

Investment Perspectives

September 2026

Diversifying Away from AI CAPEX— the Case for KAR Thematic Quality

The S&P 500 has seen an increase in the concentration in mega-cap technology stocks reliant on the AI data center spending boom, and we believe investors face a growing risk of thematic overexposure. Increasingly, this index AI exposure are in businesses with historically cyclical demand patterns, such as computer memory manufacturers. By contrast, the KAR Thematic Quality portfolio has less exposure to the AI capital expenditures (CAPEX) cycle—instead focusing on resilient, long-term themes distinct from the index’s current tilt. This differentiated positioning stems from KAR’s focus on companies with three defining traits: (1) a preference for business models with recurring revenues, (2) exposure to long-term structural themes underrepresented in the index, and (3) ownership of businesses with idiosyncratic growth drivers. In today’s market, we believe these characteristics may offer resilience and balance to portfolios increasingly tethered to a single macro engine.

The Problem

From our perspective, the S&P 500 remains a collection of high-quality businesses, but starting in 2025 and increasing in 2026, we’ve seen a growing vulnerability emerge: a significant portion of index constituents are increasingly reliant on AI data center spending to drive revenues, earnings growth, and valuation multiples. This capital expenditure boom is fueling not only the financial results of semiconductor vendors supplying graphics processing units (GPUs), central processing units (CPUs), and networking equipment, but also a broader ecosystem—utilities powering the infrastructure, construction firms building facilities, sale-and-leaseback operators monetizing GPU assets, and manufacturers of advanced cooling systems. Even financial institutions, including banks and private lenders, are benefiting from the surge in financing activity tied to AI infrastructure buildout. While this interconnected growth story has supported strong performance, we contend that it also introduces concentration risk should the pace of AI-related investment normalize or decline.

Mismatched Dollars: AI Revenues vs. AI CAPEX

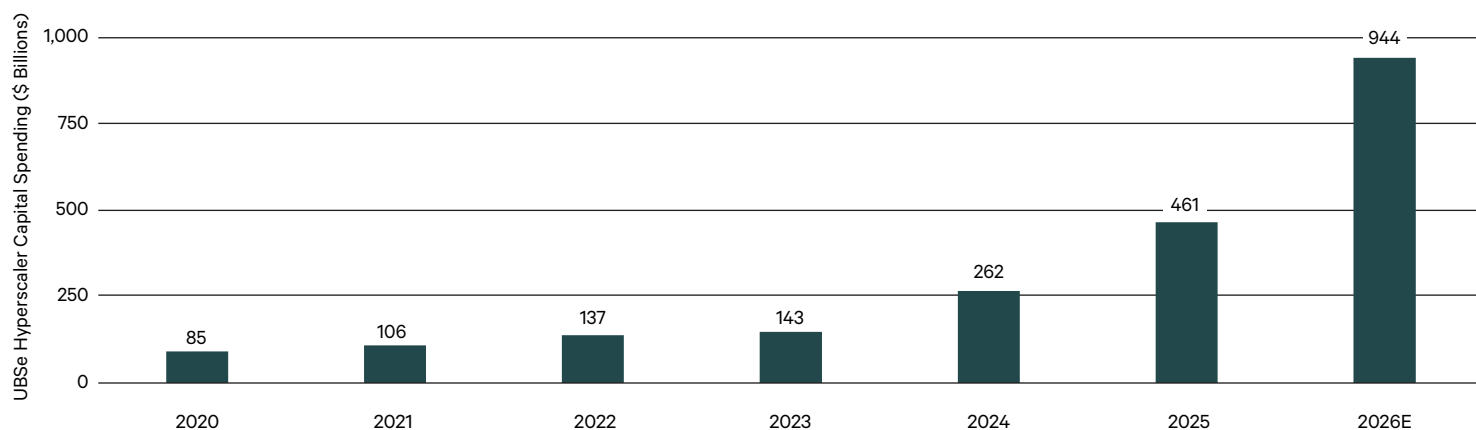
In 2026, five major hyperscalers*—including Amazon, Microsoft, Google, Meta, and Oracle—are projected to spend over \$940 billion on AI infrastructure, up from \$460 billion in 2025. This spending is what has driven much of the growth in revenues, profits, and valuations of chipmakers and other data-center-exposed businesses. If current trends continue, hyperscaler capital spending is expected to grow further in subsequent years, but investors are increasingly questioning the sustainability of this spending¹.

*Hyperscalers are large technology companies that build and operate vast cloud and data-center infrastructure, enabling businesses to access computing resources at scale and supporting the growth of technologies such as artificial intelligence and cloud computing.

¹ Reuters, “Among AI crowd, some investors position for slower hyperscaler spending growth,” July 2026, <https://www.reuters.com/business/retail-consumer/among-ai-crowd-some-investors-position-slower-hyperscaler-spending-growth-2026-07-17/>

FIGURE 1: U.S. HYPERSCALERS' CAPEX AND YEAR-OVER-YEAR GROWTH

Including Microsoft, Amazon, Alphabet, Meta and Oracle



UBS Hyperscaler Capital Spending Tracker for 2020-2025 and forecast for 2026E. Each bar is the aggregate spending of Amazon, Google, Microsoft, Meta and Others tracked by UBS. Data as of July 27, 2026. Source: Company Reports, UBS Estimates. This information is for illustrative purposes and should only be used for informational purposes and KAR does not undertake to update the information presented. KAR makes no warranty as to the accuracy or reliability of the information contained herein.

Anthropic reached an annualized revenue run rate of \$47 billion as of May 2026². OpenAI reached an annualized revenue run rate of \$25 billion as of March 2026³. Collectively, the two largest Generative AI companies with the lion's share of industry revenues together earn less than \$80 billion of annualized revenues against over \$900 billion of industry capital expenditures—a comparison that underscores the mismatch between current monetization and the scale of capital deployment⁴. While enterprise adoption is accelerating, the gap between spending and earnings raises questions about sustainability and return on investment across the broader AI ecosystem.

Despite Anthropic and OpenAI's rapid growth, both of the companies and the broader AI industry would need to increase revenues more than tenfold to approach the scale of capital expenditures currently being committed—let alone exceed it—which in our view is the norm for a profitable, mature business. In typical operating models, CAPEX represents a fraction of revenue at run-rate*. In contrast, today's AI landscape is inverted: revenues are a fraction of CAPEX. To illustrate, consider a personal analogy—your monthly car payment is usually a manageable percentage of your income. If your income were instead a percentage of your car payment, the financial strain would be unsustainable.

Generative AI is undeniably a transformative technology—one that will likely evolve into a foundational mega-theme from which many investable sub-themes emerge. Yet this long-term potential coexists with considerable near-term uncertainty: questions remain around which companies will become enduring front-runners, and around the cadence and sustainability of AI-related capital spending over the coming decade. History offers cautionary parallels. WorldCom, Global Crossing, and Lucent played pivotal roles in building the internet's infrastructure, yet none remain household names today. These examples underscore the risk of extrapolating long-term investment success from early infrastructure spending booms. Large amounts of cash flows go into the industry as CAPEX, without a commensurate amount of cash profits coming out. Hyperscalers are becoming free cash flow negative to fund the build out of AI data centers.

*Revenue run-rate is an estimate of annual revenue based on a recent month or quarter of revenue, assuming that the same pace continues over the remainder of the year. Because business conditions can change, a revenue run-rate should not be considered a forecast or guarantee of future revenue.

² Anthropic, "Anthropic raises \$65B in Series H funding at \$965B post-money valuation," May 2026, <https://www.anthropic.com/news/series-h>

³ Yahoo Finance, "OpenAI tops \$25 billion in annualized revenue, The Information reports", March 2026 <https://finance.yahoo.com/news/openai-tops-25-billion-annualized-033836274.html>

⁴ At the time of this writing, NVIDIA is in talks with OpenAI to provide a guarantee for \$250 billion of financing as part of a major data center project. Wall Street Journal, "Nvidia in Talks With OpenAI to Guarantee \$250 Billion Financing for Data Center", July 2026, <https://www.wsj.com/tech/ai/nvidia-in-talks-with-openai-to-guarantee-250-billion-financing-for-data-center-3dd6eae3>

The Cabin-Fire Analogy

Picture the economy as a fireplace inside a log cabin, deep in the woods. In the ordinary course of things, you keep the fire going by walking into the forest and gathering fallen wood—a renewable source, replenished faster than it's consumed. That is what a sustainable economy looks like. What the AI-related companies are doing today is different: rather than sourcing wood from the forest, they are dismantling the cabin itself and feeding it to the flames.

Consider how the fuel is actually being supplied. AI vendors are increasingly financing their own demand—paying customers, in effect, to purchase their products and services. For example, NVIDIA extends vendor financing to its buyers. Cloud compute providers invest capital into the AI labs, Anthropic and OpenAI, that then flows back to the cloud compute providers as revenue. Further, the AI labs charge less for AI services than it costs to deliver them.

The fire burns big and fast, and the spectacle is genuinely impressive, but the cabin represents the accumulated wealth of the world. Set it alight and it will blaze brilliantly, for a while. What it will not do is burn sustainably, the way a fire fed from the living forest can. The continuation of this fire depends on the growth narrative remaining unbroken. Yet to keep growing, it demands ever more fuel, eventually more than the cabin, the world's accumulated wealth, can supply.

Importantly, this is increasingly reliant on external financing. As hyperscalers exhaust their free cash flow, they are turning to equity markets to sustain their capital spending. NVIDIA, meanwhile, is assembling a syndicate of asset managers to finance the very GPU purchases that drive its revenues. And the AI labs have raised more than hundreds of billions in equity since inception—capital consumed as quickly as it is raised.

The imbalance between AI revenues and associated capital spending introduces ongoing fragility in the forward-looking CAPEX picture. As economist Herbert Stein famously observed, “If something cannot go on forever, it will stop.” For the AI industry, sustainability may be achieved either through a sharp acceleration in revenue growth or through a rationalization of current spending plans. Both paths imply a shift from today's exuberance toward a more durable equilibrium.

While the broader market leans heavily into AI infrastructure, we believe Thematic Quality offers a compelling alternative rooted in more consistent and diversified growth drivers.

The Thematic Quality Difference

Preference for Recurring Revenues

Thematic Quality is organically underweight Artificial Intelligence Capital Spending through its preference for recurring revenue business models. We maintain that these businesses, whether subscription-based or tied to consumable products, benefit from an installed customer base that compounds over time, driving steady cash flows and reducing reliance on new sales to sustain growth. By contrast, companies dependent on one-time equipment sales face a “leaky bucket” dynamic: each year begins with the challenge of replacing last year's revenue, leaving them more vulnerable to industry CAPEX cycles.

To illustrate:

- **Recurring Revenue:** Software subscriptions, energy drinks, water treatment chemicals, membership-based grocery retailers, and commissions earned on annually renewing insurance policies
- **One-Time Revenue:** GPUs, CPUs, networking hardware, data center services, and commissions related to debt or equity issuance

Different Themes

KAR Thematic Quality defines themes as enduring structural shifts—driven by identifiable forcing functions—that reshape industry dynamics in favor of robust business models. By favoring recurring revenue businesses, the strategy seeks to organically position itself to benefit from themes that differ meaningfully from those dominating the broader market. Representative areas of current overweight exposure include:

1. Inflation Relief
2. Digital Economy
3. Cyber Security
4. Critical Energy Infrastructure

Importantly, Thematic Quality is not categorically underweight AI. Rather, it is selectively overweight in **AI Usage Tollbooths—businesses that own the critical infrastructure and complementary software that enables productive AI usage, rather than the direct beneficiaries of AI capital expenditure**. This includes companies within the Cyber Security and Digital Economy themes, which see revenue growth tied to increased AI usage. As the AI cycle matures and shifts from infrastructure buildout to application and integration, we see these enablers offering more durable exposure to the long-term AI opportunity.

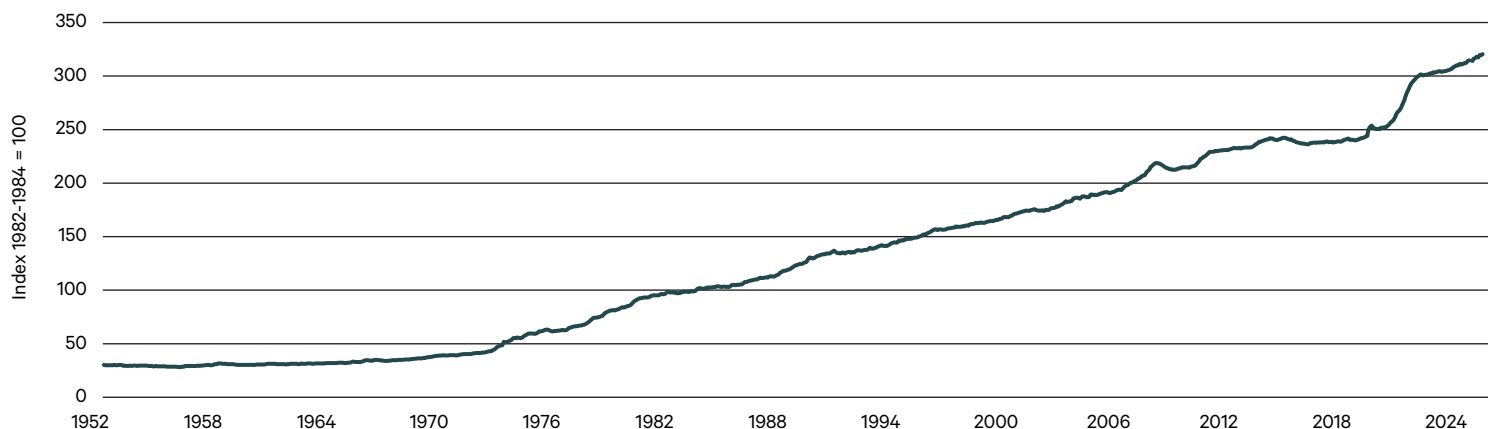
Below are some summaries of select thematic exposures within Thematic Quality:

Select Theme: Inflation Relief

Driven by elevated government indebtedness and ongoing monetary debasement, inflationary pressures are likely to remain a persistent feature of the global economic landscape. As the purchasing power of money erodes—particularly in relation to essential goods such as food—consumers are increasingly seeking ways to stretch their dollars further. From our perspective, this dynamic favors business models that deliver greater value through bulk purchasing and operational efficiency.

Retailers that concentrate their buying power into a narrower assortment of goods and suppliers can unlock scale-based savings. By passing these savings on to consumers, retailers not only deepen customer loyalty but also expand market share through value-driven differentiation.

FIGURE 2: CONSUMER PRICE INDEX FOR ALL URBAN CONSUMERS – FOOD AT HOME IN U.S. CITY AVERAGE



Data as of July 14, 2026. Source: U.S. Bureau of Labor Statistics via Fred. This information is for illustrative purposes and should only be used for informational purposes and KAR does not undertake to update the information presented. KAR makes no warranty as to the accuracy or reliability of the information contained herein.

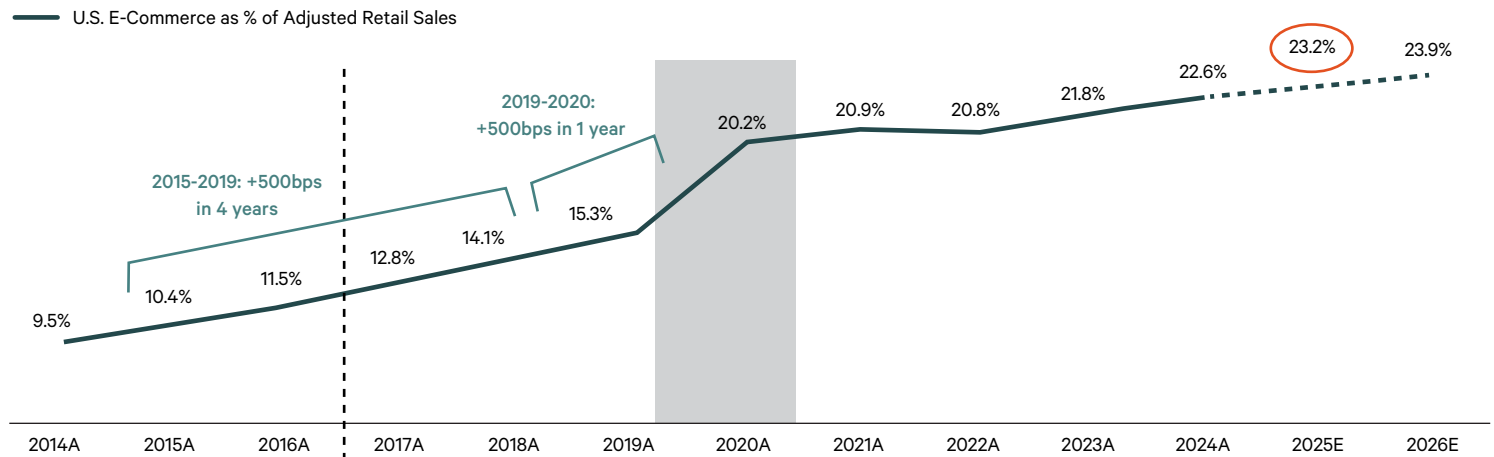
Select Theme: Digital Economy

The physical economy is constrained by frictions that delay or complicate transactions—inventory may be unavailable at a given location, and service providers may not be physically present when demand arises. In contrast, the internet offers a frictionless medium for transacting goods and services, enabling infinite shelf space, real-time availability, and asynchronous interactions between buyers and sellers.

These structural advantages continue to shift a growing share of global commerce online. As consumers and businesses increasingly prioritize convenience, access, and efficiency, digital platforms are capturing market share across retail, services, and financial transactions. This trend is elevated by the growth of Agentic e-commerce, where generative AI agents are employed by consumers to make purchases on their behalf. We maintain that the Digital Economy businesses that provide the most efficient path to connect suppliers and customers with the least friction will see increased volumes due to the heightened commercial activity driven by AI agents.

FIGURE 3: U.S. E-COMMERCE GAINS TO CONTINUE IN 2025 & BEYOND

E-Commerce as % of U.S. Adjusted Retail Sales



Data as of June 25, 2026. Source: U.S. Department of Commerce (historicals); J.P. Morgan estimates (projections). This information is for illustrative purposes and should only be used for informational purposes and KAR does not undertake to update the information presented. KAR makes no warranty as to the accuracy or reliability of the information contained herein.

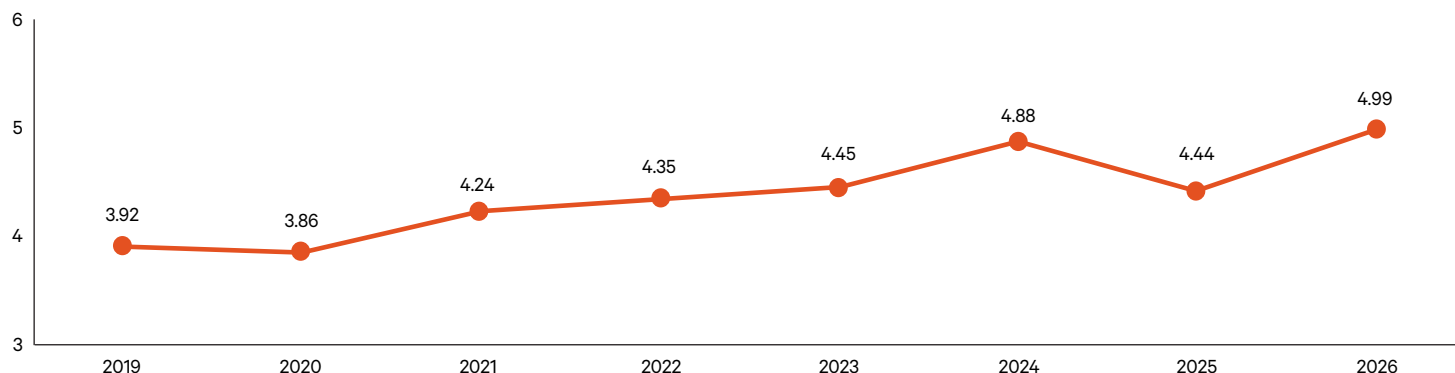
Select Theme: Cyber Security

The frequency and sophistication of cyberattacks have consistently escalated over time—and the emergence of AI as a powerful tool has only amplified the capabilities of malicious actors. As threats grow more complex and pervasive, enterprise organizations increasingly view cybersecurity spending not as discretionary, but as mission-critical to business continuation. This shift in mindset has transformed cybersecurity from a cost center into a necessity, with vendor revenues rising in tandem with threat volume.

This theme has become of greater pressing concern with the advent of Claude Mythos, and other AI models with similar cybersecurity capabilities. There is an asymmetry in AI cyber capabilities, where it is easier to attack than to defend—due to there being a larger surface area to find cyber vulnerabilities to exploit vs. the difficulty of defending the same surface area. This makes the spending on critical cybersecurity vendors more pressing in the age of cyberattack-capable AI.

FIGURE 4: GLOBAL AVERAGE COST OF DATA BREACH

Measured in USD millions



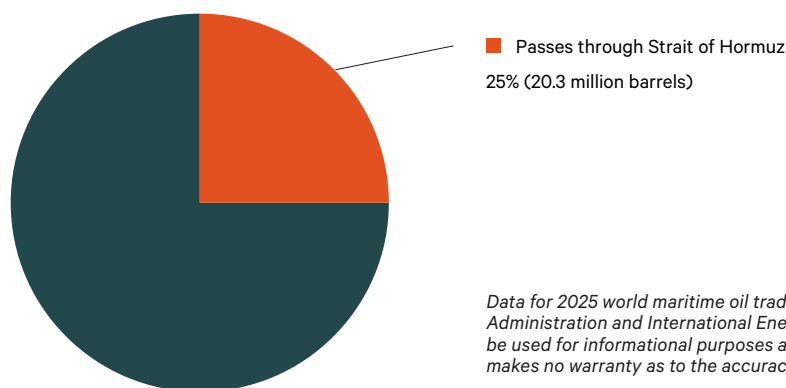
Data as of June 30, 2026. Source: IBM Cost of a Data Breach Report 2026. This information is for illustrative purposes and should only be used for informational purposes and KAR does not undertake to update the information presented. KAR makes no warranty as to the accuracy or reliability of the information contained herein.

Select Theme: Critical Energy Infrastructure

The Strait of Hormuz is the most critical waterway for global oil and liquefied natural gas trade, with over one-fifth of both essential energy commodities flowing through this narrow passage. For decades, a traffic separation scheme has governed the orderly transit of tankers carrying oil and gas in and out of the Strait, while freedom of navigation through it has been safeguarded by maritime laws⁵. In early 2026, amid the conflict between the US and Iran, the Strait of Hormuz has been restricted on-and-off by Iran from maritime traffic.

Oil and gas are fundamental goods that underpin modern life: powering lighting, heating, cooling, data centers, shipping, air travel, trucking, and car travel. Iran demonstrating the ability to close the Strait of Hormuz marks a shift in the multi-decade equilibrium in the region and in global energy markets. Going forward, we believe oil and gas produced outside of the Strait of Hormuz should see higher structural demand because of lower geopolitical risk.

FIGURE 5: GLOBAL MARITIME OIL TRADE



Data for 2025 world maritime oil trade is based on first quarter of 2025. Source: U.S. Energy Information Administration and International Energy Agency. This information is for illustrative purposes and should only be used for informational purposes and KAR does not undertake to update the information presented. KAR makes no warranty as to the accuracy or reliability of the information contained herein.

⁵ International Maritime Association, "France-UK: Summit on Freedom of Navigation in the Strait of Hormuz", April 2026, <https://www.imo.org/en/mediacentre/secretarygeneral/pages/statement-summit-uk-france-strait-of-hormuz.aspx>

Idiosyncratic Business Opportunity

The Thematic Quality strategy only participates in a theme when it identifies a business with durable competitive protections that is actively gaining market share within that thematic context. These protections—such as network effects, cost advantages, switching costs, or advantaged distribution—are essential to KAR’s investment philosophy. In the open competition of capitalism, businesses without defensible barriers risk margin compression and long-term erosion of profitability.

As an actively managed, all-cap strategy with a concentrated portfolio, Thematic Quality seeks to target opportunities that are unique to individual companies. Our goal is to size up exposure to high-conviction ideas when valuation dislocations arise. We believe that **Thematic Quality’s accumulation of high-conviction, quality businesses**—each facing their own idiosyncratic growth opportunity—has resulted in a portfolio that is naturally diversified from the broader market.

Examples of idiosyncratic opportunities that Thematic Quality owns:

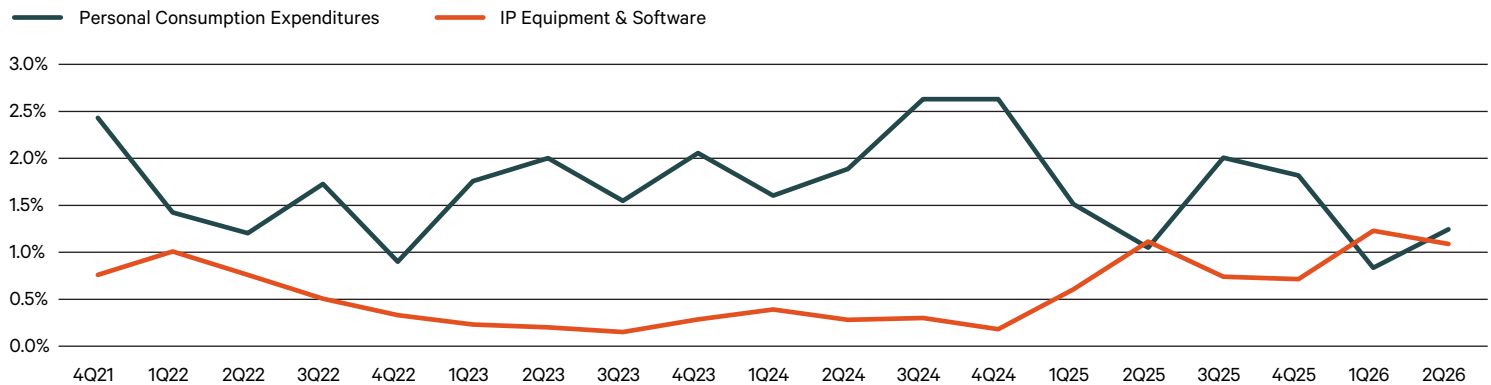
- **Tech Upgrade Cycles:**
 1. Flash memory replacing legacy hard drives
 2. Enterprise data migrating from on-premises infrastructure to cloud environments
- **Platform Expansion:**
 3. AI inference capability added to existing cybersecurity network infrastructure
 4. Autonomous driving capabilities layered onto already-computerized cars
 5. Cloud-native software embedding AI functionality to existing software-enabled workflows
- **New Category Creation:**
 6. Fitness-oriented energy drinks appealing to female consumers, expanding the functional beverage market
- **Disruptive Value Propositions:**
 7. Limited-assortment food retailers using low-cost models to outcompete traditional grocery and restaurant players
 8. Modular-built Liquefied Natural Gas Cooling Trains built in half the time required by traditional on-site Cooling Trains

Conclusion

2025 marked a unique moment in economic history—where data center capital expenditures surpassed consumer spending. This has only continued in 2026. (chart on next page)

FIGURE 6: CONTRIBUTION TO U.S. REAL GDP GROWTH

% Seasonally Adjusted Annual Rate (Two Quarter Moving Average)



Data as of June 30, 2026. Source: Bureau of Economic Analysis; Jefferies. This information is for illustrative purposes and should only be used for informational purposes and KAR does not undertake to update the information presented. KAR makes no warranty as to the accuracy or reliability of the information contained herein.

Even truly transformative technologies can experience periods where investment outpaces realized revenues, and quantitatively, that is the environment we face today with AI: massive infrastructure buildout, modest monetization.

Thematic Quality maintains naturally low exposure to AI Capital Spending due to three core attributes:

1. A preference for recurring revenue models over cyclical, CAPEX-driven businesses
2. Exposure to differentiated structural themes not overweighted in the S&P 500
3. A focus on investing in idiosyncratic, competitively protected business opportunities

Investors concerned about concentration in AI-related infrastructure spending may find Thematic Quality's exposures differ meaningfully from those of the S&P 500. We encourage you to explore with your advisor whether an allocation to Thematic Quality may provide thematic diversification.

This information is being provided by Kayne Anderson Rudnick Investment Management, LLC ("KAR") to illustrate our investment process and should only be used for informational purposes only. Information in this paper is not intended by KAR to be interpreted as investment advice, a recommendation or solicitation to purchase any securities mentioned, or a recommendation of a particular course of action and has not been updated since the date listed in the article, and KAR does not undertake to update the information presented. KAR makes no warranty as to the accuracy or reliability of the information contained herein. Holdings are subject to change. KAR has selected securities in this content based on objective, non-performance based criteria and such mention should not be considered to be a recommendation to purchase or sell the securities mentioned. KAR uses the Morningstar taxonomy to define its portfolio themes. Individual securities are categorized within this taxonomy by KAR. In Morningstar's Taxonomy, there are 31 total Theme Groupings organized in 4 Broad Themes: Technology, Physical World, Social and Broad Thematic. Portfolio Themes are emergent categorizations to communicate which secular themes the portfolio is participating in through its holdings. These classifications are outputs and are not inputs for constructing the portfolio. KAR determines which of Morningstar's Theme Groupings a holding falls into, and such determinations as well as Morningstar's Theme Groupings themselves are subject to change by KAR or Morningstar, respectively. The S&P 500® Index is a free-float market capitalization-weighted index of 500 of the largest U.S. companies. The index is calculated on a total return basis with dividends reinvested. The index is unmanaged, its returns do not reflect any fees, expenses, or sales charges, and it is not available for direct investment. Data is assumed to be reliable. **Past performance is not indicative of future results.**