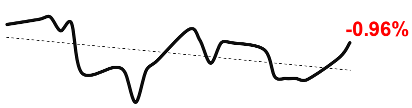
CDT June 2026 – The AI Bubble Reckoning

Market Update.

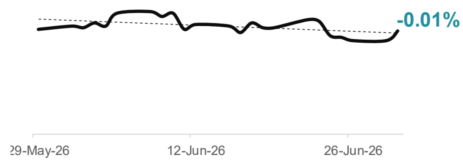
S&P 500 Total Return Index

16,773.27



10yr. Treasury Yield

4.44%



S&P 500 Excess Earnings Yield

-1.10%

S&P 500 Normalize Earnings Yield - 10yr. Treasury rate

Risk is Expensive

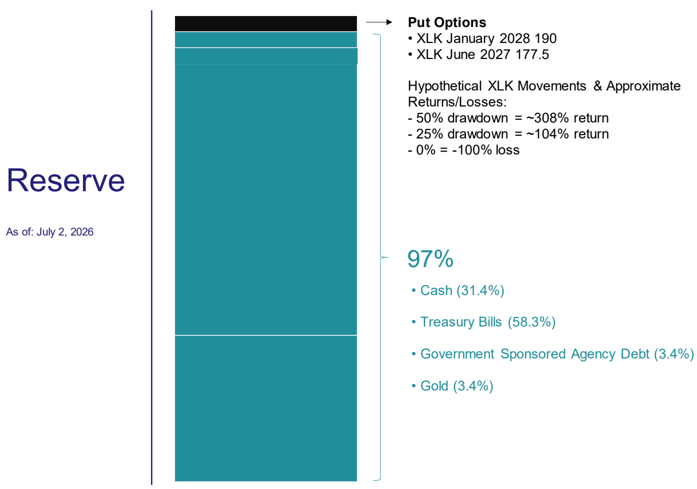
*Source: Seeking Alpha, Federal Reserve, CDT

We are worried. Throughout the years, we have deliberately struck a balanced tone in our market commentary. In the past, we have not shied away from sharing pockets of concern regarding specific market trends or sectors but never have we called out a negative whole-of-market moving narrative. The truth is that the overwhelming majority of the worry and blunder around stock market dangers ends up being a waste of time and energy. After all, these arguments face a tall mathematical reality. Historically, the stock market appreciates 70-80% of the time depending on your choice of short timeframe and has proven to go up 100% of the time in the long run.

As historians and statisticians of the market, we have a deep understanding of the cost of being negative and how history has treated bold calls of market dangers. And so, despite our company's ethos of measured temperance and positivity rooted in our belief that the stock market is the most powerful compounding force for wealth building, we are preparing for the first time in our history for a significant period of market turbulence. In that context, we have taken prudent, but extraordinary measures to ensure the endurance and success of CDT through a worst-case scenario situation.

Hedged. We will outline a cacophony of synchronizing concerns below, but before we get to the narrative, we will first explain the actions we are taking to prepare for what we believe to be an increasing probability of a volatility storm ahead. As a hedge fund, we have taken the position that most of the time markets go up and therefore mathematically, shorting the market, a speculative strategy to *profit* from the depreciation of the stock market is a losing game to play – and we have been unequivocally right. The S&P 500 Index, the most popular measure of the stock market, has been on a torrid march higher, up +142% on a total return basis since the inception of CDT. During that time traditional long-short hedge funds have struggled to keep up, while we, to our credit, have generated above market returns and navigated periods of momentary volatility in stride with our unique long-only plus reserve strategy. However, for reasons we will discuss below, we believe that now is the time to take relatively low-cost measures to buttress our hedging strategy.

Going forward, cash and short-term treasury bills will continue to be the cornerstone of our hedging strategy. However, this month, with our fiduciary duty to our partners front of mind, we have decided to bolster our hedging strategy by taking out a modest insurance policy against the technology group of the S&P 500 Index. This sector of the market represents nearly 40% of the total value of the index (a record not seen since the Dot Com era of 1998-2000) and we believe has structural weaknesses that are likely to buckle in the coming days, months or quarters. By purchasing put options or contracts that grant us the right to sell shares of an ETF, the State Street Technology Select Sector SPDR ETF (XLK) at predetermined prices during a specified period of time (Approximately 1-2 years), we can in part insulate our capital from what we believe to be inevitable market headwinds. The total cost or premium of this policy is modest at just .33% of the total asset value of our fund and is expected to pay multiples of the premium in the event of a significant price decline. Conversely, at this time, if we are wrong about our market decline thesis, timing or magnitude, our total cost to us would be the original -.33%. The known and limited downside to a put option hedge is what makes this strategy so attractive. To be clear, we are not looking to *profit* from market declines, nor do we intend to make a habit of deviating from our long-only approach – it is simply not in our company DNA. However, given our thesis to be outlined below, we believe that a temporary tactical deviation from our normal course of action is warranted as we face a highly unusual set of circumstances.



The AI Bubble Reckoning

What is the AI Bubble? In the post 2008 era, the term “Bubble” has been entrenched into the lexicon of the financial industry and media alike. Every year since 2008 there has been media and market pundit reports of a “Bubble” in something or other. Most recently, people have pointed to a “Bitcoin Bubble”, “a Meme Stock Bubble” and before that a “Cloud Computing Bubble” and even a “Cannabis Bubble.” Today it is the *“AI Bubble”*. In almost all circumstances investors lost tremendous sums of money at the prick-point of said *Bubble*, but there was a missing ingredient that in our mind is essential for properly classifying a “Bubble.” That is size and relevance to the financial system. Without the risk of severe degradation to the system, the rapid rise and fall of these asset prices are just moments in financial market history of organized manic groupthink that ends up fizzling away in the progression of time. Before now, no single “Bubble” of the past 2-decades since 2008 has posed a threat to the health of the broader financial system and stock market. Artificial intelligence has changed that. To put some context around the scale of AI, in 2026 alone, AI related infrastructure spending is projected to reach between $650B and $800B or 2% to 2.5% of the *total gross domestic product of the United States* (Article). In the pursuit of artificial general intelligence, trillions of dollars of capital have been promised with OpenAI alone accounting for $1.3T in infrastructure commitments by 2030 (Article). This type of audacious investment is driving an enormous amount of the U.S. economy, and the challenge is the mercurial math behind these extraordinary initiatives.

The OpenAI Cash Flow Reckoning: OpenAI, the company that introduced the public to AI with the launch of ChatGPT in November of 2022, is enjoying rapid revenue growth, but its cash burn and computing requirements are rising so quickly that the business remains dependent on repeated and extraordinarily large capital infusions. Earlier in the month, the audited financials of the AI lab were leaked to the Financial Times and the facts are ugly. In 2025, the company generated $13B in sales and -$21B in operating losses. That is an impressive -160% operating margin (Article). The dubious nature of a startup's financial profile should not be a surprise, but in light of such a poor financial profile, the firm's trillion-dollar plus AI buildout must be questioned. How can such an unprofitable business raise enough capital not only to cover its own cash burn, but to also cover the cost of its budgeted pie in the sky future investment promises? What perhaps makes the situation even more dire is the unknown degree of financial assistance that OpenAI is receiving from its partner and biggest investor, Microsoft (MSFT).

Through a series of capital raises, Microsoft has invested an estimated $10-20B in OpenAI and owns north of 25% of the company, but not all of the equity investments Microsoft has made to OpenAI came in the form of cash. Instead, they bartered equity for expensive credits that OpenAI can use at Microsoft's data centers for training and running their complex models. Reasonably, these credits are subsidizing the -$21B in losses, which raises another question, what do these financials look like without help from partners?

The price of service is of course one lever that companies can pull to improve profitability but only if markets allow it. Earlier in the year, OpenAI and their popular nemesis, Anthropic, moved their enterprise AI customers from a fixed paid subscription to a consumption-based model in which customers are charged closer to the true marginal cost of compute. The reaction has been vehemently negative with some customers reporting massive budget busting overruns like Uber which burned through its AI budget for all of 2026 in April (Article). Making matters worse, there is increasing evidence that AI productivity gains are present but not nearly as high as hoped with a recent NBER survey indicating that out of 6,000 companies 89% of managements are reporting no impact on labor productivity. To top off OpenAI's challenges, lower-cost, open-source competitors such as China's DeepSeek are narrowing their performance gap relative to their domestic counterparts. That is pressuring pricing and contributing to an accelerating trend of market share loss for which competitors, Claud and Gemini are already leading the charge (Article). Facing questionable returns on investment from enterprise clients and mounting competitive pressures, the market has spoken and the price increases are being rejected. This is an unenviable position for an already deeply unprofitable company and just this month, OpenAI is rumored to have considered reversing course and institute price cuts to stem the market share losses (Article).

The mounting evidence of challenges that face OpenAI is likely why the firm chose to softly cancel its plan to IPO for 2026 (Article). This cancellation cuts off the company from public funds that may not be required to keep the lights on today, but are going to be necessary if cash burn doesn't get better and soon.

To conclude, the trials and tribulations of startups is nothing new, but with $1.3T in promised investments that are backed by fairytale math, a significant fraction of the health of the AI ecosystem, the U.S. economy and stock market hinges upon a Herculean effort from a company with a limited operating history, a track record of management turmoil (Article) and likely worsening cash flow problems.

It is worth noting that Anthropic, could be in the same boat as OpenAI, but we just don't have financial data to know that for sure. We picked OpenAI because its financials were leaked to the public, but the same commentary may likely be said for Anthropic as well.

The Meta Investment Reckoning: Meta is at it again. After squandering approximately -$80B on the metaverse, the firm is parlaying that failure by once again squandering money on AI. This time the stakes are reaching new highs. In 2026, AI related capital expenditures are expected to reach approximately $125–145 billion, yet there is no verifiable evidence that any of this spend is yielding results. In fact, there is mounting and damning evidence to the contrary. Meta's Llama frontier AI models are not at the frontier of the AI race (AI Leaderboard) and external adoption has been extremely disappointing for shareholders fronting the multi hundred-billion-dollar bill. Even Meta's own employees do not use the models that they create! In a somewhat confusing and embarrassing sign, Meta, which is supposedly creating the best AI models in the world, was recently told by Google that it would be restricting its prolific use of its AI model, Gemini (Article). This must be the most damning evidence for a corporate failure possibly in American history, even Meta does not use its own models. That said if you need more to chew on look at the never-ending reports of internal turmoil coming out of the company (Article).

It is clear that there is a fuzzy vision for an AI strategy at Meta, but the lack of leadership and execution has left it permanently behind in the race. That is likely why the firm is starting to pivot from its position as AI developer to hyperscaler. In yet another indirect omission of failure, rumors this week that Meta is exploring building a cloud business to rival the likes of Microsoft, Oracle and Amazon (Article). Management has overbuilt their infrastructure for an AI model that no one uses (not even themselves) and now has to come up with a Plan B, which is arguably going to be just as difficult to execute as Plan A.

With the cash flow of the business expected to be close to nil if not negative this year, shareholders should not and are likely not going to tolerate more pain ahead. It is increasingly obvious that Meta will have to adjust its capital plans and that is a major problem for the next group our next group of companies.

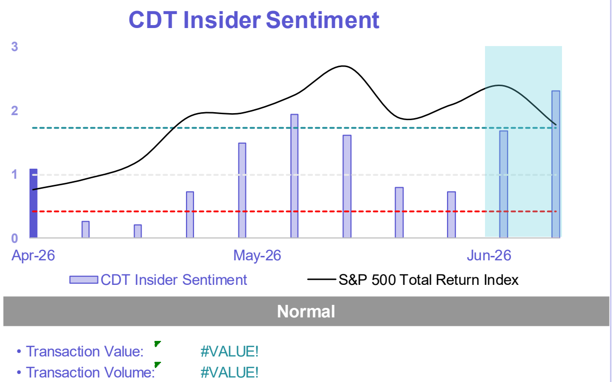
The Semiconductor Earnings Bust: By our estimate, a reduction in AI spending is not a question of if but when. Our belief is that the viability or lack thereof OpenAI's current path or the veil of Meta's AI strategy slipping will result in a period of reset capital discipline. A hangover after a capital investment spree bacchanalia of the last 3 years. The boom-and-bust cycle is a powerful feature of capitalism that at times allocates capital in extremes in an effort to invite a crossroads of industrial ingenuity and human imagination to provide the world with incredible gifts that we all benefit from. The busts are equally as important to cleanse the system of malinvestment and underutilized resources during the boom, but they are however a very painful transition, and the AI bubble bust is likely near.

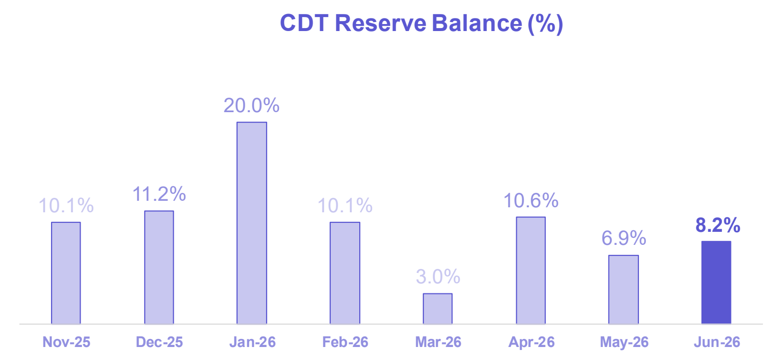
During the AI boom, semiconductor investors and speculators, especially in the last year, have been disillusioned and misled by the bounty that these companies have enjoyed as AI spend ran up to record breaking levels. Year-to-date, investors have bid up the shares of semiconductors, the SOXX, an ETF the covers the lot is up nearly 86% and was up +118% at its high back on June 22nd. This level of excitement is only justified if the economy and semiconductors are unchained by their pattern of demand cyclicality – implying a never-ending AI gravy train. However, as we have outlined, we are observing the deep cracks in this thesis and there is not so shocking evidence that the patterns of booms and busts that we have observed since the dawn of time are here to stay.

The Bust. A decline in forecasted AI spending will no doubt sober semiconductor investors as weakened demand for accelerators, servers, networking equipment and high-bandwidth memory significantly affect the earnings of these companies. From our perspective, this is going to be a hard pill for the market to swallow. In the top ten of the S&P 500 constituents, Nvidia and Micron alone now represent approximately **8.6%** of the total market index, while the rest of the semiconductor sector as a group represents a record high of **19.7%** of the market index's weightings (Article).

According to Goldman Sachs, the top 10 largest companies in the S&P 500 almost all of which are participating in the AI supply chain (Nvidia and Micron included) are expected to contribute to a disproportionate 64% of the earnings growth expected for this year (Article). While semiconductors alone are expected to contribute close to 40% of index earnings growth (Article). Excluding the top ten names, actual earnings for the total index are closer to zero. For an already expensive market, we can conclude less than favorable things when these earnings estimates start to discount a world in which OpenAI, Meta and perhaps others must adopt new paths forward to reflect the economic reality of AI. For historical context, the last time we encountered a true Bubble Bust of this nature, the Nasdaq market index declined -78% from its high.

Above The Clouds.





*Year-Over-Year Rate of Change

We will keep this brief since we have already outlined our strategy for navigating these troubled skies. However, it is not difficult to imagine how these AI challenges snowball into severe stock market challenges and real economy implications. Meanwhile, other questions like the financial system implications of the billions raised in debt related to possibly superfluous data center builds linger out on the tail of the risk curve; Morgan Stanley estimates that $500B in debt will be raise this year after a $125B raised in 2025 (Article).

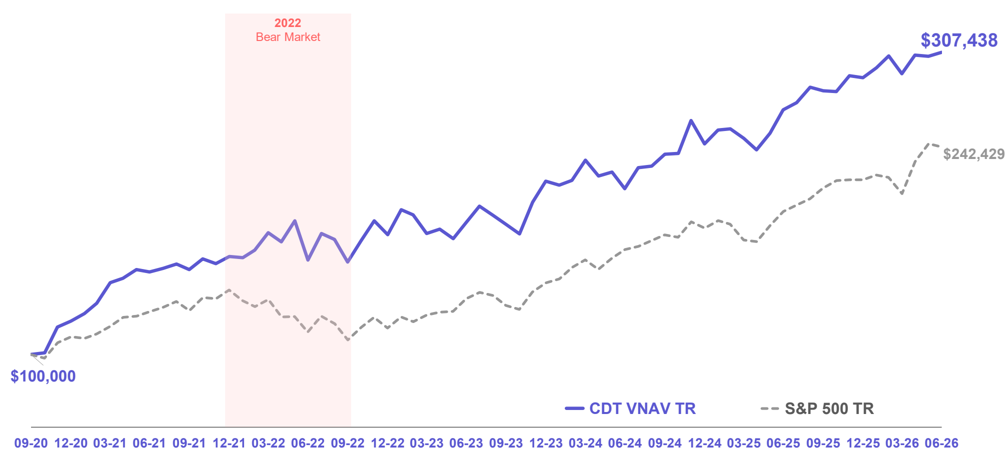
We are confident in our decision to enhance our hedging strategy defending investor capital against a darkening backdrop, but it is worth noting that the stock market is a market of stocks and not all companies have direct exposure to the AI supply chain. Insiders in their wisdom have and continued to steer our attention and capital to areas of the market that potentially benefit from the advent of AI, but their fortunes are *not* tied to its success. With very limited exception, the entirety of the portfolio meets this AI agnostic strategy.

As the market fumbled a bit with volatility last month, our AI agnostic portfolio endured with positive returns and that trend has not only continued but accelerated in the first couple of days in July. Our stock portfolio is *not* deliberately structured to be low-beta or less sensitive to the fluctuations in the value of the stock market; however, given its current composition, it is a fact that we benefit from (but only as a secondary consideration). The true value lies in the enduring theses that back our investments. For example, supporting our healthcare investments, which is now our largest sector exposure at over 33% of the asset value of the fund is the fact that the U.S. population and other developed country populations are aging. Today, approximately, a record 1-in-5 Americans are over the age of 65 and more likely to seek medical care in their golden years. Further, as emerging market economies continue to grow and prosper, healthcare becomes a higher priority in the hierarchy of human needs. In the context of global demographic tailwinds and valuations well below the market and well below recent history, it is easy to piece together the information arbitrage that these insiders made when they started buying their shares in mass earlier this year. This is a strong sector thesis that has been left behind during the runaway AI market, but insiders are seeing the opportunity, and we are happy to tag along. Backed by the added protection of our enhanced reserves and by finding value in the corners of the market with little to no public attention, we are confident in our ability to continue to generate strong results for our partners, while at the same time avoiding direct exposure to the growing cracks in the AI Bubbles.

We look forward to updating you again in August.

VNAV Performance.

	June - 2026	Year-to-Date	Since Inception (Sep 2020)	Sharpe Ratio
CDT VNAV (Net of fees)	**+0.91%**	**+6.02%**	**+207.44%**	**1.78**
S&P 500 Total Return	-0.96%	+10.20%	+142.43%	



Monthly Performance

• CDT VNAV CAGR	1.6%
• S&P 500 CAGR	1.3%
• Monthly Upside Capture	133%
• Monthly Downside Capture	85%

2022 Bear Market

• CDT VNAV Total Return	+9.1%
• Low	-2.3%
• S&P 500 Total Return	-15.3%
• Low	-23.9%

Best Regards,

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