

28 October 2026

September Monthly Report

Dear Investors

We're pleased to provide you with the September 2026 Monthly Report for the Fawkes Capital Fund ("Fund"). In this monthly report, we:

- (1) Update our performance for September 2026;
- (2) Describe our change in macro view.

Performance Update

Our Fund recorded a modest gain of 0.70% in September, largely driven by a small increase in the share price of Metasurface Technologies and a rise in US Treasury yields.

As we'll discuss in the following section, our central forecast for the macroeconomic environment has changed significantly.

Sep-26	1 Mth	3 Mth	1 yr	3 Yrs	5 Yrs	SI (ann)	SI (cum)
Fund (Net)	0.7%	-8.5%	36.9%	26.3%	18.2%	16.4%	127.4%
Blended Index	-1.1%	1.1%	2.9%	7.7%	5.5%	5.8%	34.8%
All Ords	-2.5%	1.0%	1.4%	11.0%	7.2%	7.9%	51.1%
RBA Cash	0.4%	1.1%	4.1%	4.2%	3.4%	3.1%	18.0%

*Returns are calculated net of fees and represent the combined income and capital returns over the specified period.
All returns provided are in AUD. Blended Index returns are composed of 50% All Ords / 50% RBA Cash.*

Macro-Economic Outlook

Our view of the economic outlook has changed. Whereas we were previously forecasting clear blue skies, we've started to see storm clouds gathering on the horizon.

First, an anecdote to illustrate the importance of changing our forecasts when the facts change.

It's World War II, and the Allies are trying to decide when to launch the D-Day invasion of Normandy. Since they're landing on beaches, an accurate weather forecast is critical. If the seas are too rough, their landing craft won't make it ashore. If the cloud cover is too low, they won't be able to provide air support. This is before the age of computers, and the complexities of the jet stream make predicting the weather in Western Europe particularly difficult. The Allies desperately need an accurate forecast.

There are two competing forecasters: a Scotsman, James Stagg, and an American, Irving Krick. They hold diametrically opposed views. For Monday, 5 June 1944, the provisional date chosen by General Eisenhower, Stagg predicts storms and low cloud cover as multiple low-pressure systems develop over the Atlantic. One tell-tale sign of the approaching storm is a precipitous drop in air pressure recorded at the weather station in Blacksod Point, Ireland.

Krick, on the other hand, forecasts clear skies. His approach relies on historical analogues. Similar weather patterns have appeared in previous years, and on those occasions the weather in Normandy turned out fine. He reasons that 1944 should be no different.

Monday the 5th of June, 1944 was a stormy day. D-Day is postponed until after the 18th of June due to the cycle of tides.



The story, however, doesn't end here. On 4 June, new weather observations from the Atlantic begin to indicate an improvement in conditions, the opposite of what had previously been expected. Stagg notices this and informs Eisenhower:

"since the statement made before the meeting on Saturday evening, there have been some rapid and unexpected developments in the weather situation over the Atlantic. A front from one of the deep depressions in the northwest Atlantic has moved much farther south than was expected and is now traversing the Channel areas...When that front has passed there will be an interval of fair conditions, which, from the evidence we now have, should last until at least dawn on Tuesday [the 6th of June]."

When faced with disconfirming evidence, Stagg changes his forecast, and he ends up being right.

The temporary break in the weather provides two important benefits for the Allies. First, it allows D-Day to proceed on Tuesday, 6 June, only one day later than originally planned. Second, it provides an element of surprise, since the Germans had not anticipated the improvement in weather. An accurate change in forecast likely saved countless lives. The invasion is ultimately a success.

Years later, on the way to John F. Kennedy's inauguration, Kennedy reportedly asks Eisenhower what gave the Allies the edge on D-Day. Eisenhower responds, "Because we had better meteorologists than the Germans."

We are, similarly, writing to you to inform you of a change to our forecast.

While the artificial intelligence ("AI") boom has been a medium-term boon for our Fund, we are beginning to see evidence that the story will ultimately end in a deflationary bust.

To be clear, we still believe that AI will change the world. It has the potential to unleash extraordinary advancements in productivity, as well as the potential to be used for evil in the wrong hands.

History teaches us, however, that when humans see an opportunity to profit from a new technology, there's a high likelihood of overbuilding. This occurred during the railroad boom, the rollout of electricity grids and the internet infrastructure boom. Historically, excessive capital investment has been the rule rather than the exception.

Across these examples, there are some common features in how the bubbles developed and eventually burst. Drawing on the dotcom crash and the historical analysis in the book *Capital Account*, we can identify several recurring patterns:

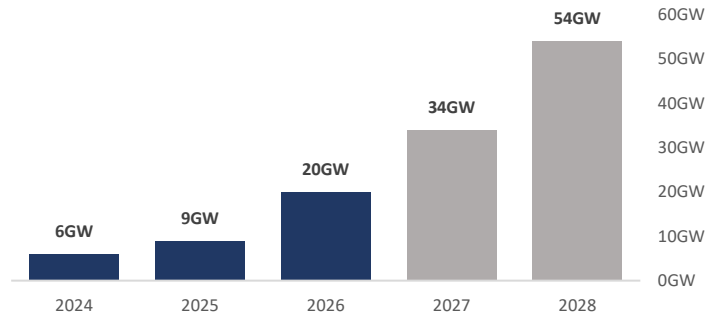
- **Extrapolation of extraordinary demand growth:** The mantra of the late 1990s was that demand for telecom bandwidth was doubling every three months. This is roughly the pace at which demand for AI tokens is currently growing. High equity valuations encourage overinvestment as companies rush to meet this seemingly insatiable demand.
- **The expectation of a new killer app:** There is a tendency to extrapolate existing trends far into the future, often justified by the expectation of some transformative new application. As the authors of *Capital Account* observe, during the dotcom boom, enormous demand projections were justified by the anticipated arrival of a "killer app", such as video-on-demand or internet videoconferencing. These applications always appeared to be just around the corner. As we'll see below, we're currently in a similar phase of waiting for the next AI killer app.
- **An eventual overbuild of infrastructure:** Capacity ultimately catches up with and exceeds demand, triggering a collapse in prices. During the dotcom bust, for instance, telecom prices reportedly fell by more than 70% annually in both 2001 and 2002.
- **A shakeout and consolidation of the industry:** As prices collapse, debts become increasingly difficult to repay and equity values decline significantly. The industry eventually consolidates, often leaving behind valuable infrastructure but substantial losses for the original investors.

Let's take a look at where we currently are in the juncture of AI.



Based on satellite imagery and construction permits, the number of data centres coming online in 2028 is expected to be almost three times that of this year.

Additional GW of AI Compute Capacity



Source: Bridgewater

If a tripling of data centre capacity were the extent of the story, we wouldn't be particularly concerned about the potential for oversupply. The problem, however, is that the effective supply of compute capacity is likely to grow by much more than this.

There are two reasons for this. First, GPUs and other accelerator chips are becoming significantly more productive per gigawatt of electricity consumed. Second, AI models are becoming far more efficient at performing inference tasks. Taken together, these improvements suggest that the effective supply of compute could increase by as much as 30-fold over the next two years.

In other words, to absorb this additional supply without creating a glut, the world will need to find demand for AI computing that is roughly 30 times greater than today's.

Where will this demand come from?

What we're reasonably confident of is that it won't come from conventional consumer applications. The reality is that these applications are relatively light users of compute. Even if every consumer used AI as intensively as the average Claude Code user, that would account for only around 14% of projected global compute capacity.

Consumer Agent Demand

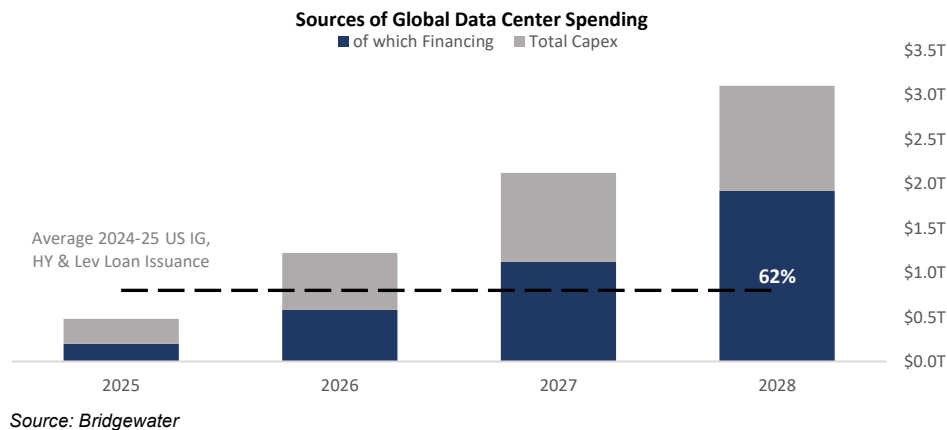
Share of Global ex-China Inference Compute

% of ex-China online population	Users	If each user's consumption equals average Claude Code user		If each user maxes out Muse free plan cap	
		Power	% Global inference capacity	Power	% Global inference capacity
10%	0.5B	1.4GW	1%	2.0GW	2%
25%	1.2B	3.4GW	4%	4.9GW	5%
50%	2.4B	6.9GW	7%	9.8GW	10%
100%	4.9B	13.7GW	14%	19.6GW	21%

Source: Bridgewater

If the consumer won't fill the gap, then will the corporate sector? It's possible, but it's a big ask.

We've triangulated how much capital expenditure will be spent on AI over the next few years based on three measures: (i) planned data centre construction, (ii) investment in chip-on-wafer-on-substrate (CoWoS) packaging capacity, and (iii) spending on wafer fabrication equipment. The following chart shows planned capex by year:



Around \$6 trillion in capex will be spent between 2026 and 2028. That's the equivalent of US\$16,667 for every working person in Europe and the United States. To put this into perspective, the amount is equivalent to around 8-10% of the entire US wage bill, a quarter of annual US corporate profits and more than 100% of annual US software sales. It's an extraordinary amount of money.

For corporate demand to increase 30-fold and absorb this additional capacity, the bottom line is that AI needs to replace a substantial amount of human labour over the next two years. We estimate that around 6–8% of the US workforce would need to be displaced by AI to justify the cumulative capital expenditure over the last 3 years.

It's not impossible that this happens. The technology is certainly getting better and adoption is growing. But the technology is only getting better at very specific tasks that mainly require deductive logic. AI is still yet to cause another bout of software engineering layoffs, job layoff announcements due to AI hasn't gathered pace, the technology has barely dented the growth of software companies it was meant to disrupt and we see very few businesses being forced to adopt AI for survival. Adoption of the newest frontier models has been relatively slow with many businesses beginning to opt for cheaper open models. It seems unlikely that businesses will be able to expand usage by enough to fill the supply glut.

Where else might this demand come from? So far, cybersecurity has proven too small to materially alter the trajectory of AI demand. It's also a double-edged sword. There is a scenario in which consumers become so concerned about their safety online that we see a major public backlash against AI development. Meanwhile, the rollout of autonomous vehicles remains slow, and humanoid robots are still years away from widespread practical adoption. Much like in 2000–01, we're at a point where we're waiting for the next "killer app".

The other problem is that the coming glut of compute capacity is likely to coincide with an enormous funding requirement for new data centres. Debt and convertible debt markets will need to absorb an extraordinary amount of issuance over the next two years. We estimate that around \$3 trillion of debt capital will be required to fund data centre construction, an amount that would place considerable strain on credit markets. At a time when the US government is running a budget deficit of around 6% of GDP, capital is already in significant demand. Interest rates may need to rise to ration the available supply of capital. A meaningful increase in funding costs could make the economics of many new data centres prohibitive.

The financing structures themselves create another vulnerability. For many data centre developers, projects are financed through special purpose vehicles (SPVs), with GPU rental rates fixed for the first three to four years. During this period, much of the cash flow goes towards servicing interest costs and repaying debt principal. A significant proportion of the return to equity investors therefore depends on the final two years of a GPU's useful life, when the initial debt has largely been repaid. If GPU rental rates collapse because of an oversupply of compute capacity, these projects could end up generating negative returns on equity.



Equity investors are betting on GPU rental rates remaining high. Debt investors, meanwhile, are relying on the collateral value of GPUs remaining elevated. But a major reason GPUs are so valuable today is that supply remains constrained. If that were to reverse, their value could collapse.

We believe this is the most likely scenario to play out over the next 18 months. The combination of falling compute prices and rising borrowing costs, reflecting both (i) the scarcity of debt capital and (ii) the increased risk of default among non-frontier data centre developers, is likely to cause a significant decline in new construction. This would, in turn, put considerable pressure on the equity valuations of companies throughout the supply chain.

We believe this boom-bust capex cycle will be the dominant force driving economic outcomes over the next 18 months. In the short term, a potential energy price shock is likely to influence the direction of interest rates. Ultimately, however, we expect a collapse in AI-related capital expenditure to overwhelm these other forces.

We believe that our change in forecast is likely to present significant investment opportunities over the coming year. If our central forecast proves correct, we see considerable upside in bonds as the boom gives way to a deflationary bust. We also expect substantial opportunities on the short side of the equity market.

Our investment thesis would be wrong if AI technology improved to such an extent that it displaced a significant proportion of the workforce, generating enough demand to absorb the coming supply of compute capacity. While we believe the probability of this is low, we continue to monitor developments closely.

Kind Regards,
Fawkes Capital Management

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