



TSCM: Inside the Investment Room

TSCM: Inside the Investment Room is a bulletin offering the Firm's perspectives on current market developments.

Market Rotation Back to Cyclical; AI Capex a Core Driver

Balancing Growth and Risk in a Diverging Market

Stronger economic data is driving a rotation toward cyclicals and value, anchored by a powerful AI-led investment cycle. Hyperscaler capex is expected to double year over year, reinforcing demand across semiconductors, industrial equipment, and power infrastructure. Fiscal support—particularly potential defense spending expansion—adds incremental stability to the macro backdrop.

At the same time, AI-driven disruption is widening cross-sector dispersion: the same capex cycle creating tailwinds for energy, industrials, and materials is generating competitive uncertainty in software, financials, and parts of consumer. Consumer-facing sectors remain soft amid cautious sentiment, and dollar debasement concerns are supporting interest in hard assets like gold. This environment rewards selective positioning and clear-eyed assessment of where AI creates value versus where it compresses it.

Sector Perspectives — Takeaways

Technology

Technology remains anchored by a powerful AI-driven capex cycle, with semiconductors and infrastructure beneficiaries leading despite ongoing valuation and disruption debates.

- **AI Capex Broadening Demand:** Hyperscaler spending is expected to double year over year, supporting compute, memory, networking, and equipment suppliers. Earnings growth is expected to drive the next leg of performance, making this the central engine of the current investment cycle.
- **Selective Software Exposure:** AI creates meaningful uncertainty around competition and seat growth in application software. Infrastructure, data platforms, and cybersecurity appear better positioned to benefit from structural AI tailwinds, while traditional enterprise software faces greater headwinds.

Industrials

The Industrials sector is entering a healthier, more stable period, supported by AI-related infrastructure demand and potential growth in defense spending. While stock prices may remain volatile in the short term, the underlying demand for many industrial businesses appears steady. Overall, the sector does not look overheated or at the end of a cycle.

- **Short-Cycle Stabilization:** Demand for many industrial products and services is starting to stabilize after slowing down.
- **AI-Driven Demand:** Investment related to AI is increasing and creating new demand for industrial equipment and infrastructure.
- **Defense Tailwind:** Government defense spending may rise, which could support companies tied to military and national security projects.

22

AVERAGE YEARS
OF EXPERIENCE

18

INVESTMENT
PROFESSIONALS



Energy & Materials

Energy and materials are benefiting from capital intensity, consolidation, and structural demand tied to electrification and AI-driven infrastructure buildout.

- **Distributed Generation & Scale Dynamics:** Consolidation in power and distributed energy resembles a “Fracking 2.0” phase, where scale (500 megawatts–1 gigawatt) and capital discipline are driving sustainable returns and limiting new entrants.
- **Materials Leverage to Capex Cycle:** Specialty chemicals and industrial materials stand to benefit from rising AI-related and industrial capex, offering cyclical upside with structural demand support.

Financials:

Financials remain supported by resilient economic activity, though dispersion is rising as AI and data-driven disruption create selective competitive pressures within information and services niches.

- **Credit & Data Services Durability:** Concerns around AI replicating proprietary datasets appear overstated; historical data integrity, embedded workflows, and switching costs continue to underpin moats for established providers.
- **Cyclical Sensitivity with Quality Bias:** A stable-to-improving macro backdrop supports core financial activity, but positioning favors firms with strong balance sheets, pricing power, and differentiated data assets.

Healthcare/Biopharma

Healthcare remains relatively insulated from AI-driven volatility, with fundamentals supported by durable demographic trends and ongoing biotech and medtech innovation.

- **Structural Demand Tailwinds:** Aging populations and continued pharma research & development activity support steady demand, with equipment suppliers (e.g., life sciences tools) benefiting from capacity expansion and drug development growth.
- **Selective AI Impact:** While AI may incrementally affect areas like clinical trial efficiency, disruption risk appears overstated, and companies leveraging AI for product innovation (e.g., diagnostics, biotech tools) are better positioned.

Consumer:

Consumer sectors face a mixed backdrop, with soft sentiment and food-related weakness offset by selective structural growth opportunities.

- **Staples Disconnect:** Food and core staples fundamentals remain weak despite valuation support, with pricing pressure and retailer pushback likely to weigh on margins.
- **Selective Resilience in Experiences & Health:** Names tied to long-term wellness trends (e.g., fitness) may benefit from increased health awareness, though near-term volatility and event risk remain elevated.

Key Macro Trends

- **AI as a Cross-Sector Disruptor:** AI is simultaneously the most powerful demand driver (capex, infrastructure, compute) and the most significant source of competitive disruption (software pricing, data moats, employment). Sectors exposed primarily to the capex side—Energy, Industrials, Materials, Utilities—appear best positioned, while Technology, Financials, Consumer Discretionary, and Communication Services face more mixed dynamics.
- **Fiscal Support via Defense Spending:** Potential reconciliation-driven defense budget expansion adds incremental support to industrial and defense backlogs, reinforcing demand in a sector already benefiting from short-cycle stabilization.
- **Consumer Softness & Sentiment Risk:** Travel, gaming, and food-related staples face weak fundamentals and cautious consumer behavior amid macro uncertainty.
- **Dollar Debasement / Hard Asset Hedge:** Central bank gold accumulation and currency concerns underpin constructive positioning in precious metals as a portfolio hedge.



The Bottom Line

We remain constructive on the AI-driven capex cycle and improving short-cycle economic momentum. Portfolio positioning favors cyclicals, infrastructure, and durable moats—sectors where AI is a demand driver rather than a competitive disruptor. We maintain selectivity in areas facing greater structural uncertainty, including enterprise software and consumer-facing names where sentiment and pricing dynamics remain under pressure. The widening dispersion across sectors reinforces the case for active, bottom-up positioning that balances growth opportunities with risk discipline.

Performance*

	4Q	1 Yr	3 Yr	5 Yr	10 Yr	Since Inception	Inception Date
U.S. Small Cap Growth (Gross)	3.70	6.91	13.31	3.11	10.44	9.51	9/30/00
U.S. Small Cap Growth (Net)	3.45	5.85	12.20	2.09	9.35	8.43	
<i>Russell 2000 Growth</i>	<i>1.22</i>	<i>13.01</i>	<i>15.57</i>	<i>3.18</i>	<i>9.57</i>	<i>6.40</i>	
U.S. Mid Cap Growth (Gross)	-4.49	10.23	15.78	7.40	13.19	10.17	9/30/00
U.S. Mid Cap Growth (Net)	-4.68	9.36	14.87	6.55	12.30	9.30	
<i>Russell Mid Cap Growth</i>	<i>-3.70</i>	<i>8.66</i>	<i>18.62</i>	<i>6.64</i>	<i>12.48</i>	<i>7.24</i>	
U.S. FOCUS Growth (Gross)	-3.55	14.84	21.18	11.87	14.82	13.61	8/31/05
U.S. FOCUS Growth (Net)	-3.76	13.88	20.11	10.84	13.72	12.42	
<i>Russell Mid Cap Growth</i>	<i>-3.70</i>	<i>8.66</i>	<i>18.62</i>	<i>6.64</i>	<i>12.48</i>	<i>10.37</i>	
International Small Cap (Gross)	-1.64	31.43	14.75	2.40	6.27	8.30	3/31/12
International Small Cap (Net)	-1.85	30.35	13.69	1.42	5.24	7.25	
<i>MSCI EAFE Small Cap</i>	<i>2.68</i>	<i>31.83</i>	<i>14.94</i>	<i>5.62</i>	<i>7.49</i>	<i>8.04</i>	
Global Small Cap (Gross)	0.73	21.74	14.93	5.17	--	6.72	12/31/17
Global Small Cap (Net)	0.53	20.79	13.99	4.28	--	5.80	
<i>MSCI World Small Cap</i>	<i>2.83</i>	<i>19.88</i>	<i>14.48</i>	<i>7.13</i>	<i>--</i>	<i>7.46</i>	

*Composite performance as of 12/31/25.

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