

OCTOBER 26 2025 | By Steven Wieting & David Bailin

Worries, Real Worries, and When to Worry

As we approach the end of 2025, talk of an AI bubble and overvalued equity market have overshadowed the positive outlook for 2026. S&P 500 year-to-date performance of 15.7% has exacerbated these concerns. Investors wonder: “How long can the good times last?”

- The critical message of the late 1990s and other boom periods (ex. housing in 2007, oil in 2014) is that fundamental weakness sparked eventual collapse.
- Today's profitable and unprofitable AI infrastructure equities would fall sharply if AI spending falls. Our assumption is such a drop is not just ahead in 2026.
- After years of tight lending standards, banks are beginning to ease again. But even with robust “shadow bank lending,” total US business debt has grown just 2.1% in the past year.
- Signs of excess – even fraud - in narrow parts of the economy does not suggest broad vulnerability.
- It's possible that Fed easing, as in 1998, helps drive more reckless risk taking and future economic pain. But even if this doesn't occur, investors today would benefit from buckets of diversification away from today's boom assets.

2026 Expectations and Portfolio Design

CIO Group's Outlook for 2026 highlights meaningful EPS growth across the US economy. With tariff uncertainty fading, the manufacturing and construction sectors are likely to see an uptick in production. The AI infrastructure boom of 2024-25 will continue at a slower pace (15%-25% YoY). Global growth is likely to be about 3% with broader growth in non-AI industries and lower energy prices providing catalysts. In short, we do not see a period of negative GDP or EPS immediately ahead of us.

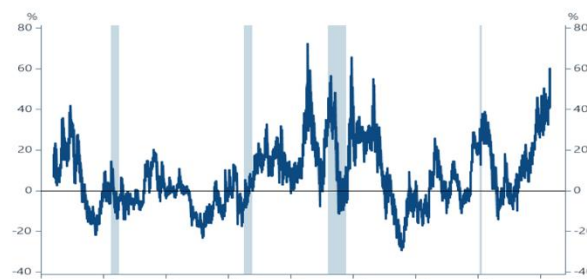
News that some small auto parts and auto finance companies and their creditors suffered fraud and credit losses sent US regional bank shares down 10% over the past month. Yet, it is a great leap to assume that consumer stress in auto finance is the “leading edge” of a soon-to-be realized collapse in credit markets.

That said, investment portfolios must reflect changing economic realities. CIO Group portfolio exposures in the later stage of economic expansion are designed to avoid the areas most likely to see stress first. These include regional banks and automobile-related lending. They also must lean into areas of sustainable growth and increase diversification to mitigate future risks.

At CIO Group, we believe balanced portfolios should stay exposed to growth at a reasonable price. Deep into a bull market such as this one, quality assets should be emphasized, with a focus on balance sheets as well as growth opportunity.

Volatility often picks up as expansions mature. Therefore, one needs an offset in uncorrelated assets.

FIGURE 1 - Hedge Risk or Take Risk? Gold Price Y/Y%



Source: Haver Analytics

Examples include healthcare shares, Asian tech, US Treasuries and municipal bonds.

Today, the bond market offers valuable diversification with a yield solidly above inflation. In equities, value is found in industries such as healthcare that have not participated in the tech boom. As the Fed eases, non-US growth equities are also likely to contribute more to returns.

Another element of CIO Group's Active Asset Allocation is building tomorrow's portfolios based on future return estimates rather than yesterday's performance. While gold is a small tactical holding in our portfolios, its 48% gain over the past year suggests it will not be a useful hedge for generalized risk aversion in the near term (see Figure 1). While we continue to hold it at a constrained weight, we also hold a 1.5% weight for Bitcoin in our medium risk portfolios as it is less mature in adoption as a store of value.

Is AI Likely to Lead to a Repeat of 1999?

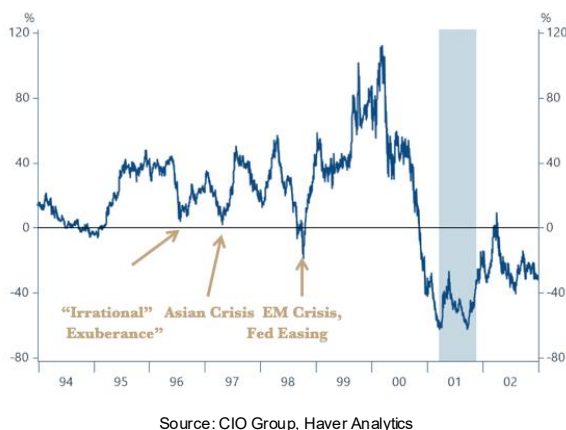
When you watch tv pundits, talk of the Great Depression, 2008, and the 1999 tech crash are often cited. But, let's look back at what really caused the 1999 tech bubble to burst.

After a 34% surge for the S&P 500 in 1995 and another 20% in 1996, then Fed Chair Greenspan warned of "irrational exuberance" in equity markets. Equities corrected 10% by early 1997 before recovering in second half of the year. The Fed subsequently maintained a tight monetary policy and a currency crisis in Asia ensued, spreading across the emerging world. This led to a 20% decline in US shares in Autumn of 1998. In reaction, the Fed quickly reduced policy rates by 75 basis points in three steps to support the US economy.

With that backdrop, optimism associated with the internet-driven "new economy" helped equities rise 27% in 1998 and nearly 20% in 1999. The Nasdaq composite surged 86% (see Figure 2). By early 2000, large cap information technology shares traded at 66X trailing earnings.

Tech valuations and earnings both peaked at the same time. Operating profits fell 57% in 2001. With accounting scandals related to equity compensation arising in parallel, the Nasdaq composite dropped as much as 78% from its 2000 peak. Many unprofitable firms failed. Excessive and quickly obsolete investments drove a capital-spending led recession. Though US corporate earnings fell modestly, losses for tech shares were profound. Today, prior industry leaders such as Cisco Systems remain below their peak valuations.

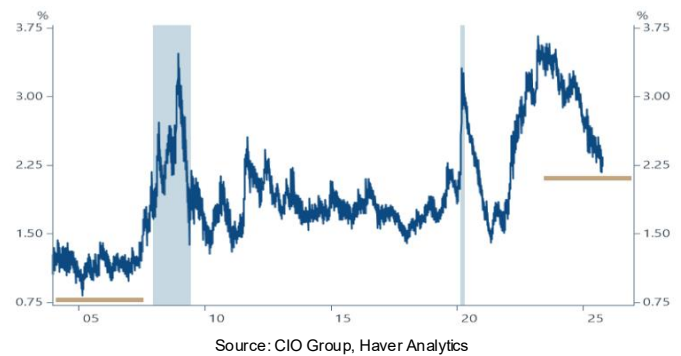
FIGURE 2 - Nasdaq Composite 1994-2002



No Banking Crisis – Quite the Opposite Now

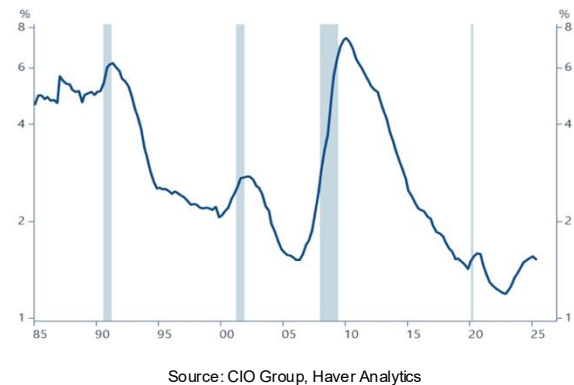
With the Fed easing and the yield curve steepening, bank profits are surging. With deregulation promised, mortgage spreads are now falling, signaling a wider availability for US home lending ahead (see Figure 3).

FIGURE 3 - Fixed Mortgage (30-Year) Spread to US Treasury



The Fed's lending officer survey shows banks are gradually easing standards across the board - though they're starting from pretty tight levels. Credit delinquencies across all forms of loans have picked up modestly (see Figure 4), but remain historically mild.

FIGURE 4 - US Banks Delinquency Rate: All Loans



In some future period of meaningful US job losses, auto lenders will suffer from non-performance. Yet, it is a great leap to assume the latest news on the fringe of auto finance is the "leading edge" of a soon-to-be realized collapse in credit markets that would threaten the US economic expansion.

What to Worry About

We do not believe the circumstances of the late 1990s are a reasonable analogy for aspects of the AI boom now. There is no impending housing price collapse (2007) or oil price collapse (2014) to drive earnings downwards. Today's profitable, leading technology companies are unlikely to see a decline in earnings growth in 2026. Some of the infrastructure being built today will suffer rapid obsolescence. However, the adoption of AI across the broader US and global economies will occur much more quickly than the use of the internet or the household purchase of PCs.

That said, there are meaningful risks associated with the growing share of client portfolios now overly-exposed to tech shares after years of double-digit appreciation. Today's profitable and unprofitable AI infrastructure equities would fall sharply if AI spending falls – though that's not likely in 2026. Moreover, the Fed will soon stop shrinking its balance sheet and reduce rates again soon, further reducing the hurdles to investment in the economy and markets.

Investors, focused on technological breakthroughs and the economy's resilience, have been deservedly optimistic. Even so, we are focused on diversification, globally and into industries like health care that have been treated harshly by markets in spite of their intrinsic earnings growth prospects as Cisco Systems remain below their peak valuations.

No Banking Crisis – Quite the Opposite Now

In our just released [Outlook for 2026](#) we discussed why CIO Group would rarely invest in regional banks or automakers. Only post-recessionary periods would favor such shares.

Conversely, we favor sustained investment in technology and its beneficiaries, especially in areas like software and services where the biggest benefits of AI lie ahead and heavy capital investment isn't a drag on cashflow. While the Fed easing to address modest weakness in the US labor market could contribute to "irrational exuberance", our view is that "sustained enthusiasm" is more likely to prevail.

In all circumstances of course, we will be watching for what to worry about in the months and years ahead.

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