

# Party Like It's 1999: Valuations, AI, and the Case for Diversification

*Why the AI Melt-Up Has Made Genuine Diversification More Important Than Ever*

June 23, 2026

All data as of market close, June 19, 2026

In our April update, written as technology stocks completed their V-shaped recovery, we closed with a caution that proved more durable than the crisis that prompted it. The market, we noted, was not cheap. Two months later, the geopolitical cloud that hung over that letter has largely lifted. Diplomatic progress in the Strait of Hormuz has eased the oil shock, and equities have pushed to fresh records, with the S&P 500 closing near 7,500. Yet the concern we flagged then has only intensified. A single force, the artificial-intelligence boom, now drives the market's gains, its valuations, and its risks all at once. In this update we examine what that boom has done to prices, why it has left the index more concentrated than at almost any point in its history, and how our Three Pillars framework reads the result. The conclusion that framework points to is the same one we keep returning to: the case for genuine diversification has rarely been stronger.

## The Echoes of 1999

It is impossible to discuss today's market without confronting artificial intelligence, which is simultaneously the best argument for current prices and the largest single risk embedded in them. The enthusiasm is not baseless. The largest technology companies are extraordinary businesses with real earnings, fortress balance sheets, and dominant competitive positions. Unlike the speculative, cash-burning ventures of 1999, today's AI buildout is funded overwhelmingly by operating cash flow rather than debt. By one widely cited comparison, the seven largest stocks trade at roughly 28 times forward earnings, rich but less than half the approximately 66 times commanded by the seven largest companies at the height of the dot-com mania.

And yet the scale of investment is staggering, and its returns remain unproven. The major hyperscalers are now expected to spend on the order of \$725 billion on AI infrastructure in 2026 alone, with one investment bank projecting some \$7.6 trillion of related capital spending across compute, data centers, and power between 2026 and 2031. AI-related investment is expected to account for roughly half of all S&P 500 earnings growth this year, a remarkable degree of dependence on a single theme. The same analysts warn that record corporate margins have been flattered by this spending wave, and that the return on equity of the seven largest technology names could fall by an average of 700 basis points next year as depreciation on all that hardware begins to bite.

History offers an instructive parallel. The late-1990s telecom buildout laid fiber-optic cable that ultimately created enormous value, but it did so after years of overcapacity that punished the early investors who financed it. AI may well prove transformative and still leave today's prices looking optimistic. The technology being real does not make the valuation safe.

## What Today's Prices Imply

Strip away the narrative and the numbers are sobering. The most reliable long-horizon valuation gauge, Robert Shiller's cyclically adjusted price-to-earnings ratio, divides the market's price by ten years of inflation-adjusted earnings to smooth out the boom-and-bust distortions of a simple one-year P/E. It currently sits near 41, more than double its long-term average of roughly 17, and approaching the all-time record of 44 set at the peak of the dot-com bubble. The only other comparable readings in nearly a century and a half of data cluster around 1929 and 1999, the very years the phrase “party like it's 1999” is meant to evoke.

This matters because the CAPE was designed to do one thing well: forecast long-run returns. The historical relationship is among the most robust in finance: high starting valuations have reliably preceded disappointing decade-long returns, and low valuations the opposite. At today's level, Shiller's own framework implies U.S. large-cap real returns of roughly 1% to 2% annualized over the coming decade. Other measures echo the warning: the ratio of total market value to GDP, the gauge Warren Buffett once called the best single measure of valuation, sits near its highest level in recorded history, more than twice the size of the economy that underpins it. No single metric is a timing tool, and each has its limitations. But when independent measures built on different inputs all reach the same conclusion, the signal is hard to dismiss: buying the broad U.S. index here means paying a price that has historically left little room for reward.

**~41**

Shiller CAPE ratio  
vs. ~17 long-term avg  
near dot-com record

**2 of 7**

Mag 7 names that beat  
the S&P in 2025  
leadership has shifted

**~70%**

of 2026 S&P gains  
from chips & memory  
(through mid-May)

**~1-2%**

implied U.S. large-cap  
real annual return  
next decade (CAPE)

## Concentration: The Hidden Bet Inside the Index

The most underappreciated risk in many portfolios is that the S&P 500 itself is no longer the diversified instrument investors imagine. Years of mega-cap dominance

left the Magnificent Seven (Apple, Microsoft, Alphabet, Amazon, Nvidia, Meta, and Tesla) at roughly a third of the index by weight, with the ten largest companies close to 38% and the information-technology sector alone near 35%. An investor who “diversifies” by holding 500 American stocks is, in practice, holding a portfolio shaped by a handful of names. That structural concentration is real, and it is the backdrop for everything that follows.

Here is the part that gets missed, though, because it runs against the headlines: those mega-cap leaders are no longer the ones driving the market. Since their peak last autumn, the Magnificent Seven as a group have actually underperformed, declining while the remaining 493 companies held roughly flat, and only two of the seven beat the index in 2025. Their combined weight has slipped from its high as investors began to question whether the enormous sums being poured into AI will earn an adequate return. The concentration risk did not go away when the leaders stalled. It simply moved.

## A New Regime: From the Mag 7 to the Picks and Shovels

Where the leadership went is the real story of this market, and it is a genuine regime change. The baton has passed from the famous mega-caps to a far narrower and more specialized cohort: the companies that build, power, connect, and cool the AI buildout rather than the household names that order it. This is the picks-and-shovels thesis we laid out in our first research paper on the AI gold rush, and it has only sharpened since. In a gold rush, the durable fortunes were made selling the picks and shovels, not panning for gold; today the equivalent is the AI infrastructure layer. By one estimate, semiconductor and memory stocks alone accounted for roughly 70% of the entire S&P 500's gains in the early months of 2026, and the leadership now runs through specialized semiconductors, the memory and storage supercycle, optical and photonics interconnect, data-center construction, and the electrical and cooling systems that keep these facilities running. The list goes on, but the common thread is narrow: a single capital-spending cycle.

Several of our holdings sit squarely in this group, which is no accident given the framework we have been working from. Arista Networks (ANET) supplies the high-speed networking that connects AI server clusters and has been growing revenue more than 30% a year. Broadcom (AVGO) designs the custom AI accelerators and networking silicon that the largest hyperscalers increasingly use in place of off-the-shelf chips. Comfort Systems (FIX) builds the mechanical and cooling systems inside those facilities, with a backlog that has roughly doubled. KLA Corporation (KLAC) makes the process-control equipment without which advanced chips cannot be manufactured, and Cummins (CMI) supplies the backup power generation that data centers increasingly depend on. These are real businesses with real earnings, and we are glad to own them. But we hold them with clear eyes: their fortunes are tethered to the same AI capital-spending cycle that now drives the index. Their strength is a feature of the very narrowness we are describing, not an exception to it. The leadership has changed hands, but it has not broadened; if anything, it has narrowed further.

Meanwhile, the rest of the market that investors think of as “working” largely is not. Only about 37% of the index's members have outpaced the benchmark over the past year, well below the historical norm of roughly half, and the equal-weighted S&P 500 has endured one of its worst stretches of relative underperformance in decades. Large parts of software, much of health care, and most of the economy outside the data-center buildout have been left behind even as the index prints new highs.

And there is a final twist that makes the present moment harder to read. Even as the AI infrastructure names have led, the most recent leg of the rally has been carried not by the highest-quality companies but by the lowest. Across the small-cap market, unprofitable companies have roughly doubled the returns of profitable ones, and a basket of money-losing firms has surged dramatically off its 2025 low. One prominent economist recently warned that something is broken in price discovery when companies with negative earnings consistently outrun those that actually earn money. So the market is being driven at the top by a narrow band of AI-infrastructure names and, beneath the surface, by the most speculative companies of all, with quality left in the middle. That combination, narrow leadership above and a dash for trash below, is the kind of behavior that has historically appeared late in a cycle rather than early, and it is exactly when the discipline of owning a broad, balanced portfolio matters most.

## The Three Pillars: Where We Stand

We filter all of this through our Three Pillars framework, which assesses the Economy, Monetary Policy, and Market Conditions and resolves them into a single read on how much risk a portfolio should be taking. The value of the framework in a moment like this is that it separates two questions investors tend to blur together: whether to be invested at all, and how to be invested. Here is where the pillars stand today.

| ECONOMY                                                                                                                           | MONETARY POLICY                                                                                                        | MARKET CONDITIONS                                                                                      |
|-----------------------------------------------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------|
| Constructive                                                                                                                      | Neutral                                                                                                                | Stretched                                                                                              |
| Late-cycle growth and tightening credit, offset by a roughly 6–7% fiscal impulse. Constructive on net, with fragility underneath. | Fed near neutral around 3.6%, inflation re-accelerating, and the market pricing essentially no rate cuts through 2027. | No near-term edge in the short-term signal, but long-term valuation at a rare Extreme (CAPE near 42x). |

**Master regime: Aggressive.** Strong market conditions override the late-cycle caution elsewhere, so the framework still says stay fully invested, but tilt the composition toward quality and free cash flow given how stretched long-term valuations have become.

That last line is the whole point, and it is worth sitting with. The framework is not telling us to retreat from equities; the stack resolves risk-on, and the cost of being out of a rising market is real. But it is telling us, emphatically, that this is not a moment to own the market indiscriminately. Two of the three pillars are flashing

caution, and the one carrying the regime, Market Conditions, is doing so on near-term momentum while its own long-term valuation reading sits at an extreme seen only a handful of times in a century. The instruction that falls out of that is not “sell,” it is “stay invested, but in the right things”: quality, durable free cash flow, and genuine diversification rather than a passive bet on the most expensive and most crowded corner of the market.

## Why Diversification Matters More Than Ever

None of this is a call to abandon equities or to attempt to time a top. Valuations are a poor short-term timing signal; expensive markets can grow more expensive for years, and exiting entirely is its own form of risk. The worst outcomes come from the extremes: either fleeing the market in fear or doubling down with leverage. The disciplined response to stretched valuations is not retreat but breadth.

The opportunity set outside U.S. large-caps looks meaningfully more attractive on price. International equities outpaced the S&P 500 by a wide margin in 2025 and have continued to draw support from a softer dollar and far lower valuations. The ten largest companies in the major international index represent only about 11% of it, versus roughly 38% domestically. Major institutions from Morgan Stanley to BlackRock have argued the coming decade favors global diversification, even as some houses still see U.S. leadership persisting. We do not need to predict which view prevails. We need only recognize that anchoring an entire portfolio to a single, historically expensive, highly concentrated market is a bet that no longer carries the margin of safety it once did.

Beyond geography, the most direct answer to a market being pushed higher by a narrow set of expensive leaders and a speculative fringe is a sleeve of assets that depends on neither. This is the role our Alternative Allocation is built to play. Rather than relying on bonds, it pairs global defensive and deep-value equity with managed-futures and trend-following strategies that tend to do their best work precisely when markets are under stress, an activist-catalyst manager, and a dedicated allocation to gold, which has repeatedly set record highs on central-bank buying. The purpose of the sleeve is not to chase the AI trade or to bet against it, but to give a portfolio genuine, independent sources of return when the leadership is this concentrated and this speculative. In the 2022 drawdown, that approach delivered a positive return while the broad market fell sharply, which is exactly the behavior we want from it in an environment like today's.

The case we are making is not dramatic, and that is rather the point. **When the largest, most expensive segment of the market also dominates the index that most investors hold, true diversification, across geographies, asset classes, and sources of return, stops being a matter of preference and becomes a matter of prudence.** The math on U.S. large-caps has grown demanding enough that the burden of proof now rests with optimism. In that environment, owning a broad and balanced portfolio is not a concession to caution. It is the most rational expression of humility about a future none of us can forecast.

## What This Means for Portfolios

None of this changes our core discipline; if anything, it sharpens it. Consistent with what the Three Pillars are telling us, we are staying fully invested rather than trying to time a top, while deliberately tilting the composition of that exposure. Within equities, we favor quality and durable free cash flow over the most expensive and most crowded names, which is why our holdings cluster in profitable, cash-generative businesses rather than the speculative fringe now leading the tape. Where we own the AI infrastructure beneficiaries, we own them for their fundamentals and size the positions with full awareness that they ride the same cycle as the index.

Around that equity core, we continue to broaden the sources of return. We maintain meaningful exposure outside U.S. large-caps, where valuations are more reasonable and concentration is far lower, and we lean on our Alternative Allocation to supply returns that do not depend on the AI trade continuing. The combination is intended to do something a passive index position cannot: participate in the upside if the bull market persists, while holding up considerably better if leadership narrows further or the speculative names that have run hardest give it all back. That is the balance the present environment calls for, and it is how we are positioned today.

As always, we remain constructive on the long-term power of markets and disciplined about the price we pay to participate in them. We would welcome the opportunity to review how your portfolio is positioned for the environment described above. Please do not hesitate to reach out with questions.

## GLR Partners

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