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MAGAZINE



Investment Insights



DECEMBER 2025

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FROM THE EDITOR



Dear readers,

Welcome to our final edition of **Best of the Best** for 2025.

Time to move out from the shade.

While we can never identify a bubble with absolute certainty until it bursts, the "shadow" cast by artificial intelligence (AI) suggests shifting returns in 2026. Some classic signs of a peak include debt-fuelled infrastructure spending, extreme valuations, and the infamous "TIME Magazine Cover Curse" – this year featuring 'The Architects of AI'.

The economics of today's AI boom are precarious. Unlike the high-margin software as a service (SaaS) era, AI carries high physical costs. A generative AI response costs up to US\$0.02, roughly 400 times the cost of a standard Google search. Meanwhile, valuations have detached from reality; Nvidia trades at 77 times revenue, and CoreWeave holds over US\$10 billion in graphics processing unit (GPU) backed debt.

History warns that when structural dreams meet cyclical realities, volatility follows. With the S&P 500's price-to-earnings (P/E) ratio at 22.75, many anticipate low single-digit or even negative average annual returns over the next decade.

The prudent move is not to exit the market, but to rebalance. Investors should consider rebalancing into alternative assets with nil correlation to the S&P 500, such as the market-neutral arbitrage funds or high-grade private credit funds.

To discuss rebalancing into funds that Montgomery Investment Management offer, please call David Buckland or Rhodri Taylor on (02) 8046 5000.

Roger Montgomery

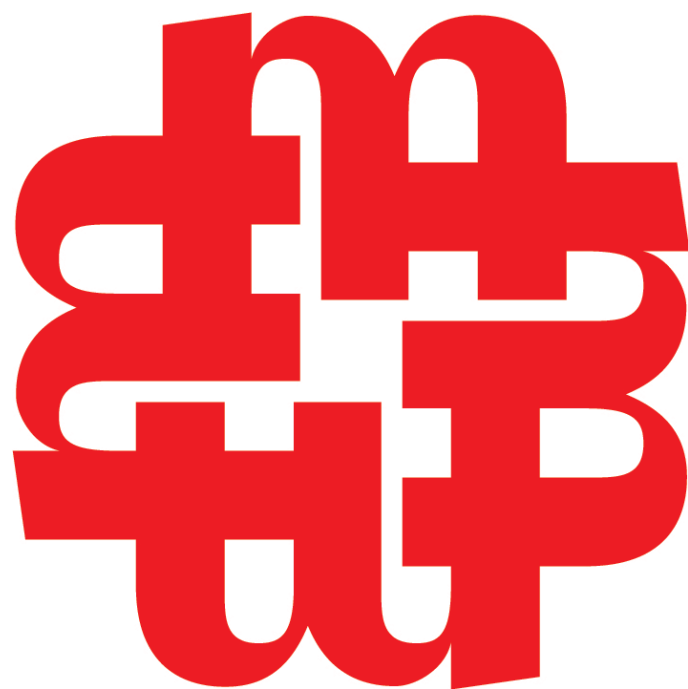
Founder and Chairman of Montgomery Investment Management.





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Hidden in the sands – Iluka's rare earth revival



In this article Sean Sequeira, Chief Investment Officer of Australian Eagle, explains why Iluka is undervalued, pointing to hidden assets, low risk rare earths growth, and upcoming projects that could drive a market re rating.

At face value, Iluka Resources (ASX:ILU) is best known as a mineral sands producer. However, the market continues to undervalue the hidden strategic and financial assets embedded across its diversified portfolio. With a current market capitalisation of over A\$3 billion, Iluka trades below the implied value of its tangible holdings alone – ~A\$1 billion in mineral sands inventory, ~A\$1.3 billion in rare earths concentrate feedstock (potentially greater than A\$2 billion Net Present Value (NPV)) and a A\$450 million equity stake in Deterra Royalties (ASX:DRR) – therefore ascribing very little value to the core mineral sands business.

The real catalyst for re-rating lies in Iluka's development of its vertically integrated rare earths business. The flagship Eneabba refinery – currently under construction – will be Australia's first fully integrated rare earths processing facility, capable of producing separated light and heavy rare earth oxides. Backed by a A\$1.65 billion non-recourse loan from the Australian Government, Iluka's only financial contribution is A\$414 million in cash – accompanied by A\$1.3 billion rare earths feedstock. This structure means that Iluka bears very little risk in the construction of this asset. Slated to be operational by 2027, Eneabba will serve as a critical Western-aligned processing hub at a time when many countries are actively seeking to reduce reliance on Chinese-controlled supply chains.

Strategic tailwinds are also building. The U.S. Department of Defence recently struck a deal with MP Materials that effectively sets a premium floor price (US\$110/kg) for Western-produced Neodymium-praseodymium (NdPr) – a crucial rare earth allow input in permanent magnets. Iluka is well-positioned to command a similar premium, especially as government interest in rare earth sovereignty increases. Australia is now considering the creation of a domestic strategic reserve in rare earths, further enhancing the potential for favourable offtake pricing and volume security.

Meanwhile, Iluka's mineral sands business remains robust despite external headwinds. Commissioning of the high-grade, long-life Balranald mine in the second half of 2025 will deliver a new wave of zircon, rutile and synthetic rutile supply. Mineral sands inventory already on balance sheet (~A\$1 billion) provides an additional buffer and monetisation lever, especially as commodity prices bottom. The company's position in Deterra Royalties also continues to generate cashflow and exposure to high-margin iron ore royalties without operational risk. The investment team views Iluka Resources as a rare mix of mispriced assets and asymmetric upside optionality. As commissioning of Balranald and Eneabba draws closer and pricing dynamics shift in favour of Western-aligned supply, we expect Iluka to re-rate – both on a sum-of-the-parts basis and through improving earnings visibility. The Australian Eagle investment process involves recognising change and inflection in company operations and this resulted in Iluka moving from a short position to a long position.

Disclaimer:

The Montgomery Fund, Montgomery [Private] Fund, and the Australian Eagle Equities Fund own shares Iluka Resources. This article was prepared 20 October 2025 with the information we have today, and our view may change. It does not constitute formal advice or professional investment advice. If you wish to trade this company, you should seek financial advice.



Why the AI dream could turn into a market nightmare in 2026



In this article Roger Montgomery, Founder and Chairman of Montgomery Investment Management, examines the AI boom, arguing rising costs and fading liquidity could test expectations and drive greater market volatility as investors look ahead to 2026.

At the outset, let me state unequivocally that no one knows whether the equity market will crash. The fact is, we can't even definitely identify a bubble until after its demise, which therefore means we cannot know for certain if we are in one.

With that caveat out of the way, I am reasonably confident we should expect greater volatility and lower returns in 2026. Let me explain why I think that's a reasonable assessment.

Since 2022, I have suggested that investors maintain a bullish disposition.

In January I said that I had hitched my wagon to the bullish camp since 2022 and that as 2025 progressed – provided the prospects for deflation, economic growth, earnings growth and supportive liquidity were positive – the underlying narrative would be one of a durable bull market.

It's panned out well, so far, but I fear changes are afoot.

Support from positive economic growth, disinflation and expanding liquidity can no longer be assured, and that's because inflation is not declining much, if at all, economic growth is slowing (the majority of U.S. growth can be attributed to the construction of data centres), and global liquidity growth is also slowing.

Consequently, the volatility we saw a little of this year could be more pronounced in 2026.

Moreover, with three years of very solid returns under our belt, valuations have risen to the point that future returns are expected to be lower over the next few years. If they are positive, American economist Robert Shiller expects they will amount to the low single digits for the S&P 500.

We're living and investing during one of those infrequent episodes called a thematic boom. This time, the theme is artificial intelligence (AI). What is less well known is that the AI boom is merely a manifestation of abundant liquidity. When there's plenty of money floating around – due to central bank largesse – that money needs a home. If the period of abundant money coincides with the emergence of a new general-purpose technology (GPT), money will converge on the companies that benefit from the scale and sale of that technology. As they rise in market value, they begin to dominate not just the narrative but also the market indices.

And that's what we have seen for the past few years. Excessive liquidity found a home in AI stocks, driving prices higher and culminating in Nvidia's market capitalisation reaching US\$5 trillion (\$7.6 trillion), despite the company's forecast 2026 revenue amounting to US\$65 billion, or just 1/77th of its market cap.

We could experience heightened volatility and lower returns in 2026 because a little bit of mania has crept into markets.

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But investors need to recognise that the business of AI is fundamentally different from the high unit profitability of the software businesses we've invested in since 2010. Software as a Service (SaaS) businesses enjoy very high margins – up to 85 per cent because the software is written once and sold infinitely.

Why AI is different

AI, however, is different. Delivering AI-generated outputs introduces a physical cost to every digital interaction.

For most of us, apps such as ChatGPT, Grok, Claude, Gemini and Replit deliver a polished experience that makes us feel that AI is an elegant, easily accessible tool that improves productivity and generates new opportunities.

Under the hood, however, what's required are multibillion-dollar models, trained on thousands of graphic processing units (GPUs) (each built on US\$250 million Extreme Ultraviolet lithography scanners) housed in multibillion-dollar data centres that require city-sized electricity supplies and, locally at least, an estimated 20 per cent of Sydney's water supply.

And after all the investment, providing the output also costs the AI company money.

It's estimated that a single ChatGPT query uses 10-15 times more energy than a traditional Google search. And while a Google search costs Alphabet roughly US0.003c, a generative AI response can cost upwards of US1c-US2c. It might not seem much, but that's a 300 to 400-fold increase in marginal operating costs.

On the subject of energy, and by way of example, OpenAI's Sam Altman has said his "audacious long-term goal is to build 250 gigawatts of capacity by 2033". To put that in perspective, that's more than India's entire peak power demand in 2025. India has almost 300 million households and is the world's fourth-largest economy.

To manage this, Truthdig estimates OpenAI would need to purchase 30 million GPUs a year, and run them 24/7, 365 days a year. That would cause faster burnout, requiring more frequent replacements and upgrades.

To meet those requirements, OpenAI would need the world's 10 most advanced fabricators to operate around the clock all year, every year, demanding levels of energy that would squeeze the industry and drive up prices by reducing availability. And that says nothing of the price and reduced access to clean supplies of water, which would have adverse long-term societal and health implications.

Stock markets tend to cast their shadow before them, meaning investors will exit before the rubber hits the road, and 2025's AI dream could quickly turn into a 2026 nightmare.

For all of those reasons I suspect 2026 will look a little different to 2023, 2024 and 2025: Lower returns with more volatility.

This article was written on 04 December 2025. All prices and movements are on this date.



Rates reset across the West



In this article David Buckland, Chief Executive Officer of Montgomery Investment Management, talks about global interest rate cuts, comparing six Western economies, inflation and labour trends, and how these statistics may signal broader economic conditions in 2026.

Back in October, I examined the emerging trend of interest rate cuts across the Western world, looking at why they were occurring and how different economies were responding. Since then, rate cuts have continued in several countries. In this update, I return to the same six economies (Australia, the U.S., the UK, Europe, Canada, and New Zealand), incorporating more recent inflation expectations and labour-market data to assess what these developments may signal for 2026.

I have tabled the cash rate movements from the Central Banks of these six Western World economies, accompanied by some brief economic observations.

Australia

Cash rate (%)	
Peak	4.35
February 2025	4.10
May 2025	3.85
August 2025	3.60
Difference	-0.75

Australia has cut its cash rate on three occasions between February 2025 and August 2025 from 4.35 per cent to 3.60 per cent. With the latest inflation data running at an annual rate of 3.8 per cent, Reserve Bank of Australia (RBA) Governor, Michele Bullock, will need to rethink further interest rate cuts if inflation continues to remain sticky. In November the Australian unemployment rate, which has been in a gentle uptrend from 3.5 per cent in mid-2022, was 4.3 per cent.

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United States

Cash rate (%)	
Peak	5.50
September 2024	5.00
November 2024	4.75
December 2024	4.50
September 2025	4.25
October 2025	4.00
December 2025	3.75
Difference	-1.75

The U.S. has cut its cash rate on six occasions from 5.50 per cent to 3.75 per cent over the 15 months to December 2025. U.S. short-term inflationary expectations remain elevated with consumer prices increasing by 3.0 per cent, whilst the unemployment rate stands at 4.4 per cent, the highest level since October 2021. That said, some of this data is lagging given the government shutdown. The market is also somewhat anxious over Jerome Powell's successor, as Governor of the U.S. Federal Reserve, in May 2026.

United Kingdom

Cash rate (%)	
Peak	5.25
August 2024	5.00
November 2024	4.75
February 2025	4.50
May 2025	4.25
August 2025	4.00
Difference	-1.25

The UK has cut its cash rate on five occasions from 5.25 per cent to 4.0 per cent over the 12-months to August 2025. UK inflation was running at 3.6 per cent in the year to October 2025, and while it is coming down it remains the highest rate of the G7 (US, Canada, France, Germany, Italy, Japan, the UK) economies. The UK unemployment rate sits at 5.0 per cent, the highest level since July 2021.

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Europe

Cash rate (%)	
Peak	4.50
June 2024	4.25
September 2024	3.65
October 2024	3.40
December 2024	3.15
January 2025	2.90
March 2025	2.65
April 2025	2.40
June 2025	2.15
Difference	-2.35

The Eurozone has cut its cash rate on eight occasions from 4.50 per cent to 2.15 per cent over the 12-months to June 2025. The region's economy appears to be under stress with the annual inflation rate sitting at 2.2 per cent in November 2025, whilst the most recent unemployment rate sits at 6.3 per cent. Spain (10.4 per cent), Finland (10.0 per cent), Sweden (8.8 per cent) and France (7.6 per cent) are the stand outs amongst the more developed economies.

Canada

Cash rate (%)	
Peak	5.00
June 2024	4.75
July 2024	4.50
October 2024	3.75
December 2024	3.25
January 2025	3.00
March 2025	2.75
September 2025	2.50
November 2025	2.25
Difference	-2.75

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Canada has also cut its cash rate on eight occasions, from 5.0 per cent to 2.25 per cent over the 18-months to December 2025. The inflation rate was 2.2 per cent in October 2025, whilst the unemployment rate at 6.5 per cent in November 2025, was down from the nine-year high of 7.1 per cent in September 2025.

New Zealand

Cash rate (%)	
Peak	5.50
August 2024	5.25
October 2024	4.75
November 2024	4.25
February 2025	3.75
April 2025	3.50
August 2025	3.00
October 2025	2.50
November 2025	2.25
Difference	-3.25

New Zealand has cut its cash rate on eight occasions from 5.50 per cent to 2.25 per cent over the 16-months to November 2025. The annual inflation rate hit 3.0 per cent in the September 2025 Quarter, up from 2.2 per cent in the September Quarter 2024. The unemployment rate in the September 2025 Quarter was 5.3 per cent, a five-year high.

What does it all mean?

The six economies have, over the past 15-18 months, seen an average of six interest rate cuts (ranging from 3 in Australia to 8 in the Eurozone and Canada). The average cut across these six economies has been 2.0 per cent (ranging from 3.25 in New Zealand to 0.75 per cent in Australia) from an average peak of 5.0 per cent to a current average cash rate of 3.0 per cent. And in percentage terms, that is a 40 per cent reduction.

The impact has varied greatly. For example, Europe, Canada, New Zealand appear to be the three weaker economies with unemployment running at 6.3 per cent, 6.5 per cent and 5.3 per cent, respectively. Europe has cut its cash rate from 4.50 per cent to 2.15 per cent, Canada has cut from 5.0 per cent to 2.25 per cent and New Zealand has cut from 5.5 per cent to 2.25 per cent.

In contrast Australia and the U.S. have remained more resilient, supported by relatively lower unemployment but grappling with stickier inflation.

With inflation averaging around 3.0 per cent across these six economies (with a range of 3.8 per cent to 2.2 per cent), the one highlight is that we have noticed inflationary expectations have crept up a little in recent months.

For 2026, we expect cash rates to come down a little further in Australia (3.6 per cent), the U.S. (3.75 per cent) and the UK (4.0 per cent), with the unemployment rate continuing to trend up, and the rates of inflation declining modestly.

Read Part One here: [Rates reset across the West.](#)

This article was written on 12 December 2025. All prices and movements are on this date.



From bullish to cautious – Why 2026 may bring lower returns and higher volatility



Roger Montgomery, Founder and Chairman of Montgomery Investment Management, discusses why elevated valuations, sticky inflation and artificial intelligence (AI) mania point to higher volatility in 2026. Perhaps investors should consider rebalancing a portion of their portfolios into market neutral strategies.

Let's state the obvious right at the outset: No one knows for certain if the equity market will crash.

The reality of investing is that we can rarely identify a bubble until after it has burst, which means we can never be sure when we are inside one. However, with that necessary disclaimer in place, I am reasonably confident that investors should prepare for a shift in 2026.

That's because, while the last few years have been kind to bulls, I currently expect greater volatility and lower returns in 2026.

There's a number of reasons for a shift from the unbridled bullish disposition we have held since 2022.

Back in 2022, I "hitched my wagon to the bullish camp" on the back of two basic premises. The first was that disinflation, economic growth and liquidity would support a bull market, just as those factors have every time they have converged since the 1970s. The second reason was simple arithmetic; with price-to-earnings (P/E) ratios at near historic lows in 2022, and investor could earn a return equal to the earnings-per-share (EPS) growth rate of the companies they purchased, even if the stock market never gained in popularity again. All an investor had to do, was hold on.

Today, an investor could also earn, over the next five years, the EPS growth rate of the companies they pick, but the stock market would also need to remain very, very popular, as it is today.

The price-to-earnings (P/E) ratio is a measure of the stock market's popularity. If you buy when P/E ratios are broadly low, as they were in 2022, you can assume the stock market will gain popularity again sometime in the future, and as the P/E ratios expand, you'll earn a return that is even better the earnings-per-share (EPS) growth rate of the company you have invested in.

But if you buy when the P/E ratio is extremely high – when the stock market is extremely popular – you run the risk of it becoming less so in the future. That will eat into your returns.

Remembering the aphorism, 'the higher the price you pay, the lower your return', it's reasonable to expect lower returns for the broad index from here.

Since 2022, our thesis has played out well. But now the supportive pillars of that narrative are beginning to crack.

First, the requirement for disinflation. Inflation is sticky. It isn't declining much, if at all.

Second, economic growth is slowing. And under the surface of the U.S. economy, a majority of growth can be attributed specifically to the construction of data centres.

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Third, liquidity is drying up. Global liquidity growth is slowing and even after a bump last week, it remains below the all time highs. That might explain why the Federal Reserve (the Fed) has commenced Quantitative Easing (QE) again.

Finally, precisely because we've had three years of solid returns, valuations are now elevated. As Robert Shiller suggests, from these valuation levels, future returns for the S&P 500 are expected to be in the low single digits.

For index investors, are low single-digit returns enough to justify the risk of being 'all in'?

A little bit of mania

Unless you've had your head in the sand, you can't have missed the latest investment hype surrounding the artificial intelligence (AI) theme. Thematic booms come and go, and while their birth is always attributable to ample liquidity – when central banks provide excess money, it needs to find a home/theme – they can create a life of their own when the theme is perceived to be 'structural'. When that coincides with a new general-purpose technology (GPT), capital converges on the companies that sell that tech.

Today's AI boom is undoubtedly perceived as structural. The problem with such perceptions is that they eventually run up against the realities of a cyclical customer and a business cycle. Developing datacentres will be met with opposition about their location, the impact on energy prices and their use of precious water resources. And customers may not have the dollars to be able to buy enough AI tools to generate a decent return on the AI capital expenditure (capex) being committed to by the AI hyperscalers.

We see this clearly in Nvidia, where its market capitalisation reached US\$5 trillion, despite forecasts for 2026 revenue just US\$65 billion – that's a market valuation 77 times revenue.

And the hype is spreading. Take prediction market companies – those e-businesses that allow people to bet on absolutely anything. For the last six years, a betting market company called Kalshi grew slowly, raising just US\$100 million. But since June, the U.S. company's valuation has increased 450 per cent, as it raised US\$1 billion in early December, valuing the company at US\$11 billion.

Elsewhere, Anthropic, the company behind the Claude Large Language Model (LLM), completed a funding round that valued it at US\$183 billion. That doesn't seem unusual, except that the valuation, struck in September, is three times higher than its valuation of US\$61.5 billion six months earlier.

And OpenAI, the company that birthed LLMs now has a half a trillion U.S. dollar valuation even though it will incur a loss of US\$9 billion this year, and the losses are projected to grow to an annual loss of US\$74 billion by 2028.

Did someone say, 'other people's money'?

The little bit of mania that has crept into the markets, has created a disconnect that is the primary driver for the volatility I foresee in 2026.

The unit economics problem: AI is not SaaS

Investors need to recognise a fundamental difference between the tech darlings of the last decade and the artificial intelligence (AI) giants of today.

Since 2010, investors have loved Software as a Service (SaaS) businesses. SaaS businesses enjoy massive margins (up to 90 per cent) because code is written once and sold infinitely. AI is not SaaS. Delivering AI-generated outputs introduces a tangible, physical cost to every single interaction. While apps like ChatGPT, Grok, or Gemini feel like elegant software, under the hood, they require multi-billion-dollar models, thousands of Graphic Processing Units (GPUs) (built on US\$250 million Extreme Ultraviolet (EUV) scanners), and massive data centres requiring city – or even country – sized power supplies, and significant water consumption (locally estimated at 20 per cent of Sydney's water supply).

And then there's the marginal cost of supplying each answer to a prompt. The financial difference that results is staggering. A standard Google search reportedly costs Alphabet roughly US\$0.00003. A generative AI response, however, costs upwards of US\$0.01 to \$0.02. That's a 300 to 400-fold increase in marginal operating costs.

The real world

Beyond the financials, there are the physical constraints.

OpenAI's Sam Altman has stated his "audacious long-term goal" is to build 250 gigawatts of capacity by 2033. To put that into perspective, that's reportedly more than the entire peak power demand of India in 2025 – the world's fourth-largest economy with nearly 300 million households.

To achieve this, news site Truthdig estimates OpenAI would need to purchase 30 million GPUs a year, run them 24/7, 365 days a year, and utilise the world's 10 most advanced fabricators around the clock, forever, to make them.

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Of course, running hardware this hard will burn out the GPUs, requiring more frequent replacement. This level of energy and manufacturing demand would squeeze the industry, drive up prices, and strain clean water supplies.

It's just hard to imagine it working out without speed bumps along the way. Those speed bumps are the source of my predicted volatility.

Stock markets tend to "cast their shadow before them", meaning investors will exit long before the problems arise.

For all these reasons, I suspect the easy ride is over. 2026 will look very different from the last three years. I am not saying there will definitely be a crash. But I am saying it's reasonable to expect lower returns from here with the possibility of a little more turbulence thrown in.

So what?

The worst thing to do is to sell up and run for the hills. That's an immature approach to investing. It is wiser to think about your allocations. What percentage of your wealth do you want in the stock market? What percentage in property? In cash? In income-producing assets such as Private Credit (with no property development exposure of course!). What about alternatives?

Each year you should rebalance back to those proportions that reflect your risk profile and financial needs.

Three years of solid stock market gains could mean your allocation to equities is higher than the original settings. Going back means rebalancing some profits to other asset classes.

And to properly diversify, rebalance towards asset classes or funds with very low correlations to the stock market from which you've just harvested some profits.

For more information about rebalancing into a Private Credit fund, visit our [Private Credit webpage here](#) or call David Buckland or Rhodri Taylor on (02) 8046 5000.

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