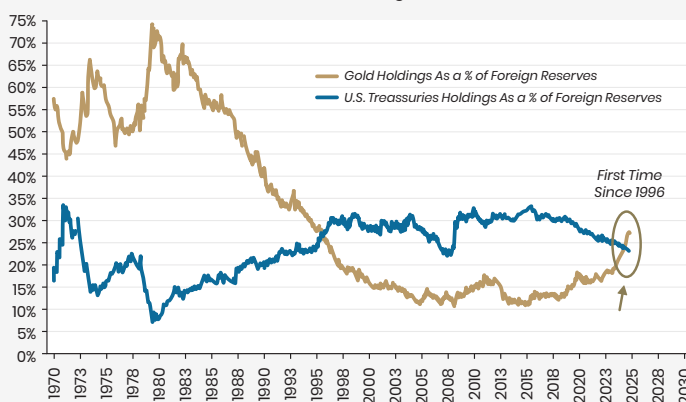
Gold

Gold has emerged as the clear beneficiary of an ongoing rotation out of U.S. dollars, with both bullion and gold mining stocks experiencing strong inflows and price acceleration.

The bullion price now approaches \$4000 per ounce and the stocks have begun to outperform the bullion. This is a departure from the performance of the miners to the metal. The “catch-up” which began in 2025 has further to run even as both have been reaching new highs. The opportunity cost of holding gold continues to fall, reinforcing its appeal as both a hedge and a reserve asset. Gold also provides strong hedging and diversification benefits within an equity and bond portfolio. Amid rising uncertainty, investors globally have begun to treat it as the new “safe haven” asset. Central bank demand, particularly in emerging markets such as China, have been a key driver of gold’s rally. Central banks have increased the pace of gold purchases roughly fivefold since the freezing of Russian reserves in 2022. In fact, for the first time since 1996, central banks now hold more gold than U.S. Treasuries in their foreign exchange reserves. This structural shift reflects not only dollar depreciation but also growing concerns over the dollar’s weaponization in global trade and finance. Our overweight position in gold and gold stocks reflects our view that the U.S. economy continues to run “hot.” In this environment, we are seeing rising upside risks to inflation, particularly if the Federal Reserve continues to cut interest rates.

Foreign Central Banks Hold More Gold Than Treasuries

Central Banks' Gold vs. US Treasuries Holdings As a % of International Reserves



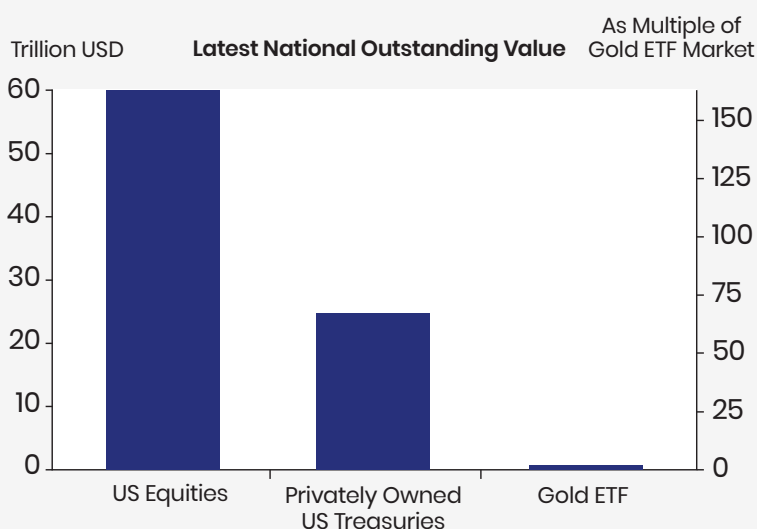
Disclosure: Crescat may or may not own the securities discussed here, investing involves risk including risk of loss.

Source: Bloomberg; Tavi Costa

Chart As of 8/27/2025

© 2025 Crescat Capital LLC

Private Sector Exposure in the Gold Market Is Small Relative to Bond and Equity Markets



Source: Goldman Sachs

Looking ahead, continued central bank buying could provide further support for gold, while a new powerful catalyst may come from private investors who have only begun to participate in gold’s rally. As Goldman Sachs has noted, the market is relatively small (Western gold ETF holdings amount to just 1.5% of privately owned U.S. Treasuries—so even modest diversification out of developed market fixed income could trigger the next meaningful leg higher in gold prices.

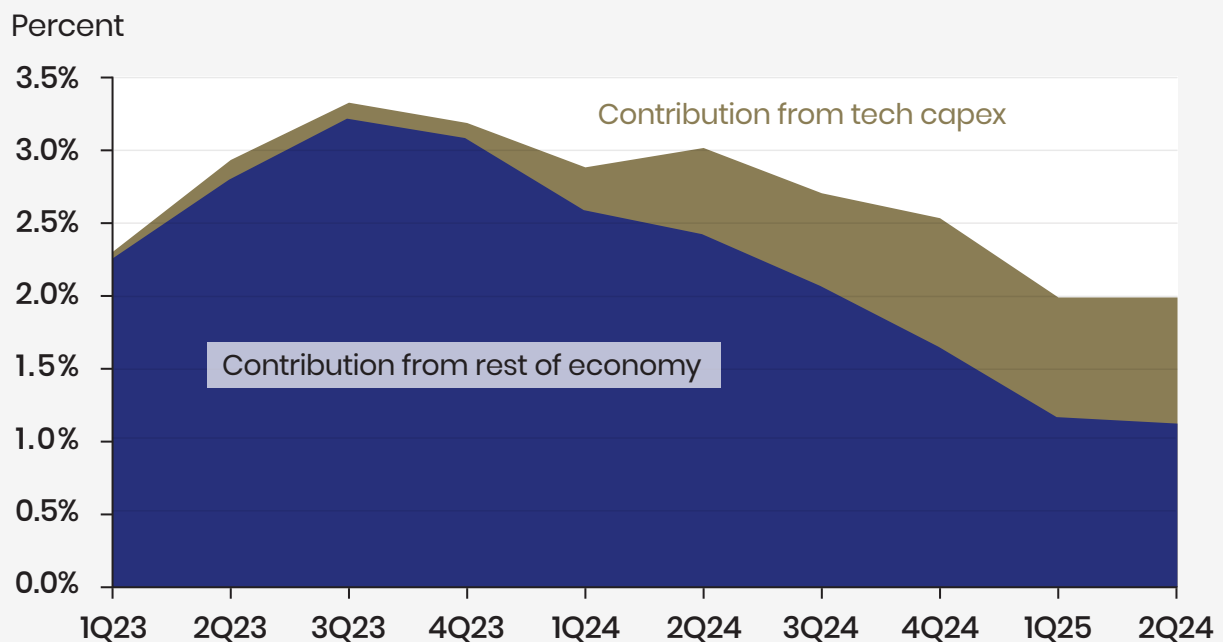
U.S. Equities

U.S. equities delivered another strong quarter, with gains broadening beyond the narrow leadership that dominated much of 2024. Large cap stocks continued to advance, led by the hyperscalers and particularly Alphabet, while small capitalization stocks staged a meaningful rebound after years of underperformance. Small cap stocks and value stocks have been noteworthy laggards over the last fifteen years. For equity investors with a mean reversion bias, diversifying beyond large cap growth has been mostly frustrating. And so while the risk to owning large cap growth stocks has grown, momentum continues to propel shares higher.

The AI Spending Cycle Driving The Market Bubble

Led by the hyperscalers (Meta, Alphabet, Microsoft, and Amazon), large cap growth equities have been the primary engine for client portfolio returns over the last fifteen years. Given the AI arms race, these companies are projected to spend an unprecedented \$3 trillion on data centers and \$1.4 trillion on R&D through 2029. Competitive fear drives continued spending based on a kind of Prisoner's Dilemma among tech giants. As Alphabet's CEO Sundar Pichai has said, "the risk of underinvesting is dramatically greater than the risk of overinvesting," while Meta's Mark Zuckerberg remarked that "if we mis-invest a couple hundred billion, so be it."

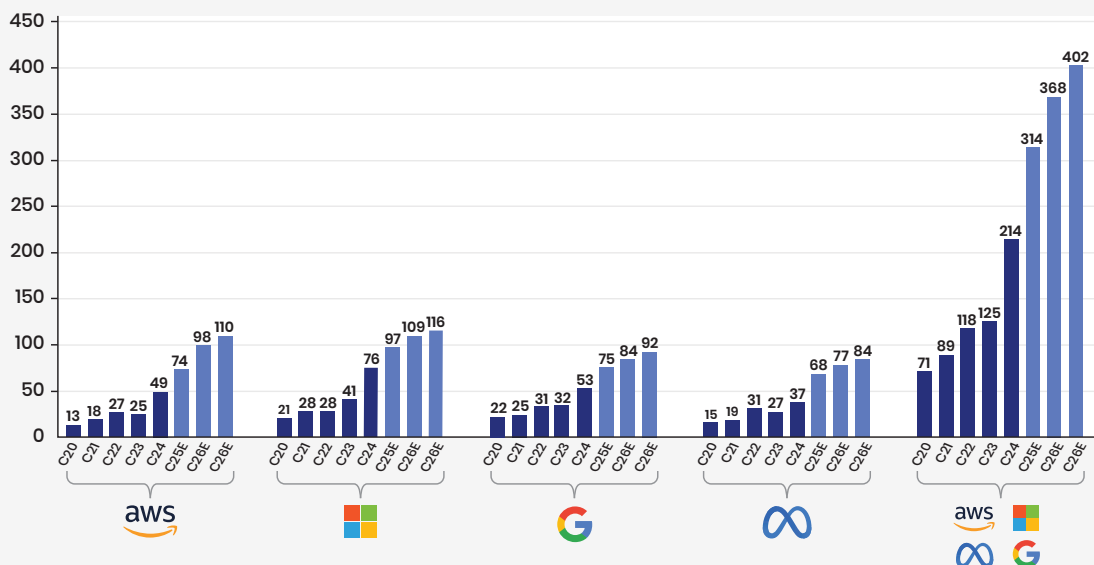
US Real GDP Growth Contribution From Tech Capex



Source: Bridgewater, August 2025

JP Morgan chart showing the rising contribution to GDP from tech capex

Historical and Projected Capex for U.S. Cloud and Hyperscale Providers (post 1Q25)



Source: Company data, Goldman Sachs Global Investment Research

Still, current revenues remain small by comparison and tangible returns remain elusive: a recent MIT study found that 95% of 300 publicly disclosed AI projects failed to boost profits, and McKinsey reported that over 80% of companies using generative AI have yet to see earnings impact. At the same time, the pace of technological change is accelerating, creating a mismatch between capital life cycles and innovation cycles. Hyperscalers still depreciate hardware over five to six years, but with new chip platforms from Nvidia arriving annually, that schedule looks increasingly outdated. Amazon has already shortened its depreciation period, citing the “increased pace of technological development” – a move others may be forced to follow as asset obsolescence accelerates.

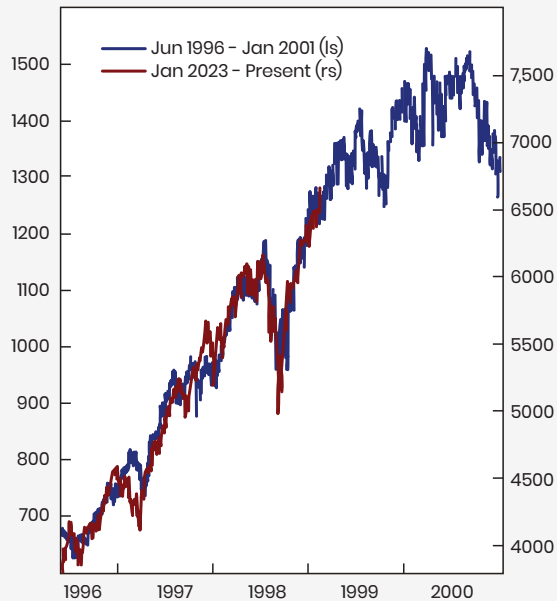
This unprecedented surge in infrastructure spending is drawing parallels to the late 1990s mania that preceded the bear market of 2000 – 2002. Like the internet boom at that time, AI represents a technology disruption that could lead to massive profit pools. And similarly, capital markets are supporting large outlays with uncertain visibility into the profitability of these projects, as the top ten U.S. tech firms have added \$12 trillion in market

value since ChatGPT's launch. Having invested in the late 1990s and early 2000s, we are aware of both the eye-watering gains to be had as well as the pain, disappointment and capital destruction that was the aftermath. To put numbers to this, the S&P rallied over 100% from Federal Reserve Chairman Alan Greenspan's Irrational Exuberance speech in December 1996, until March 2000 and then lost 50% over the next two and a half years starting in the spring of 2000. For the Nasdaq, which represented the tech leadership, the moves were even more breathtaking. In the final months of the rally from Q4 1999 to March 2000, the Nasdaq rose 67% before declining 89% by Q3 2002.

The 1999 historical analogs to today illustrated in the charts below are running pretty tightly and could portend further gains despite already high valuations. There is a strong FOMO attitude coupled with a favorable monetary backdrop, lower taxes and deregulation that should support higher prices even as worries mount and spending disconnects from profitability. In addition, strong seasonality in the 4th quarter and a mid-term election in 2026 could keep this going for many more months.

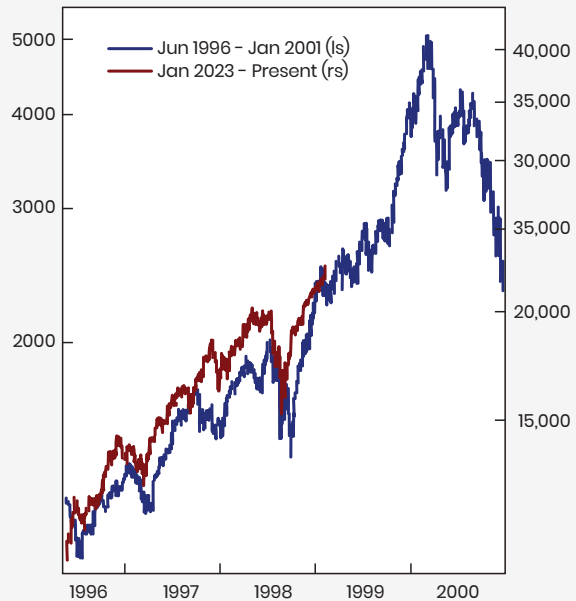
What Stage Are We In This Bubble?

S&P 500 Index:



© Alpine Macro 2025

Nasdaq Composite Index:

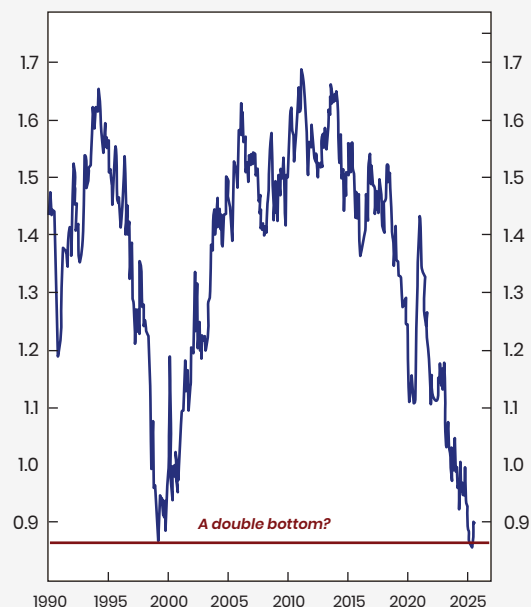


© Alpine Macro 2025

Small Capitalization Stocks vs the S&P 500: Are We Hitting A Bottom?

This quarter, we added a modest position to small capitalization equities. For the last fifteen years, small cap stocks have underperformed their large cap brethren by a wide margin. Historically (over many decades), small cap stocks have outperformed large cap stocks given their relative riskiness. Our analysis indicates we are at an interesting juncture for an asset class we believe is a long-term outperformer. Fundamentally, the return differential between small and large cap stocks is at historical levels not seen since the late 1990's. As the chart below indicates, these levels preceded a historic rally in small cap stocks throughout the 2000s. A dovish Federal Reserve that continues to cut interest rates could be the catalyst to spark future outperformance.

**Total Return:
Russell 2000 vs S&P 500**

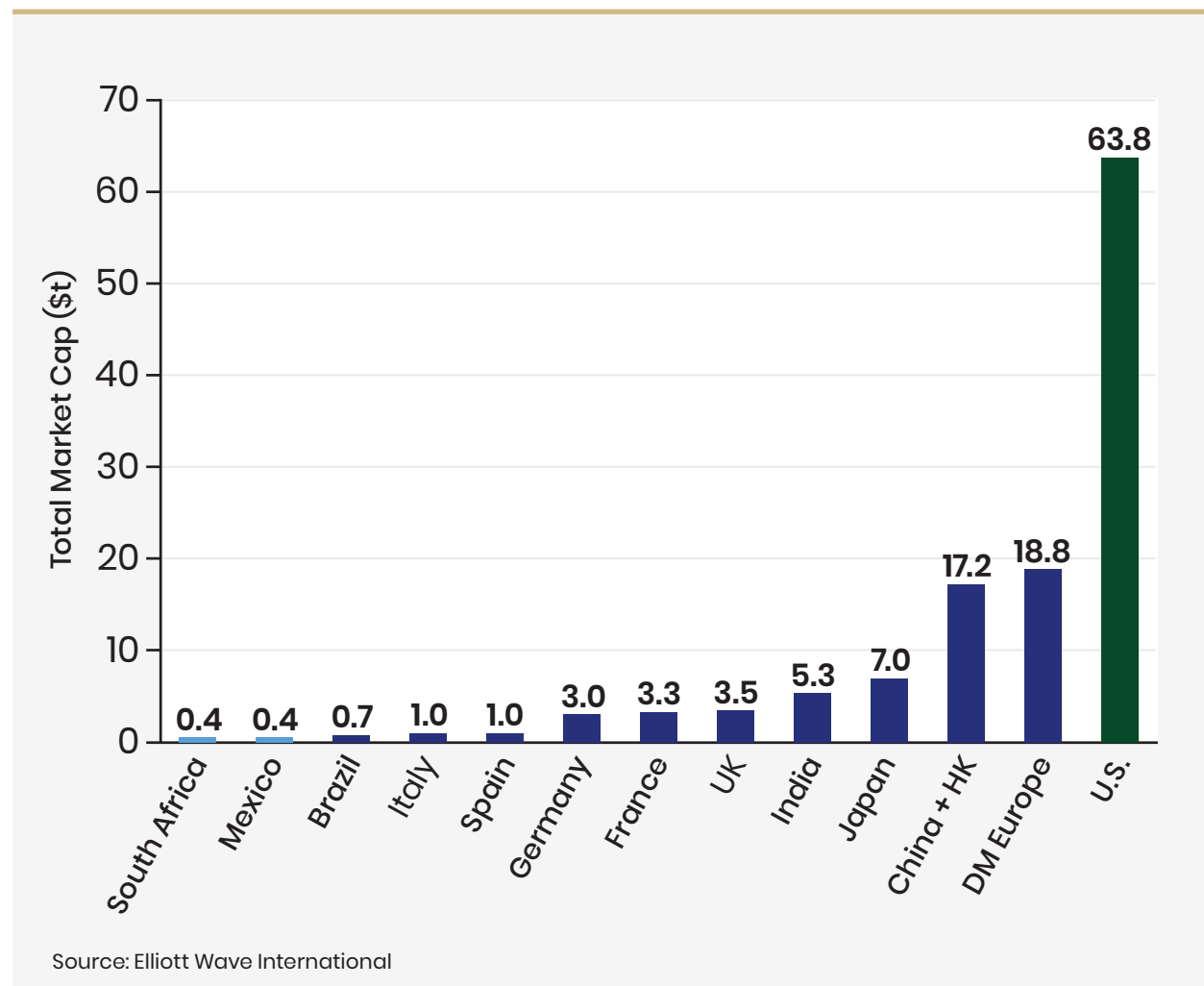


© Alpine Macro 2025

International Markets

International markets have sustained their strong performance since the second quarter of this year. Historically, September has been one of the weakest months for global equities, yet this was not the case in 2025 as international equities continue to benefit from a weaker dollar. The MSCI Emerging Market index was up over 10% for the period, while the MSCI EAFE returned over 4%. While European equities powered international returns in the first half of the year, recent highs were evident throughout Asian markets. Chinese AI and semiconductor technology companies were particularly strong, bolstered by domestic policy support and the deceleration of U.S. – China trade tensions. As we noted in our second quarter strategy piece, *Eye of the Storm*, currency risk, geopolitical tensions and tariff policy will continue to be significant going forward, but international exposure remains attractive as valuations outside the U.S. provide opportunities. As the chart below shows, the current market value of the U.S. is now greater than the combined value of all other countries combined. After fifteen years of relative exceptionalism in the U.S., valuations and a declining U.S. dollar would support continued capital flows outside the United States.

The value of the U.S. stock market is more than the value of all other countries shown on the next graph combined.



Conclusion

Two strategic themes continue to dominate our investing worldview: the technological disruption potential of Artificial Intelligence and the resulting race to win the AI war, and the movement toward de-dollarization. These themes have informed much of our portfolio positioning for the last two years. While these narratives may seem extended short-term, there is not enough evidence to suggest that these trends are complete. With the de-dollarization trend, we would even suggest that this trend is in its infancy.

As we mentioned earlier this year, we encourage you to resist the stress that comes from the news and its day-to-day impact on your portfolio. Especially in times of uncertainty, our experience matters. We will continue to follow our process, rather than letting the news drive investment decisions. If you have any questions or would like additional information about our analysis, please do not hesitate to contact us.



Clara Basile

Ross Revenaugh



VISIT OUR WEBSITE

The opinions expressed are those of Avalon Capital Management as of October 16, 2025 and are subject to change. There is no guarantee that the forecasts made will come to pass. This material does not constitute investment advice and is not intended as an endorsement of any specific investment. Investment involves risk of loss, especially in volatile markets. Past performance is no guarantee of future results. Investing in foreign markets involves currency and political risks. Data contained here is obtained from what are considered reliable resources; however, its accuracy, completeness or reliability cannot be guaranteed. Indexes are unmanaged, do not incur fees or expenses, and cannot be invested in directly. Investment strategies such as diversification do not assure a profit and do not protect against losses in a declining market. Other than the research noted by footnotes, the research underlying this piece represents Avalon Capital Management's proprietary research activities. Most indices we mention are well known and full descriptions can be found at Wikipedia.