

October 14, 2026

Quarterly Commentary

3rd Quarter 2026

Crowding Out

"There are no medium-sized trees in the deep forest. There are only the towering ones, whose canopy spreads across the sky. Below, in the gloom, there's light for nothing but mosses and ferns."

– Terry Pratchett, *Small Gods*

There are forests in which the trees grow so large they let little sunlight through, leaving smaller plants unable to grow into rivals for light and nutrients. This is a type of crowding-out in nature. A similar phenomenon occurs in economics. Crowding-out, as it relates to economics, occurs when an entity or group – whether a private company, public company or government – generates such a large degree of demand that prices rise to a level that crowds out other potential buyers who are not willing to pay or cannot afford the higher price. The larger entities soak up so much sunshine that smaller, less notable, ventures are stunted. This economic sunshine is capital or money. In this missive, we are focused on the price of money, better known as interest rates.

A positive economic environment creates investment opportunities for those who have the capital to pursue them. If you do not have the capital, you will have to raise it, usually through finding a willing lender – bank or bond investor – or by selling equity. Importantly, interest rates are a fundamental component of expected rates of return for equities and bonds. U.S. treasury rates set the base upon which expected returns are set for corporate bonds (a little riskier) and stocks (a lot riskier). When the supply of capital in the economy is high relative to demand, interest rates and the cost of equity tend to fall. Alternatively, interest rates tend to rise when demand for capital is high relative to the supply of available capital. Currently, there are two sources of demand for capital that are so large they are likely causing interest rates to rise, thus crowding out other potential borrowers and sellers of equity who have legitimate opportunities to grow existing businesses or start new ones.

Firstly, Artificial intelligence (AI) is the largest infrastructure buildout in U.S. history as a percentage of GDP. AI developers and providers of AI-related infrastructure (buildings that house AI data centers, a.k.a. hyperscalers; servers, chips and networking equipment; HVAC systems; gas turbines and batteries that ensure power 24/7/365) is expected to equal ~3.63% of gross domestic product annually from 2025 through 2032 (see Chart 1). The “Big Five” hyperscalers (Alphabet, Amazon, Meta, Microsoft and Oracle) are expected to spend approximately \$800 billion on capital expenditures (capex) in 2026, **more than double** the \$381 billion spent in 2025 (see Chart 2).

One of the most attractive aspects of investing in the Big Five has been their ability to internally fund their AI-driven growth from their core businesses that are less capital intensive and generate massive cash flows. However, as the AI buildout has progressed, capex projections have grown by multiples, which has driven free cash flow (cash from operations less capex) expectations ever-lower. The “Big Five” are expected to have negative free cash flows in 2027 (see Chart 3).

As their ability to fully fund capex with operating cash flows has waned, the Big Five and many other AI players have increasingly been accessing the public and private debt markets to fund their ambitious spending plans. In July, Oracle increased their fiscal 2027 (ending in May) capex guidance from \$60 billion to a range of \$90- \$95 billion, which would drive their net debt (debt less cash) to over 4x earnings before interest, tax, depreciation and amortization. S&P, one of the world’s

Chart 1: Average annual infrastructure spending as a percentage of GDP

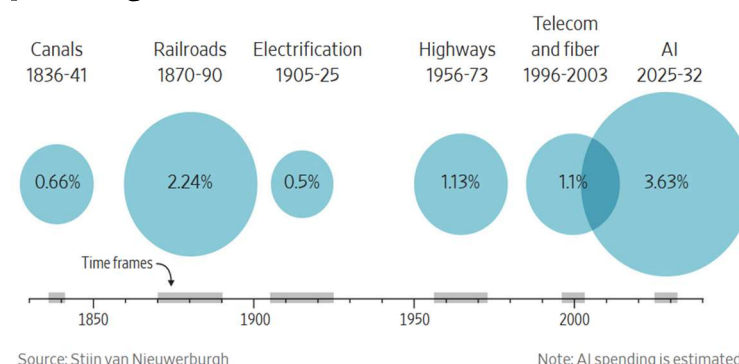


Chart 2: Capital spending at top five hyperscalers

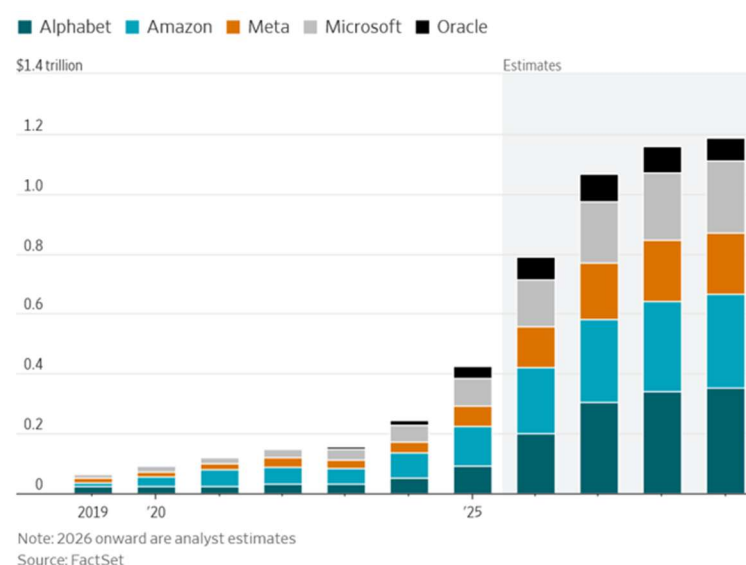
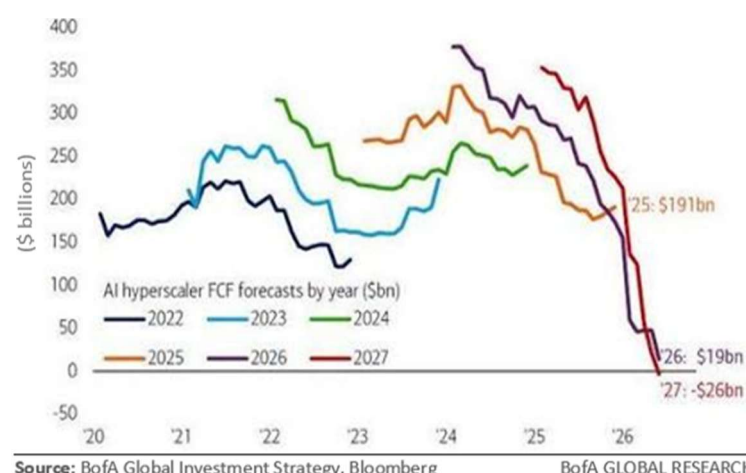


Chart 3: AI hyperscaler free cash flow forecasts by year



most highly regarded ratings agencies, promptly downgraded Oracle's credit rating. Recently, more companies have included equity capital raises alone or alongside debt to avoid weakening their balance sheet to the point where they risk suffering the same credit rating downgrade fate as Oracle.¹

During the twelve months ended 6/30/26, the Big Five's incremental debt issuance was equal to 32% of capex compared to 9% of capex in fiscal 2024. Since the end of the second quarter, hyperscalers and AI developers have announced well over \$100 billion in debt and equity capital raises (Chart 4). These companies, save for Space X, are shifting from a business model that has low capex relative to free cash flow (capital-light) toward a strategy that is more capital-intensive. Recently, while speaking at a conference in Singapore, Broadcom CEO Hock Tan said that capital has replaced GPU and memory chip shortages as the primary constraint in AI development. Consequently, as the AI buildout progresses, the Big Five and the rest of the AI-horde will be competing against other potential borrowers and sellers of equity stakes to raise capital with a probability of crowding out smaller, yet profitable businesses depriving them of the economic sunlight needed to thrive.

Chart 4: Announced/completed hyperscaler & AI developer capital raises since 6/30/26

Company	Date Announced / Completed	Offering Type	Deal Size / Value (\$ billions)	Purpose & Key Details
Alphabet (Google)	October 2026	Debt (Multi-part Bond)	\$20 B – \$25 B	10-part U.S. bond offering to scale up AI compute capabilities and infrastructure.
Alphabet (Google)	Completed Q3 2026	Equity (Follow-on)	\$84.75 B – \$90 B	The largest multi-tranche equity transaction in history.
Meta Platforms	Autumn 2026 (In preparation)	Debt (Euro Bonds)	Multi-billion (TBD)	Meta's first-ever European euro-denominated bond, continue funding AI physical infrastructure expansion
SoftBank Group	September 2026	Debt (High-Yield Bond)	>\$11 B	Largest junk bond issue in history, raised to finance its investment in OpenAI
SpaceX	October 2026	Debt (Loans & Bonds)	\$40 B (\$10 B loans / \$30 B debt)	Explicitly earmarked to purchase Nvidia chips for AI infrastructure
Anthropic	Target Q4 2026	Equity (IPO)	Projected \$100 B valuation	Fund AI development and compute needs

To be clear, we are not claiming that *only* the AI-horde will be able to raise capital. Just as some light reaches the rainforest floor, non-AI related companies will still raise capital, but they will experience crowding-out in the form of higher interest rates. Some potential borrowers and issuers of stock that are arguably less risky and have the potential to earn higher returns on capital than the AI-horde will find willing contributors of capital. However, the cost of capital will be linked to higher interest rates than otherwise would have been necessary if not for the weighty presence of the AI-horde in capital markets. So, even for those that are not *fully* crowded out, they are still crowded out in that they are not able to access capital at lower interest rates.

¹ S&P, Research Update: Oracle Corp. Downgraded To 'BBB-/A-3' from 'BBB/A-2' On Rising Business Risk And Weaker Cash Flow; Outlook Stable, Andrew Chang and Christian Frank, 7/9/26

“Increased government spending can provide a temporary stimulus to demand and output but in the longer run higher levels of government spending crowd out private investment or require higher taxes that weaken growth by reducing incentives to save, invest, innovate, and work.”

— *Martin Feldstein*

The second source of crowding-out in the financial markets stems from the government simply needing to meet current budgetary demands and pursue national security goals. The trailing 12-months U.S. federal deficit totaled \$1.95 trillion as of 7/31/26 (latest available) and trailing 12-month interest expense was \$1.26 trillion as of 4/30/26 (April is the most recent available number) racking up growth of 110.5% and 120.0%, respectively, since April of 2019.² The increase in interest expense was driven by a \$17.44 trillion increase in debt and an increase in the average coupon rate 2.60% to 3.19% of debt.¹ Unfortunately, all signs point to even higher deficits and higher interest rates going forward.

Regardless of one’s opinion about the conflict with Iran, it has been fiscally detrimental to date. The Congressional Budget Office estimates direct costs of the conflict totaled \$38.1 billion through 8/1/26 and the estimated current run rate is \$2 billion to \$3 billion per month. The latest White House supplemental budget request totaled \$87.6 billion, of which \$67.1 billion was for the Pentagon and the CBO estimates \$42.3 billion is tied to the war with Iran.³ Even if the conflict ended today, non-war related military expenses are likely to rise as the U.S. replenishes and expands munition stockpiles. Moreover, maintaining military superiority will require increased spending on naval assets, drone forces, the Golden Dome, an expanded presence in Greenland, defensive and offensive cyber capabilities and pay raises to improve recruitment and retention among service members.

The U.S spent approximately \$919 billion on defense in fiscal 2025⁴ and the expected 2026 defense spending is just over \$1 trillion. In addition, the White House has proposed a 2027 budget of \$1.5 trillion including budget reconciliations.⁵ At the same time, nearly every nation on the planet is stepping up their defense spending, especially as nations that have historically relied on allies to carry the load come to realize that their protector’s interests do not always align with their own.

² FRED Data, Federal Reserve Bank of St. Louis

³ RealClear Policy, www.realclearpolicy.com, Congress Hasn’t Voted to Pay for the Iran War by Jose Navarro, 10/3/26

⁴ USAFacts, www.usafacts.org, State of Defense in Numbers, US Defense and Foreign Affairs Fact Sheet: State of the Union 2026

⁵ Center For Strategic & International Studies, www.csis.org, Unpacking the \$1.5 Trillion FY 2027 Defense Budget Topline by Seamus P. Daniels, 4/10/26

Chart 5 shows that NATO countries, excluding the U.S., expect to increase their defense spending as a percentage of GDP from 1.4% in 2014 to 2.53% in 2026. Moreover, while U.S. spending as a percentage of GDP is expected to have fallen over this time, GDP growth will have outpaced the other NATO countries. Consequently, if expected GDP figures from the IMF turn out to be accurate, the increase in absolute U.S. defense dollars spent over the 12 years will approximately equal 80% of the increase for all other NATO members combined. Other than Denmark, Greece, Ireland and Norway, NATO members are expected to run deficits in 2026⁶, and they will all be competing against the U.S. and every other player in the global bond market for much needed capital.

Furthermore, defense is not the only item that is likely to add to the deficit. As China and the U.S. engage in economic competition with the threat of denying each other access to certain markets and critical inputs, the line between commercial trade and national security issues is blurring. The world is shifting from a global economic structure to a defensible regional strategy. In response to these risks, the U.S. government has made numerous grants available to mining projects that will enhance U.S. self-reliance regarding 60 minerals named on the U.S. Geological Survey's List of Critical Minerals.⁷ Additionally, the U.S. has directly invested in the stock of businesses that have national security implications. Most notably, the U.S. government purchased a 9.9% stake in **Intel (Nasdaq: INTC)** for \$8.9 billion. This falls within the bounds of national security as the U.S. must protect domestic semiconductor manufacturing to limit supply chain risks associated with China invading Taiwan, home of the world's most advanced semiconductor manufacturer, Taiwan Semiconductor Manufacturing Company.

Finally, countries are increasing their geopolitical gamesmanship to avoid being at the mercy of commodity choke points around the world. For the U.S., this maneuvering (Panama, Iran, Venezuela, Greenland) may secure our long-term economic interests, but these actions have associated costs that will require access to capital. As other countries engage in counter or cooperative gamesmanship, they will also bear the associated costs which will require capital that they do not have on hand. Being the largest issuer of debt globally, the U.S. Treasury market casts a wide shadow over other debt issuers, and the competition to soak up a few rays of economic sunshine (capital) will likely drive interest rates higher for all, even the one absorbing the most sunlight.

Chart 5: NATO increasing defense spending (% of GDP)

	2014	2026*	% Chg
Lithuania	0.88%	5.33%	4.45%
Latvia	0.97%	4.92%	3.95%
Estonia	1.90%	5.10%	3.20%
Poland	1.86%	4.68%	2.82%
Denmark	1.15%	3.49%	2.34%
Sweden	1.07%	3.22%	2.15%
Norway	1.50%	3.17%	1.67%
Luxembourg	0.37%	2.03%	1.66%
Germany	1.16%	2.69%	1.53%
Netherlands	1.12%	2.58%	1.46%
Turkiye	1.44%	2.85%	1.41%
Greece	2.24%	3.65%	1.41%
Hungary	0.86%	2.09%	1.23%
Finland	1.46%	2.65%	1.19%
Canada	1.01%	2.13%	1.12%
NATO: Europe & Canada	1.40%	2.53%	1.13%
NATO: Total	2.56%	2.86%	0.30%

Source: NATO, Gwladys Fouché
*estimate

⁶ European Commission, www.economy-finance.ec.europa.eu, Spring 2026 Economic Forecast: Slowdown in growth as energy shock drives up inflation, 5/21/26

⁷ U.S. Geological Survey, www.usgs.gov, Interior Dept releases final 2025 List of Critical Minerals, 11/14/25

Why Does It Matter?

Obviously, we are not doctors, but the Hippocratic principle of “first, do no harm” is a wise approach when acting as an investing fiduciary. Respecting the risk of higher rates, we prefer to own companies that are not highly dependent on refinancing debt as it matures. A company might be the best operator in the industry, but if it is overindebted the probability of surviving hard times dwindles. This is not to say that some of our portfolio members do not need to do some work at shoring up their balance sheet. However, the companies that we would like to see improve their balance sheets were purchased at prices that we believe more than accounted for this needed work, and their management teams have made debt reduction a high priority. Overall, we believe that all but a few of our portfolio companies are prepared for higher interest rates. Some may even benefit from them.

We would like to highlight a couple ways in which our portfolio companies possess defensive properties that are helpful in a rising interest rate environment. There are two primary types of rising interest rate environments. The first is one in which rates are rising due to strong borrowing demand from companies that see a plethora of opportunity to put capital to work. The second is one in which rates are rising due to lenders being more discerning about to whom they extend credit or equity capital. We are currently concerned mostly about the latter environment. Of course, an investment’s future return will be strongly correlated with its current valuation. While we feel good about the return prospects based on the valuations of our portfolio companies, this portion of the commentary is a discussion about resilience, because if the company is not built for tough times, it may not make it through to the good times.

Our natural resource companies (oil and gas producers, gold and copper miners and fertilizer companies) have all been through hard times in their history and they have learned that the aggressive pursuit of growth financed by debt is a recipe for pain in a cyclical industry. Most of these companies trade at low valuations, because investors and index builders have shunned them due to past mistakes. The market’s neglect of these companies provided them with an incentive to position themselves to become self-funded via internal cash flows should the need arise. If you do not have to go to the market to raise capital, you do not have to worry about being locked out of the capital markets.

For example, oil and gas producers overbuilt going into the Great Financial Crisis of 2008-2009. West Texas Intermediate (WTI) crude oil peaked at over \$145 in early July 2008 and bottomed under \$40 in February 2009. The dip was short-lived, as WTI and other oil benchmark prices rebounded above \$80 by the spring of 2010. For the next four years, companies of all sizes pursued growth for the sake of growth and often financed their efforts with the free-flowing credit available during the Fed’s zero interest rate policy (ZIRP) era. In 2014, OPEC decided to inflict pain on the aggressive oil and gas producers who were threatening the oligopoly’s market share. OPEC increased production and pushed oil prices below \$40, driving overindebted and higher cost producers out of business. Those that were built for such hard times were hurt as well, but they also were able to buy up premium oil reserves from distressed and bankrupt competitors. Today, we can see that the pain of OPEC’s production increase benefitted the strong companies in the long run.

Miners went through similar downturns after the ZIRP era. The ones that survived developed a healthy reluctance to issuing debt unless used to purchase assets that can clearly service that debt even in a challenging economic environment. Gold miners began a bull run in November of 2008 that stretched through the fall of 2011 rising from the low \$700 range to nearly \$2000 per ounce and slowly walked back down to nearly \$1,000 per ounce by late 2015. Throughout that painful reversal, miners shutdown high-cost mines. The strong bought the weak and paid down debt. To date, the current cycle has peaked with the price of gold breaching \$5,000 in January of this year then retreating back under \$4,000 as recently as July, but miners are not panicking. They have hardened their balance sheets. They do not even consider counting metal in the ground as part of their reserves unless they believe they can earn a 10% return on investment when gold trades at \$2,000 per oz. In the case of some individual mines, they use a gold price as low as \$1,200 per oz for reserve accounting.

Post 2011, copper prices dropped by more than half from over \$4.60 per pound in February 2011 to \$2.00 per pound in late 2015, and copper miners went through a purging of the weak. Today, much like the gold miners, copper miners have positioned themselves for hard times. If the metals market or the stock market were to experience a nasty downturn, our portfolio stocks are likely to decline too. However, we expect their low valuations and their balance sheet strength to dampen the downside and hasten their recovery versus companies with debt-laden balance sheets or stocks that trade at extremely high valuations kept aloft by ultra-optimistic expectations that can easily disappoint.

In healthcare, our pharmaceutical companies generate substantial cash flows relative to their debt maturities over the next five years. Consequently, their debt levels appear to be manageable even during a hard recession. While increases in unemployment do hurt pharmaceutical revenue and earnings performance as layoffs mean fewer insured workers, the demand for pharmaceuticals tends to be inelastic. A recession is not as likely to impact a pharmaceutical company to the degree it would a consumer discretionary or information technology company.

Furthermore, our two largest insurance holdings, **Berkshire Hathaway (NYSE: BRK/B)** and **Fairfax Financial (TSX: FFH; OTC: FRFHF)** have low duration bond portfolios with relatively short maturities, which means the price sensitivity of their bonds to changes in interest rates is relatively low. The benefit to owning short maturity bonds in a rising interest rate environment stems from the ability to take advantage of reinvesting at higher yields as bonds mature. Finally, both companies have a history of conservative underwriting and reserve accounting against future losses, as well as plenty of cash and equivalents. Their large cash and short-term bond positions may be most valuable during recessions. Recessions can present opportunities to lend at above average yields or buy attractively priced equity stakes in companies who have strong operations but lack the capital to ride out the storm. By using their strong balance sheets and employing a disciplined approach to capital allocation, many of our portfolio companies do their most impactful value creation when the rainclouds show up. Even when there is not a lot of sunshine to go around, they can persist in the face of crowding-out.

The Fairfax Way

Fairfax Financial Holdings Limited (TSX: FFH, OTC: FRFHF) is a holding company for global property and casualty insurance and reinsurance operations and other diversified investments. The stock has been one of our largest holdings for 25 years! Many of you might be surprised to know that, if Fairfax were a U.S. listed company, it would rank 7th among U.S. listed company annual stock returns from 1985 to 2025 with a compound annual return of 19.5%, as shown in Chart 6. Amazing!

A recently published book titled *The Fairfax Way*, by David Thomas, seems long overdue considering the company's long and established track record. The book discusses how Prem Watsa built a globe-spanning enterprise and a compounding machine. The strengths of Fairfax are based on disciplined value investing, a decentralized management structure, and a singular corporate culture with long-term thinking prioritized over quarterly optics. It is a great read for anyone who is interested in learning more about this important portfolio holding.

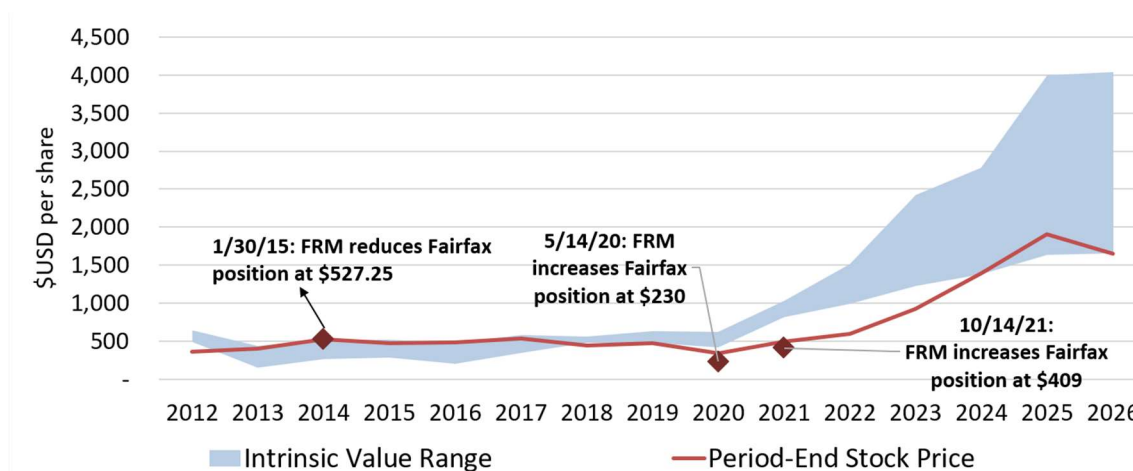
Over the course of the last 40 years, Fairfax has enjoyed annual growth in book value of 18.7%. Our estimate of the company's intrinsic value has increased at an even faster rate, particularly in the last six years as shown in Chart 7. We want to highlight just how incredibly Fairfax's intrinsic value has increased in the last few years. When we last showed our clients this illustrative chart back in 2023, Book Value stood at \$803 per share. Today, it is \$1,272 per share, a 58% increase in three years. In 2023, Fairfax's 5-year average return on equity (ROE) was 12.9%. Today, its 5-year average ROE is 20.6%. Our intrinsic value estimate range in the chart still uses the same metrics despite this improved performance.

Chart 6: Fairfax is among the highest compounders of value

	Compound Return (%) ⁽¹⁾
1 Apple	22.7
2 Home Depot	21.3
3 Applied Materials	21.2
4 Amgen	20.4
5 Danaher Corporation	20.1
6 UnitedHealth Group	19.7
7 Fairfax	19.5

(1) Including dividends Source: Fairfax Financial

Chart 7: FRM's Historical Intrinsic Value Estimate for Fairfax Financial



The Fairfax Way contends, and we agree, the company is set up to continue to grow and to create and compound value for shareholders. We continue to purchase shares for new portfolios. There are four key reasons underlying our continued enthusiasm for owning Fairfax and why we believe in its prospects.

First, Fairfax is still in the sweet spot for compounding capital. At a \$35 billion market capitalization, Fairfax retains a large opportunity set. The most recent example occurred on 10/7/26 in which the company announced a partnership with Wittington Investments to acquire U.K. pharmacy chain Boots. Fairfax will contribute \$2.3 billion to the \$8.9 billion (including debt) transaction and will own 50% of the equity. Wittington will operate Boots and brings to the deal expertise developed over decades in the retail, pharmacy and beauty industries. Fairfax is uniquely positioned to be a long-term partner in these kinds of opportunities.

Second, the company's earnings power is real and durable. Fairfax has \$41 billion in insurance "float" (premiums received but not yet paid out) that makes it a beneficiary of rising interest rates. Fairfax has recently kept their portfolio average maturity very short, putting them in a position to reinvest in higher interest rates as rates move higher (which they currently are!). Their \$41 billion float reinvested at a 5% yield locks in \$2 billion in annual interest regardless of market gyrations and grows to \$2.5 billion when combined with dividend income from their many diverse equity investments. Fairfax's underwriting profitability has been consistent even across underwriting loss years. In 2025, the company had a 93% combined ratio $\left[\frac{\text{(insurance claims + administrative expenses)}}{\text{earned premiums}} \right]$ and made a record underwriting profit of \$1.8 billion despite \$1.2 billion in catastrophe losses, mainly from the California wildfires.

Third, Fairfax continues to benefit from the appreciation of non-insurance equity investments that are not reflected in the company's stated book value. During the first half of 2026, this unaccounted-for value increased to \$4.4 billion from \$3.1 billion as of December 31, 2025. (This six-month increase of \$1.24 billion represents ~4% of the company's book value.) Fairfax's investment in publicly-traded Eurobank contributed \$2.8 billion to the total \$4.4 billion of excess in fair value over carry value related to the non-insurance equity investments, and \$0.8 billion came from Fairfax's remaining interest in container ship leasing and management company Poseidon. Additionally, the company continues to repurchase shares with outstanding shares dropping 28% since 12/31/2021, from 27.8 million to 20 million.

Finally, we believe Fairfax has built a durable culture that we consider to be its most valuable asset. Prem Watsa and his family have proven to be wise stewards of stockholders' capital and their controlling stake in Fairfax means the family has a strong interest in the success of the company and its shareholders. Furthermore, the holding company executives bring valuable experience to the table with an average tenure of 20+ years. We continue to be very enthusiastic long-term holders of Fairfax Financial.

Disclosure

Please remember that past performance may not be indicative of future results. Different types of investments involve varying degrees of risk, and there can be no assurance that the future performance of any specific investment, investment strategy, or product (including the investments and/or investment strategies recommended or undertaken by Foundation Resource Management, Inc. ("FRM"), or any non-investment related content, made reference to directly or indirectly in this commentary will be profitable, equal any corresponding indicated historical performance level(s), be suitable for your portfolio or individual situation, or prove successful. Due to various factors, including changing market conditions and/or applicable laws, the content may no longer be reflective of current opinions or positions. Moreover, you should not assume that any discussion or information contained in this commentary serves as the receipt of, or as a substitute for, personalized investment advice from FRM. Please remember to contact FRM if there are any changes in your personal/financial situation or investment objectives for the purpose of reviewing/evaluating/revising our previous recommendations and/or services or if you would like to impose, add, or modify any reasonable restrictions to our investment advisory services. FRM is neither a law firm, nor a certified public accounting firm, and no portion of the commentary content should be construed as legal or accounting advice. FRM claims compliance with the Global Investment Performance Standards (GIPS®). GIPS® is a registered trademark of CFA Institute. CFA Institute does not endorse or promote this organization, nor does it warrant the accuracy or quality of the content contained herein. A copy of FRM's current disclosure Brochure (Form ADV Part 2A) discussing our advisory services and fees or our GIPS-compliant performance information is available by e mailing Abby McKelvy at amckelvy@frmlr.com.