Mosaicfi *Market Insights*

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Are we in an AI bubble or aren't we?

That seems to be the question on many investors' minds. The AI frenzy is certainly having an impact on the economy, the markets, and even interest rates.

It is estimated that over half of GDP growth in the US this year has been from investments into AI from big technology companies (i.e. Meta, Amazon, Microsoft, etc.){1} The Magnificent 7 stocks (see above) also account for over 36% of the market value of the S&P 500.{2}

What would happen if all this investing in AI didn't exist?

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ALL QUARTER END RESULTS TABULATED BY DIMENSIONAL FUND ADVISORS AS OF 9/30/2025.

In our opinion, it is likely that we would be experiencing slower economic growth, which could ultimately result in the Federal Reserve being more justified in lowering interest rates at a faster pace.

So, back to the question: are we in an AI bubble?

It would make sense to compare and contrast it to the dotcom bubble of the late 1990s. The similarity is in the massive amount of investment in data centers needed to house all the GPU chips that run the AI queries to the fiber optic cables that were laid in preparation for all the 'demand' from the dotcom companies of the 1990s. Back then, the investment proved to be overdone, and for several years, those fiber optic cables sat unused.[3]

Eventually, the YouTubes and the Netflixs of the world found use for all that fiber optic capacity.

Will all the current investment in AI data centers play out in a similar fashion?

The big distinction between these comparisons relates to the useful life span of the fiber optic cables vs. the GPU chips in the data centers. The fiber optic cables had a useful life of approximately 20-40 years.[4] The GPU chips currently made by Nvidia are estimated to have a useful life of 2 to 3 years.[5]

This is where the analogy parts ways; if it turns out that there is significant over-investment today in these data centers that may get utilized in the years to come, the chips being invested in today would likely need to be replaced (which is estimated to be approximately 40-60% of the data centers' cost.[6])

So, whereas there was ultimately a return on investment in fiber optic cables, the current investment in the buildup of GPU chips in the data centers, may become obsolete before they are ever utilized.

If that were the case, these investments would need to be written down. It appears to us that the valuations today of the technology companies making these investments are assuming a positive ROI on the data center investments.

THE EQUITY MARKETS

Global equity markets, as measured by the MSCI All Country World Index, were up 7.67% in the 3rd quarter. The developed international equity markets underperformed U.S. equity markets for the quarter.

International developed markets were up 5.33% vs. U.S. equity markets, which were up 8.18%. So far in 2025, international stocks have significantly outperformed the U.S. markets, returning 25.34% vs. U.S. stocks which are up 14.40%. Emerging markets are the top performing equity market, up 10.64% this quarter and up 27.53% in 2025. U.S. REITs continue to underperform, up 5.09% in Q3 and up 4.50% this year.

The U.S. small cap market outperformed large cap stocks this quarter. Small cap stocks were up 12.39% for the quarter versus large caps, which were up 7.99%. Large cap growth stocks continued to outperform large cap value; with growth stocks up a whopping 10.51% vs. value stocks up 5.33%. This brought the large cap performance to 14.60% so far in 2025 and small cap performance to 10.39%.

THE FIXED INCOME MARKETS

For the quarter, the yield on the 10-year UST declined 8 basis points. The U.S. bond market, as measured by the Bloomberg U.S. Aggregate bond index, returned 2.03% for the quarter and is up 6.13% so far in 2025. After under-performing the taxable market for the first half of the year, the municipal bond market, as measured by the Bloomberg Municipal bond index did well in Q3, ending the quarter up 3% and is now up 2.64% for the year.

As corporate bond spreads continue to tighten, corporate bonds outperformed the treasury market in the 3rd quarter. Intermediate corporate bonds were up 2.04%, with comparable treasuries up 1.26%. The high-yield market once again outperformed the investment grade market, up 2.54% in Q2 and is up 7.22% for the year. U.S. TIPS (inflation protected securities) were up 2.10% for the quarter.

So, what did all this mean for investors?

Depending on the asset allocation, given the performance of the stock and bond markets, a diversified index portfolio in the 3rd quarter was up between 4-6%.

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LOOKING AHEAD

The Federal Reserve lowered interest rates by 25 basis points in September despite inflation being above their 2% target. The Fed chairman, Jerome Powell, stated that the signs of weakness in the employment numbers was the main driver of this decision.[7]

The Federal Reserve is expected to continue its trajectory of lowering interest rates at a measured pace. Inflation is still well above their 2% target, with the latest reading coming in at 3% year-over-year.

The Fed appears to have pivoted to being more concerned about weaker employment numbers and less so about the risks of rising inflation. This makes it more likely that they will be inclined to lower interest rates incrementally at their meetings over the next several months.

We will continue to watch the developments in the AI space, but we believe our best buffer to exposure in any market that may be overextended and frothy is to 'not put all our eggs in one basket'.

Having diversification across geographies and asset classes within our portfolios is what allows our clients to experience the trajectory of growth in the overall markets but limit the extreme downside that any one part of the market may experience at any point in time. As always, we love to hear from you. Please contact us anytime.

Endnotes

{1} J.P. Morgan Asset Management reported that "in the first half of 2025, AI-related capital expenditures contributed 1.1% to GDP growth, outpacing the U.S. consumer as an engine of expansion." Barclays estimated that AI capital expenditures "added roughly 1 percentage point to GDP growth in the first half of 2025." Other analyses found AI investment accounted for 31% of GDP growth in H1 2025. Sources: Fortune, "Without data centers, GDP growth was 0.1% in the first half of 2025" (October 7, 2025); J.P. Morgan Asset Management, "Is AI already driving U.S. growth?"; Investing.com, "What is the effect of AI capital expenditures on the US GDP growth trajectory" (October 2025); The Tradable, "AI Investment Drives 31% of U.S. GDP Growth in 1H 2025."

{2} The Magnificent 7 stocks continue to dominate S&P 500 performance through 2025. As of October 21, 2025, the Magnificent Seven account for 36.6% of the S&P 500's total market capitalization, up from 33% at the start of 2025 and 28% at the start of 2024. DataTrek Research analysis found that the S&P 500 "would have barely registered a gain without the Magnificent Seven" over 2023-2024

{3} During the dotcom boom, telecommunications companies invested over $500 billion in debt and raised nearly $2 trillion in equity to lay more than 80 million miles of fiber optic cables. The result was catastrophic overcapacity - even four years after the bubble burst in 2000, an estimated 85% to 95% of the fiber laid in the 1990s remained unused, earning the nickname "dark fiber." Sources: Fortune, "Everyone's wondering if, and when, the AI bubble will pop" (September 28, 2025)

{4} Sources: PPC, "4 Factors That Influence How Long Your Fiber Network Will Last" (August 3, 2022)

{5} TrendForce, "Datacenter GPUs May Have an Astonishingly Short Lifespan of Only 1 to 3 Years" (October 31, 2024)

{6} Balancier Capital, "Does AI datacenter capex make financial sense?" (July 8, 2024)

{7} Federal Reserve Board, "Federal Reserve issues FOMC statement" (September 17, 2025)

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