Investment Strategy
October 2026

The market swung heavily in our favor in July and August as hard assets, including gold and oil, surged higher. In September, tech stocks closely aligned with the AI bubble bounced back while nearly all other assets suffered. The more interesting events of this past month included the interest rate on the 10-year U.S. Treasury bond breaching 5% and diesel prices hitting an all-time high. Taken together, rising global interest rates and much higher energy prices will slow economic growth and trigger more inflation. Many stocks are already responding to this economic deterioration as 44% of the companies in the S&P 500 index are already down over 20% from their recent highs[1]! The excitement and reckless spending around AI are masking weakness in the economy and the stock market. However, the industry is facing a "moment of truth" as the leading AI firms struggle to sell shares to the public. This (potentially) massive infusion of cash is desperately needed to buy ongoing services from their "investors". As we continue to stress, we want to be as far away from the entire AI complex as possible.

Interest rates have been rising in every major western country in 2026. The 10-year U.S. Treasury bond recently punched through 5% and then rapidly jumped to 5.3%, reaching the highest level since 2002. The UK and France have their highest borrowing costs since before the housing bust 20 years ago. Japan's interest rates have also been surging, now at a rate last seen in 1996. Interest rates are responding to many different factors including rising inflation, deteriorating government finances, and a reduction of buyers. Regardless of the reason, higher interest rates are increasing the cost of all types of credit including corporate borrowing, home mortgages, or car loans. This will reduce economic activity as it will inhibit the next marginal car purchase or large home repair. Rapidly rising interest rates also impact investment financing. As we have discussed previously, there are growing problems in commercial real estate, private equity investments, and insurance company bond portfolios. Higher rates will negatively impact the value of these investments, likely leading to larger investor losses.

Surging energy prices are another negative force impacting the global consumer and overall economic activity. Since the beginning of the Iran War, the world has been drawing down on reserves of oil and natural gas as well as refined products such as gasoline, diesel, jet fuel, and fertilizer. At the same time, Ukraine developed longer-range drones that have allowed them to decimate Russian refinery capacity. As a result, oil prices have remained

[1] 52-week highs

(relatively) subdued[2] while diesel has emerged as the product in shortest supply[3]. This has resulted in record global diesel prices, a particularly painful problem because diesel is the fuel for nearly all logistics (heavy trucks, ships, and trains). As a result, rising transportation costs are feeding into nearly all consumer products. Separate from diesel, Europe is barreling into winter with abnormally low levels of natural gas in storage as their typical supplies from Russia and the Middle East have been restricted. While this is just another example, the disarray in the global energy markets is making countries and individuals increasing vulnerable as they face rising costs.

It is slowly becoming apparent that energy supplies are not going to be "returning to normal" anytime soon. Within the past few weeks, Iranian proxies have begun attacking Saudi Arabian pipelines, refineries, and other energy infrastructure. Their allies in Yemen have also seized additional territory that allows them to better threaten shipping out of the other side of the Middle East. The most important "pressure release value" in the Iran conflict has been Saudi Arabia's ability to pipe roughly 7.5 million barrels of oil a day across their country to be exported out of the Red Sea. This energy escape route was cut off a few weeks ago after several pumping stations were attacked[4]. While the future is unknown, it's safe to assume that energy exports out of the Middle East will not be returning to pre-war levels anytime soon, if ever. This should result in elevated profitability for energy producers for the next several years as well as increased contracting work for oil servicing companies. As a result, we continue to be heavily overweight the energy sector while the S&P 500 Index remains historically underexposed[5].

While negative forces are clearly building against the global economy, you wouldn't know it from the U.S. stock market or U.S. economic statistics. A recent Columbia University study[6] has deemed the AI buildout as the largest investment project in U.S. history. It's roughly estimated that AI companies are spending $750 billion in 2026 with expectations to spend another $1 trillion next year. The reckless size of this bubble is driving an abnormal amount of U.S. economic growth and the AI-associated stocks are masking significant deterioration in the market over the past 6 weeks. This isn't healthy any way you look at it, and it leaves both the economy and stock market quite vulnerable if the boom simply slows, much less ends.

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[2] Blown up refineries don't consume oil

[3] Russia exported roughly 1 million barrels of diesel a day pre-war. The Middle East exported roughly 1.7 million barrels of diesel a day pre-war

[4] Saudi Arabia has claimed they restarted some flows but there's no public information of how much

[5] Energy sector makes up only 3.6% of S&P 500 index while the Keating ETF is 22.2% energy

[6] *Financing the AI Buildout* by Stijn Van Nieuwerburgh

The ability for the boom to continue is largely dependent on the top two AI companies (OpenAI and Anthropic) selling their shares to the public through Initial Public Offerings (IPOs). In addition to the billions of dollars of stock they hope to sell, this will also allow them to more easily access the debt markets. Up to this point, OpenAI and Anthropic have been able to periodically sell their stock to private investors to fund their money-losing operations. However, most of the funding has really come from the major established tech companies (Amazon, Microsoft, NVIDIA, Oracle, Google, Broadcom) who have made "investments" into these two companies to supply them with more capital. At this stage, these two AI companies now need to go public to pay back these "investments" by purchasing computer power or hardware through non-cancelable contracts. For instance, it was leaked that Anthropic is committed to spending at least $415 billion with these "investors" over the next 7-10 years. The problem both OpenAI and Anthropic face is that to IPO they must legally disclose a lot of detailed financial information, such as the spending obligations we just mentioned. On paper, both companies appear to be horrific investments. They are generating billions of dollars of losses each year with no end in sight. Despite their terrible financial performance, both companies want to come public at a valuation between $1-2 trillion. Unsurprisingly, this is a tough sell and OpenAI has already pushed back their potential IPO until 2027. Anthropic's IPO has also slipped, but they hope to launch by Thanksgiving.

While we await some of the most ridiculously priced IPOs in human history, the rest of the global economy is being battered by high interest rates and rising energy costs. Consumer-facing companies are already responding to these pressures as they lower sales expectations and many of their stocks have already fallen noticeably. We remain invested in attractively priced energy stocks that we believe will generate above average profits for the next few years. We also continue to hold several gold mining companies making huge profits at current metal prices. Overall, our collection of stock holdings are trading for a much cheaper valuation than the overall market while completely avoiding the incredibly priced tech stocks that are fully gripped by a historical investment bubble.

Sincerely,

Keating Investment Counselors, Inc.

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