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FCM Weekly Market Notes

The Certainty of a Burst Bubble

Deliberating over whether there is an AI-related bubble is a complete waste of time. Developing a behavioral-based strategy to navigate it's bursting is not.

When you combine a transformational technology with human nature, you get money set on fire. It cannot be otherwise; in fact it is a key ingredient to that technology moving forward. ***Eventually, the rate of the change of the change in that technology's advancement slows and that is where the danger starts. We are there now.***

In the AI story we will almost certainly see hundreds of billions of dollars set alight. Mega-cap tech started spending out of its vast cashflow coffers and has now moved to debt and equity issuance. The arms race eventually begins to lack a logic and devolves into more must be spent because more is being spent by the other guy.

And this week reminded us of the relatively new twist on this bubble: credible competition from outside the US. Low-cost Chinese AI models with comparable performance that are customizable continue to be developed and released to market. Previously DeepSeek, this week it was Moonshot. Cheaper, open source, more cost efficient, and only slightly inferior to US models according to experts. "There goes a big chunk of potential market share" seems like a logical conclusion.

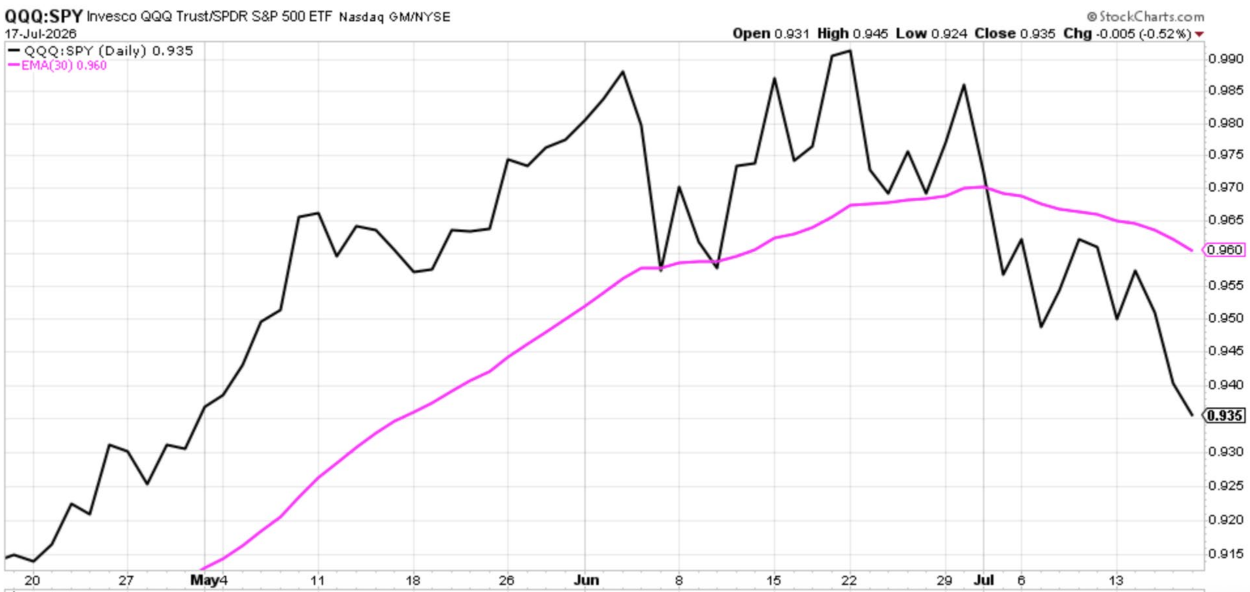
With a classic bubble story unfolding plus, extended valuations, and about a doubling of the market indices over the past 2.5 years, what is an investor to do?

The first rule is to seek price validation for your thesis. A sound investment process should keep you out of trouble—even through important market shifts. We have a simple rule: a break below a 30-day moving average requires a risk reduction. Note that the decision is pre-made, removing any emotional biases.

This week we saw a classic case in tech:

Do we know with certainty that this is the AI bubble bursting? No. But we have eliminated the necessity to endlessly deliberate around that question. And if the thesis turns out to be true—and history says eventually it will be—we will have avoided significant downside.

Lots of things follow from this. Overly complicated portfolios must be reviewed for places where the fallout might not be immediately obvious. If you own passive indices as a core that won't be touched, you can shift from tech-heavy to tech-lighter. This is the ratio of the price of the Nasdaq 100 versus the S&P.



If you invest in “factor” funds, avoid or (better) eliminate momentum. This is not the market regime where that factor shines.

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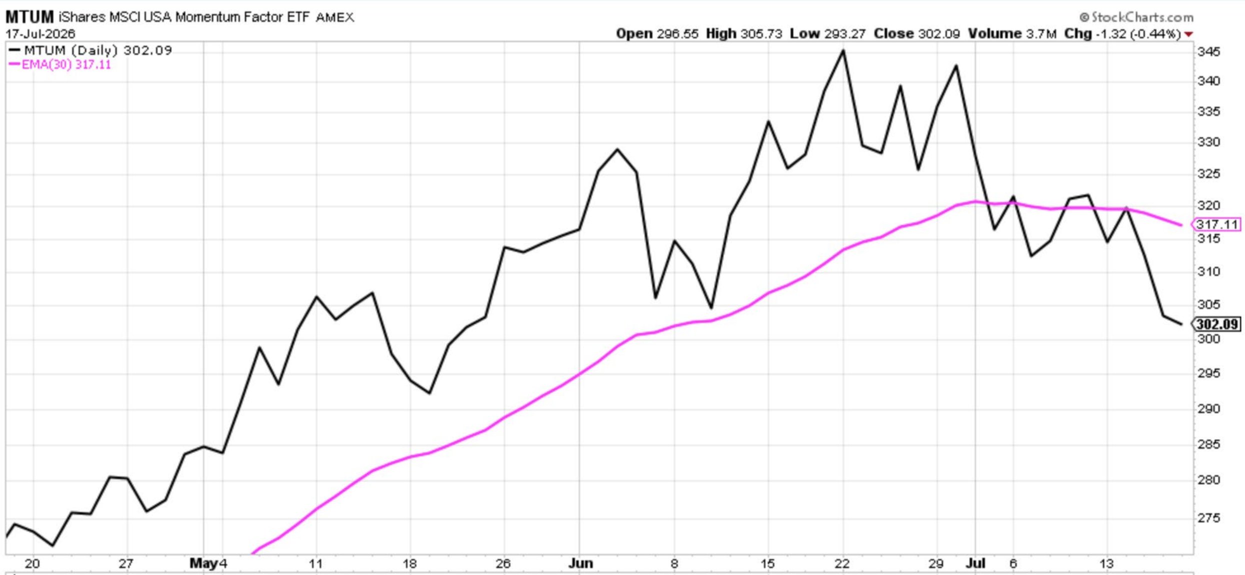

Factors closely adjacent to tech are under-performing and factors related to value are out-performing. This chart shows performance relative to the S&P. A great place to start understanding what you own, and where your vulnerabilities might be, is to ask which bucket each of your holdings might be most correlated to.

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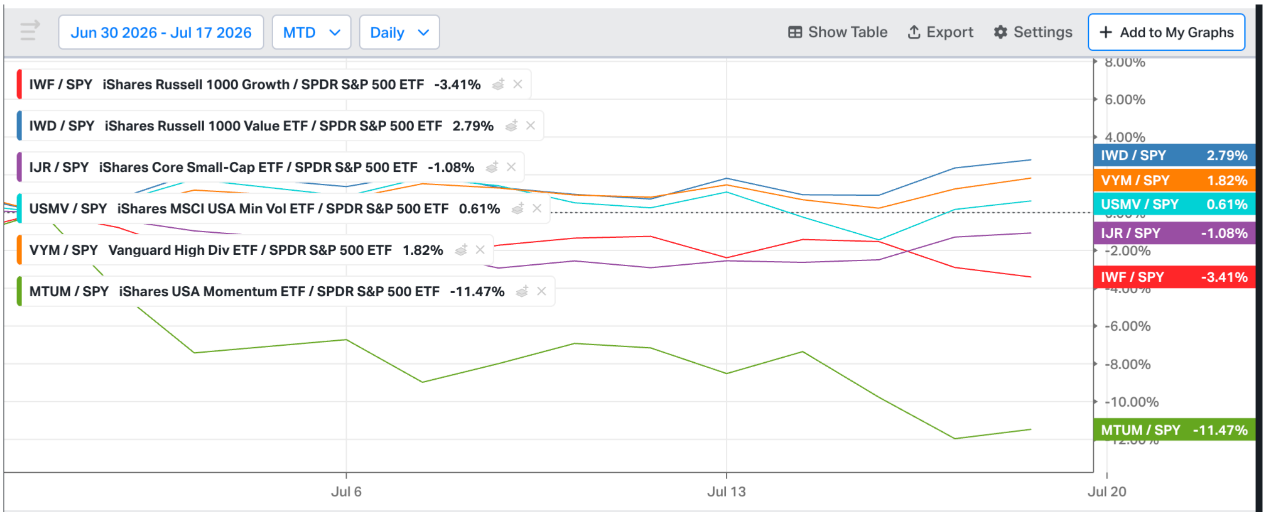

A sound portfolio will both be diversified but also easily understood in terms of what you own, its correlation to other holdings, and its vulnerability to large market events. If you can't look at each of your holdings and answer those questions your portfolio is likely to be overly complex.

You don't need to know whether this is the start of "the big one". You will, with 100% certainty, discover it in hindsight and then you can read all the pundits explaining why it was obvious from the start.

An investment process based on objective indicators that is simple, consistent, and appropriate for any market weather is the only necessity for surviving and thriving when the bubble goes. Let the rest of the market argue about its characteristics.

James Barrineau, Chief Investment Officer

Fiduciary Capital Management LLC

1621 Central Ave

Cheyenne, WY 82001

Website: www.FiduciaryCM.com   Direct:

(914) 588-1978

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