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Historically, investors have braced for the third quarter to be the most challenging stretch of the year. That familiar pattern did not hold in 2025. Instead, major indices advanced and now sit at or near all-time highs. A fertile combination of robust earnings growth and benign inflation readings propelled markets higher.

Speculative pockets of the market—most notably quantum-computing stocks—were among the strongest performers. High levels of froth coupled with stretched valuations are prompting comparisons to the dot-com era. For now, however, investor optimism remains elevated as we head into the fourth quarter.

EARNINGS, INFLATION, AND MONETARY POLICY

Entering the third quarter, trade tariffs were widely expected to spark inflation and suppress growth. Many economists even projected recessionary conditions. Yet corporate America once again delivered earnings above already-tempered expectations.

These results were bolstered by reports showing relatively benign inflation. While inflation remains above the Fed's 2% target, investors have interpreted recent trends as tame enough to give the Fed room to cut rates. Indeed, the Fed followed through in September with a 25-basis-point reduction, and markets are anticipating two additional cuts before year-end, contingent on stability in both employment and price levels.

SPECULATION AND MARKET RISKS

Ostensibly, the combination of solid earnings and subdued inflation should support further gains. Yet excess speculation is creating overheated conditions in some corners of the market. Stocks tied to the generative AI data-center buildout—ranging from semiconductors to energy providers to real estate assets—are commanding valuation multiples that are increasingly difficult to justify.

This dynamic bears resemblance to the late-1990s fiber-optic expansion. Carriers poured hundreds of billions into network infrastructure, dramatically overshooting demand. The "dark fiber" glut became emblematic of speculative excess, and when dot-com demand collapsed, bankruptcies swept across telecom and infrastructure providers such as WorldCom and Global Crossing.

The analogy is not perfect, but it is instructive. Today's data-center buildout is viewed as the backbone of generative AI. The technology is real and transformational, yet the risk is that the physical infrastructure may be overbuilt ahead of demand, echoing lessons from the dot-com era.

THE RIVERBRIDGE PERSPECTIVE

At Riverbridge, our investment discipline remains grounded in identifying enduring growth drivers rather than chasing short-term euphoria. Instead of focusing on the speculative buildout of data-center capacity, we are seeking companies that deploy generative AI to enhance profitability, deepen strategic positioning, and expand competitive moats.

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Already, we have observed tangible evidence across our portfolios—companies deploying AI to meaningfully improve efficiency and accelerate margin expansion. These durable applications of generative AI, rather than speculative infrastructure buildouts, are where we believe enduring shareholder value will be created.

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