



Lynx Capital Group Ltd

Disciplined Strategic Investment Management

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2026 Market Update: A Narrow Market

“Never in the field of human conflict has so much been owed by so many to so few.”

A famous line from Winston Churchill’s speech to the UK House of Commons on 20 August 1940, praising RAF airmen during the height of the Battle of Britain.

Winston Churchill; British statesman, military officer and Prime Minister of the United Kingdom from 1940 to 1945, during the second world war.

Similar to the observation by Churchill so far in 2026 stocks owed so much to so few: Roughly half of the gains have come from **one** industry (out of 74!): semiconductors.

Below is what drove returns, what held them back, and how we think about the risk.

- **Narrow leadership.** The best performing group this year was not the familiar "Magnificent 7." It is semiconductors, memory and AI hardware.
- **Earnings are real but at peak “windfall profits and margins” that will NOT last indefinitely.** Chipmakers are earning record margins on spending by a few very large tech companies building data centers, which are increasingly borrowing to pay for it.
- **Concentration is still approaching extremes.** The top 10 (out of 500) companies are roughly 40% of the index with Nvidia alone at 8.3%.

Chipmakers are earning margins rarely seen in any industry. Nvidia's gross margin was about 75% last quarter on \$96 billion of revenue. Micron's gross margin rose from 38% to 85% in one year as memory prices soared. Those margins depend on one set of customers building data centers continuing to purchase semiconductor chips.

The buyers are spending more cash than they make. In the April–June quarter, Amazon, Alphabet and Meta spent about \$129 billion combined on capital projects. Amazon's free cash flow was negative at \$8.8 billion, Alphabet's negative \$5.9 billion, and Meta's fell to \$1.7 billion.

Debt is filling the gap. Amazon issued about \$82 billion of debt in the first half of 2026 and Alphabet about \$56 billion. Morgan Stanley expects AI-related debt issuance to reach about \$570 billion this year, as demand for new hyperscaler bonds fell from nearly 5x coverage in February to under 2x in July.

Some headline profit is paper gains. Magnificent 7 earnings grew 118.5% last quarter, but only 43.2% when excluding investment gains. Alphabet booked about \$98 billion and Amazon \$53.4 billion of mostly **unrealized** gains, largely on stakes in AI lab Anthropic. The Magnificent 7 as a group gained about 5% through August, trailing the index.

Due to the concentration we believe that the S&P 500 is now more risky than most people are aware of: By our estimate, chipmakers, AI hardware and the big spenders together are well over a third of the index, and all depend on the same spending cycle. These points could change the whole landscape:

- **Margins revert.** Memory chips are one of the most cyclical businesses in the market. An 85% gross margin at Micron is a peak, not a new normal.
- **Spending slows.** If borrowing costs rise or bond buyers keep pulling back, the big spenders may trim capital budgets. That hits chip revenue directly.

While it looks like the overall market is stable, there is a lot going on under the surface with some short-term challenges. This quarter's S&P 500 gains have mainly come from five stocks (Microsoft, Meta, Apple, Alphabet and Nvidia). The Russel 2000 index, a good proxy for the market's breadth (and health) lost 6.9% for this quarter. The median stock now trades at 16% below its 52-week high. Healthy advances are characterized by broad participation. In addition, the 10-year yield topping 5.2% creates more competition for the stock market at the margin as risk averse investors can lock in an "almost" guaranteed 5% return. We also have the uncertainty of the mid-term elections, a hawkish Federal Reserve that is set to raise interest again in October and elevated oil prices. Goldman Sachs believes that there is potential for lagging stocks to catch up when macro uncertainty eases.

New technologies change the world, but the companies that build them don't necessarily sustain or keep the profits long-term. It's only a matter of time once a new technology goes mainstream, competition and extra capacity push prices and margins down, and the benefit passes to customers. In the past chasing the largest companies in an index has not had a good track record, as most of their value has already been discounted into the price of the stock. General Electric and Cisco Systems, both darlings of the dot.com era, lost 85% and 86% respectively of their values after the dot.com bubble burst. It's the nature of capitalism that there will always be a few winners in any new industry but rarely continue to dominate once the new technology gets established and becomes mainstream. Below are past examples of "new technologies" and their subsequent performance:

Boom	What investors believed	What happened
Railroads (peaked 1881)	Rail would reshape the economy. At the peak, railroads were about 66% of the US stock market.	It did, but building too many lines led to price wars, heavy debt and waves of bankruptcy through the 1890s.
Radio (1920s)	Every home would own a radio. RCA was the hot stock of the decade.	Radios became common and cheap. The stock collapsed in the 1929 crash and didn't recover for decades.
Fiber optics and telecom (1990s-2002)	Internet traffic would grow forever. The boom lasted about 10 years.	Traffic did grow, but capacity grew much faster, much of it paid for with debt. Values collapsed quickly. Global Crossing went from a \$47 billion value in 1999 to bankruptcy in January 2002 without ever earning a profit (Global Crossing).
Cisco, the supplier (2000)	The "picks and shovels" of the internet were a safe bet. Cisco was briefly the world's most valuable company, worth over \$500 billion.	When telecom customers stopped spending, it lost about 80% of its value by 2002. It took about 25 years, until December 2025, to close at a new record (Cisco).
Memory chips (repeating)	Every shortage feels permanent.	Every shortage has ended in a glut. Micron earned \$8.7 billion in fiscal 2022, then lost \$5.8 billion in fiscal 2023 (Micron).

What this means for AI. Today's big spenders are highly profitable, and they still pay for most of their spending with their own cash. The warning signs we are watching are the ones from past booms: borrowing growing faster than revenue, and new competitors are emerging every day, especially from China in Semiconductors and AI. Alphabet and Amazon now design their own AI chips, and memory makers are adding capacity.

We expect AI to be as important if not more important than the railroad or the internet. That doesn't mean today's chip margins will last. We favor owning the **broader diversified market** rather than betting heavily on one industry's peak "windfall" profits. 6 of our 30 positions in our dividend & growth portfolio are in technology stocks)

Bonds are supposed to be boring. Lately, they haven't been. The Federal Reserve has cut short-term rates several times since September 2024, yet the 10-year Treasury yield, which drives mortgage rates, is higher than when the cuts began. The Fed sets short-term rates; investors set long-term ones, and they require higher interest on existing bonds to compensate for perceived heightened risk as inflation is stuck above the Fed's 2% target. Washington borrows nearly \$2 trillion a year. GDP continues to outpace interest rates for the time being. Nominal growth has been significantly higher than 6%, above the 5.16% 10-year yield, but growth adjusted for inflation has been about 2%. How long can the GDP continue to outpace interest rates, and how long can the US economy continue to expand more quickly than debt? When lenders demand more, existing bonds have to drop to compensate.

The biggest risk is an inflation flare-up pushing long-term rates higher. A one-point rise cuts about 8% from a 10-year Treasury's price and 14% from a 30-years. 2022 showed stocks and bonds can fall together. We are watching inflation reports, demand at Treasury auctions, and whether long-term rates keep rising regardless of the Fed. A lot is riding on the war with Iran. Should the war continue longer there is a good chance the oil prices could go a lot higher, whereas, if there is an agreement worked out, oil prices will drop precipitously and alleviate inflation.

2022 was the worst year on record for bonds, which began with the 10-year Treasury paying about 1.5%, leaving little income to absorb losses. **Today's higher yields provide a real cushion, and reinvested dollars earn more.** A lower price on a high-quality bond is like the online estimate of your home's value: it matters only if you sell, and a Treasury held to maturity will repay its full-face value. History agrees: the 1994 "Great Bond Massacre" (down 7.8%) was followed by an awesome 1995 (up 31.7%).

Three ways this could play out;

The slow grind. Inflation cools gradually, rates drift sideways, and bonds simply earn their interest.

The rescue rally. The economy slows, the Fed cuts faster, and long-term rates finally fall, lifting bond prices.

A second wave of inflation, raising rates higher. Inflation or deficit fears remain sticky; short-term bonds hold up; long-term bonds take more pain. Should rates rise a lot higher, this would be problematic for stocks, especially riskier ones.

Where floating rate preferred's fit - which we have incorporated into our existing bond portfolios. Floating-rate preferred stocks have the opposite weak spot from long-term bonds: their dividends reset with short-term rates, so their prices tend to hold steady when long-term rates jump, though their income shrinks when the Fed cuts. Their vulnerability is the banks that issue most of them, as March 2023 showed when Silicon Valley Bank's collapse sent bank preferreds sharply lower. They complement high-quality bonds rather than replace them. We have selected our floating rate investments only in the highest credit-worthy and quality companies.

Bonds do not have to be exciting to do their job: paying you reliably and cushioning your portfolio when stocks stumble. Even though bonds have depreciated in the past three months due to rising rates nothing has changed that.

How we are positioning portfolios

As always, we stay fully invested but are not chasing stocks on a single theme.

- **The capex cycle will eventually turn.** What investors are currently underappreciating is that this wave of data center investment will come to an end, and in turn, chip and memory stocks will come back to earth, as they have so many times in the past.
- **Know the real exposure.** We are reviewing how much each portfolio rides on AI spending, including any index fund or ETF we hold, not just individual holdings.
- **We always maintain a balanced cap-weighted exposure.** Equal-weight, value and dividend strategies spread risk across more of the market's 500 companies.
- **Take gains with a plan.** Where stock positions have grown well past their targets, we are rebalancing and offsetting gains by taking some losses with attention to tax efficiency.
- **Watch credit, not just stocks.** Demand for hyperscaler bonds is an early signal of whether the spending cycle can continue, this bears watching closely.

Given this backdrop, we remain well diversified, long-term focused, favoring companies with durable earnings power and strong barriers to entry, applied through a value-oriented lens. We have kept the bond side of our portfolios biased to short term, but we are also well diversified.

We encourage you to reach out with any questions or concerns or to schedule a portfolio review including your allocation to stocks and bonds to ensure your goals and tolerance for risk remain aligned.

Thank you for the continued trust you place in us.

Warm regards,



Brian Chait, President, October 2nd, 2026

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