

Party Like It's 1999?

The Capital Ideas Fund was up +2.05%¹ in July, -1.55%¹ YTD and up +33.57%¹ over the last 12 months.

There has been a lot of media coverage and we've been getting questions about the comparisons between the dot com bubble and the current stock market, especially concerning Artificial Intelligence stocks and the overall market valuation. More interesting for us and our investors is the behavior of small caps during and after the dot com bubble, and what that means for the outlook going forward. So, let's jump back in time.

The year is 2000, the stock market has been ripping higher for years, led by companies tied to the rollout of both the internet and the cellular phone.

The internet is changing the world. Information is at our fingertips with Google, buying online is gaining steam with Amazon and information is in your hand with a Palm Pilot. Surging productivity is boosting profitability and economic output.

The impact on productivity was real. The growth of the economy was real. But human nature has a way of getting ahead of itself. The tech-heavy Nasdaq composite went up almost 600% from 1995 to 2000. What happened next would go down as one of the biggest "bubble bursts" in history.

There is an old adage that bull markets don't die of old age, they are killed by the Fed. The Federal Reserve raised interest rates six times between June 1999 and May 2000 to combat inflation. The bubble burst in March 2000 and worsened with additional negative events like the Enron bankruptcy in 2001, September 11th tragedy in 2001 and the Worldcom scandal in 2002. Over the next two and half years, the Nasdaq Index would fall close to 80% from the peak.

The internet was revolutionary. How the world operates today versus how business was done pre-internet is almost unrecognizable. But that doesn't mean you can pay any price for anything related to revolutionary technology.

Fast forward to today. The Artificial Intelligence narrative has many similarities to the Internet narrative, and rightfully so. It is already boosting productivity, improving lives, and generating significant growth and profitability for many companies. BUT, there are some important details to look at.

Let's use data to cut through the narrative. We have compared the largest 6 tech companies from the 1990s to the 6 largest tech companies today.² What you'll notice is that the revenue growth and earnings growth is eerily similar. More importantly, profit margins now are considerably higher, and valuations are high but much lower than 2000. Not cheap, but much lower. This is why we don't think we're near a peak like March 2000, plus the fact that interest rates are declining around the globe. The bull murdering Fed isn't at the doorstep.

Revenue Growth

	<u>1997</u>	<u>1998</u>	<u>1999</u>	<u>2000</u>
Cisco Systems	57%	31%	44%	56%
DELL	47%	59%	44%	38%
Microsoft	31%	34%	29%	16%
Intel	20%	5%	12%	15%
Oracle	35%	26%	24%	15%
IBM	3%	4%	7%	1%
Average	32%	27%	27%	23%

Revenue Growth

	<u>2023</u>	<u>2024</u>	<u>2025</u>	<u>2026E</u>
Amazon	12%	11%	10%	10%
Nvidia	0.2%	126%	114%	54%
Apple	8%	-3%	2%	4%
Meta	16%	22%	17%	15%
Microsoft	7%	16%	15%	13%
Alphabet	9%	14%	-4%	12%
Average	9%	31%	26%	18%

Earnings Growth

	<u>1997</u>	<u>1998</u>	<u>1999</u>	<u>2000</u>
Cisco Systems	12%	60%	60%	22%
DELL	107%	89%	61%	26%
Microsoft	56%	30%	74%	21%
Intel	35%	-13%	21%	44%
Oracle	36%	11%	59%	54%
IBM	20%	9%	40%	9%
Average	44%	31%	53%	29%

Earnings Growth

	<u>2023</u>	<u>2024</u>	<u>2025</u>	<u>2026E</u>
Amazon	54%	37%	43%	16%
Nvidia	-35%	364%	144%	50%
Apple	0.3%	10%	6%	7%
Meta	54%	40%	36%	22%
Microsoft	7%	21%	16%	12%
Alphabet	26%	29%	32%	12%
Average	18%	84%	46%	20%

EBITDA Margins

	<u>1997</u>	<u>1998</u>	<u>1999</u>	<u>2000</u>
Cisco Systems	37%	36%	31%	29%
DELL	5%	6%	8%	9%
Microsoft	48%	49%	55%	53%
Intel	48%	43%	48%	50%
Oracle	28%	24%	26%	34%
IBM	18%	17%	21%	19%
Average	31%	29%	32%	32%

EBITDA Margins

	<u>2023</u>	<u>2024</u>	<u>2025</u>	<u>2026E</u>
Amazon	17%	21%	23%	25%
Nvidia	32%	49%	56%	53%
Apple	33%	35%	34%	35%
Meta	50%	53%	50%	53%
Microsoft	50%	55%	60%	57%
Alphabet	32%	38%	50%	51%
Average	36%	42%	46%	46%

Average P/E

	<u>1997</u>	<u>1998</u>	<u>1999</u>	<u>2000</u>
Cisco Systems	44	47	85	122
DELL	22	35	86	51
Microsoft	51	58	163	128
Intel	27	22	79	216
Oracle	42	37	37	99
IBM	16	20	32	23
Average	34	37	80	107

Average P/E

	<u>2023</u>	<u>2024</u>	<u>2025</u>	<u>2026E</u>
Amazon	163	63	29	27
Nvidia	45	151	94	41
Apple	26	32	29	27
Meta	23	24	24	23
Microsoft	29	39	36	35
Alphabet	24	27	18	17
Average	52	56	38	28

Today's biggest tech stocks are great companies. Higher margin, sitting on a ton of cash, and trading on high valuations, but they are still much cheaper than the dot com peak.

What to worry about is the combination of valuation and disruption.

The AI landscape literally changes everyday. If you follow the daily developments, there are LLMs (large language models) leap frogging to the top of the leaderboard continually. The day over day innovation is astounding. It seems like small, medium, and large companies are in hyperdrive and progressing tech innovation at a heightened pace. The point being, will the leaders of today be the leaders in 5 or 10 years? Paying 38 times earnings does imply a lot of staying power and forward growth, meaning investors are taking on a good amount of valuation risk.

Small vs. Large

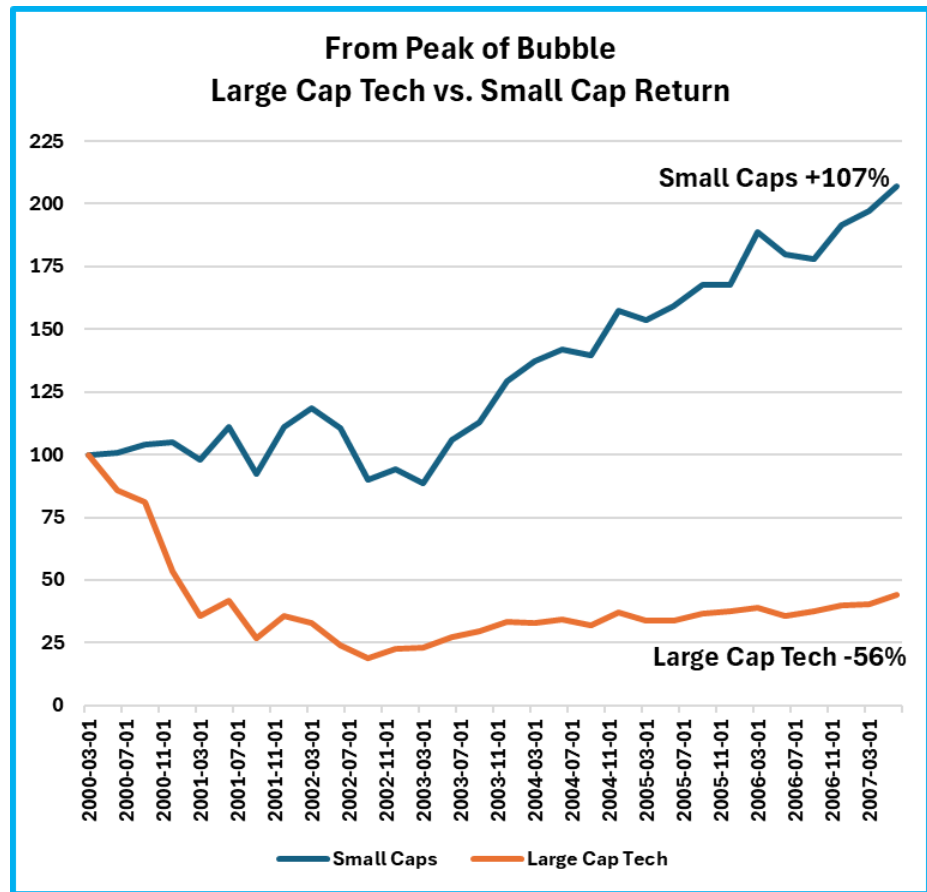
Context and history are important, especially with the amount of hyperbole used in the media, but the main point for writing this piece was not to compare the likes of Oracle in 2000 to Amazon today. The catalyst for this topic stems from Morgan Stanley's July 7th, 2025 report *Missing the Forest-and the Trees?*³

*In our view, the proliferation of new equity investment instruments has encouraged short-termism and weakened investor insight into benchmarks and their diverse, individual components. We believe significant value can be added by investing in differentiated and durable companies. **Historically, this quality approach to small-cap investing has delivered attractive risk-adjusted returns, and we believe today's current valuations point to a compelling, possibly generational, opportunity.** – Morgan Stanley, July 7, 2025*



Let's take a look at the first red arrow in the chart above⁴ and put ourselves in the shoes of the investor in the late 90's. The sexy internet stocks get all the news headlines and end up being over-owned by investors while the small caps are shunned. Investors get ahead of themselves and chase returns.

We're seeing the same scenario play out today. The valuations of large caps versus small caps are now back to the extremes last seen in 2000. The narrative being that the value and growth going forward comes from large caps, with a majority of that tied to AI. However, this narrative doesn't take into account disruption and what type of growth is needed to support these valuations. Just like the late 1990's and early 2000's, the small caps get shunned and large caps get all the attention. The lesson being what happened after March 2000.



From the peak in March 2000, large-cap tech stocks would decline over 80%, at the same time small caps declined 10% and would go on to return over 100% while large cap tech struggled.⁵ From the dot com peak in 2000, small caps would be up +107% over the next 7 years while tech stocks returned negative -46%.⁵ This isn't how many investors remember this time in the market and isn't probably how they're thinking about the outlook going forward but valuations and disruption matter.

Small companies can't be bunched together. Some small companies used to be bigger companies and are declining. Some small companies provide niche products and will never grow into big companies. But some small companies are growing quickly and take market share from larger companies.

For example, Nvidia, Adobe and AMD were small caps in 1999. They proved to be extremely disruptive and have grown into some of the largest companies in the world today. There are many other profitable small caps from the 90's that have performed extremely well, including Copart, Waste Connections, Toro Company, Fastenal, and Cintas. These companies were \$200M, \$300M, \$1B, \$1.5B, and \$2B small caps. They are now \$45B, \$48B, \$7B, \$54B, and \$90B companies. Compared to companies like Cisco and Intel that are still worth less today than they were in 2000.

This valuation disconnect is why we like the outlook for the next few years. At the previous lows, like now, all the talk was about the best largest companies. Nothing else mattered. Then small caps would bottom and go into multi-year bull runs. Small caps are unloved now, but you get a lot of downside protection when these stocks are this cheap.

We're obviously investing according to this strategy. We don't own the largest companies in the world as we don't have any significant insight or edge in those markets. We stay focused where we can provide value to our shareholders and provide diversification from the largest ETFs and stocks out there.

The main counterpoint is that most small caps don't have the growth, profitability, or balance sheets of these large companies. However, there are enough smaller companies where you can build a portfolio with more growth, and more profitability at much cheaper prices. That in and of itself is enough to want to diversify there.

Final Thoughts

There are similarities between now and the dot com bubble but also significant differences. With rates falling, companies having higher margins and trading at cheaper valuations, the AI boom still has room to run. As of now, AI investments are accelerating, not declining. The risk being, if the ROI on those AI investments doesn't pan out, then the current valuations won't make sense.

That being said, we continue to stick to our expertise in finding up and coming compounders. Currently, there are many high growth, highly profitable, small companies that trade at very attractive valuations. As evidenced by the large vs small valuation difference noted above, we think small companies have both upside from here and protection to the downside based on how cheap they are. Many investors would benefit from diversifying their exposure and taking a lot less valuation risk.

We are encouraged by the strong results we have seen from our investment companies up to this point. Our next monthly commentary will focus on Q2 earnings with most companies reporting in the first few weeks of August. These summaries and reviews will provide some great examples of small caps that are growing faster, with higher profit margins, and trading at much cheaper valuations than large caps.

Sincerely,

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The S&P/TSX Composite Total Return Index, the S&P 500 Total Return Index, and the Russell 2000 Total Return Index ("the indexes") are similar to the DKAM Capital Ideas Fund LP ("the fund") in that all include publicly traded North American equities of various market capitalizations across several industries, and reflect both movements in the stock prices as well as reinvestment of dividend income. However, there are several differences between the fund and the indexes, as the fund can invest both long and short, can utilize leverage, can take concentrated positions in single equities, and may invest in companies that have smaller market capitalizations than those that are included in the indexes. In addition, the indexes do not include any fees or expenses whereas the fund data presented is net of all fees and expenses. The source of the indexes' data is Bloomberg.

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¹ Time weighted return, net of fees and expenses

² 2026 estimates based off internal DKAM estimates

³ Article can be found at, <https://www.morganstanley.com/im/en-us/individual-investor/insights/articles/missing-the-forest-and-the-trees.html>

⁴ Profitability of companies based on companies with positive expected earnings. Large-cap stocks are the largest 750 U.S. publicly-traded companies. Small-cap stocks are the next 2000 companies in market capitalization.

⁵ Small caps are S&P 600, Large Tech Cap is Nasdaq Composite