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AI'S OTHER OPPORTUNITY

Artificial intelligence (AI) has come to dominate today's market. But as many investors devote more of their attention and money to AI stocks, what is happening with the rest of the market? Burgundy CIO Andrew Iu explores why quality companies have become unusually inexpensive relative to the broader market, the opportunities we're finding as a result, and how some businesses across our portfolios are benefitting from AI in ways the market may not yet appreciate.

KEY POINTS

- Money flowing into AI has to come from somewhere
- Quality companies are trading at unusually low valuations relative to the broader market
- You don't have to be an AI company to benefit from AI
- We invest in AI selectively, favouring businesses that can succeed across a range of potential outcomes

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Nearly every client conversation this year has started with a question about artificial intelligence. We understand why. In the headlines, on company earnings calls, even at dinner parties, AI has taken over the narrative and, increasingly, the market itself. Behind all this attention is a genuine transformation with far-reaching implications, and our Investment Team is seeing it firsthand. When we meet with companies, AI now comes up in most of our conversations—even in industries with no obvious connection to technology.

This piece isn't about whether AI matters. It's about the opportunities we see when we look beyond the market's dominant story.

THE MONEY HAS TO COME FROM SOMEWHERE

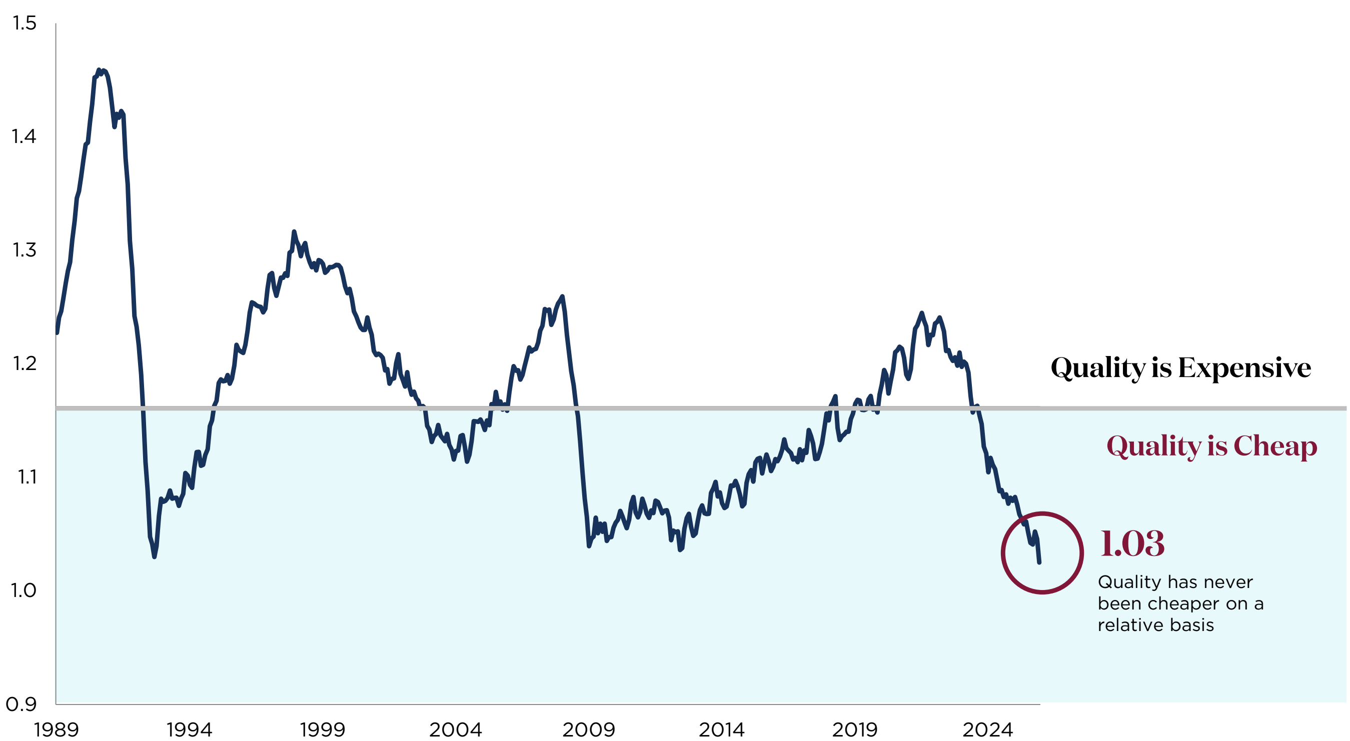
The AI-related portion of the market has become remarkably broad, extending beyond the companies most closely associated with it. This universe includes giant cloud-computing providers (also known as hyperscalers), semiconductor companies that design and manufacture the chips, as well as businesses supplying the equipment, electricity, and networking gear that data centres require. We spend a lot of time researching and getting to know these companies, and some have been in our portfolio long before AI captured most of the headlines, including leading companies like Amazon, Alphabet (Google's parent company), and Taiwan Semiconductor Manufacturing Company (TSMC).

Together, we estimate AI-related companies now account for roughly 35% of the global equity market. That scale reflects just how dominant the AI theme has become. It also poses an important question: Where does the money come from when investors want to increase their exposure? Buying more of one company usually means selling another. And in a market captivated by AI, the steady, profitable, non-AI stocks can become easier to part with when investors are in a hurry to gain exposure.

QUALITY IS CHEAP

Quality stocks usually cost more than ordinary ones. That premium is rational. A business with a durable competitive position, low debt, and predictable earnings should be worth more, particularly when economic conditions become more challenging. Today, however, that premium is eroding. On a price-to-earnings (P/E) valuation basis, the U.S. quality universe is trading at its lowest level relative to the broader market, going back to 1989. In more than 35 years of data, quality has never been cheaper relative to everything else. We also see the same pattern in international stocks.

FIGURE 1. U.S. QUALITY UNIVERSE: RELATIVE P/E
Median = 1.16x



Source: GMO as at May 31, 2026 (latest available).

WHAT THIS MEANS FOR OUR PORTFOLIOS

Against this backdrop of unusually attractive valuations for quality companies, our team has been busy. We invest with a long-term perspective, typically holding companies for about five years, with some positions remaining in our portfolios for more than two decades. We don't trade frequently, but with more opportunities to act on, we are buying and selling more than usual. Across our regional funds, portfolio turnover rates are up.

Europe is a good illustration. The average holding period in our European equity portfolio is close to eight years, yet turnover in Europe over the past year has been the highest since the 2008 Global Financial Crisis. When a patient Portfolio Manager starts trading, it usually says something about what's available.

Despite all the attention on AI stocks, our companies are performing well. On average, corporate profits across our Partners' Global holdings, our model equity portfolio for private clients, grew 16% over the past 12 months, well ahead of our long-run average of 9%.[1] Some of our holdings are also showing that you don't have to be an AI company to benefit from AI. Several have publicly stated that they expect their use of AI to contribute to earnings growth in 2027. We think these potential benefits are underappreciated because the companies that use AI aren't viewed by investors as AI stocks, at least not yet.

For example, we own a global insurance brokerage with an excellent track record of hitting efficiency targets. Its management team recently committed to investors that automating manual processes with AI will meaningfully boost profit margins over the next few years. In Europe, we own a fast-growing credit bureau that is using AI coding tools to hold its developer-heavy headcount flat as it grows. And in the U.S., we own a serial acquirer of financial technology businesses that reduces manual processing costs at the companies it acquires. AI has already yielded promising results, with the company reporting that it reduced the time needed to integrate its latest acquisitions by half.

> “Some of our holdings are also showing that you don't have to be an AI company to benefit from AI.”

OUR AI INVESTMENTS

As noted earlier, we have exposure to the AI ecosystem, though our participation is selective. At the time of writing, roughly 10% of our Partners' Global strategy is invested in AI-related companies, including Amazon, Alphabet, and TSMC, against about 35% for the MSCI World Index. Rather than invest in companies that depend on any single AI technology coming out on top, we invest in businesses that we believe should do well regardless of which AI chips or research labs survive. We believe all are leaders in what they do.

Our exposure to AI reflects a desire to participate in a transformation we believe is real without sacrificing our disciplined approach to quality, valuation, and risk management. That's the balance we are trying to strike.

WHAT THIS MEANS FOR YOUR PORTFOLIO

For more than three decades, we've aimed to grow our clients' capital while protecting it. Our approach has always been grounded in pursuing these two objectives in tandem, without sacrificing one for the other.

1. Last twelve months (LTM) earnings per fund unit as of August 31, 2026. Calculated by dividing NAV per unit by the fund's trailing P/E ratio (weighted harmonic average of the P/E ratios of the fund's holdings, where available). Source: FactSet.

Periods like this can pressure investors to abandon preservation and chase what has already worked. We've lived through enough cycles to resist that urge. Recently, most of our new investments have gone into non-AI stocks, where valuations have become more attractive and, in our view, prospective returns have improved. At the same time, we are seeing other companies in our portfolios beginning to benefit from AI in a way the market may not yet fully appreciate.

Taking advantage of opportunities sometimes requires a willingness to look where others aren't. If some investors are willing to part with quality companies in pursuit of the dominant market narrative, we're happy to take the other side of the trade.

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