



Fourth Quarter 2026 Commentary

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When Capital Cycles Become Financial Cycles

Earlier this year, the Sierra Ridge Investment Committee examined a question that has become increasingly important for investors: are semiconductor valuations being supported by the economic returns ultimately generated on the enormous amounts of capital flowing into artificial intelligence?

Our research reviewed the relationship between valuation and return on invested capital across six of the largest semiconductor companies from 2015 through 2024. The results did not show a clear relationship between the P/E multiples investors were willing to pay and the ROIC these businesses produced. We concluded that large technology investments often require substantial time to earn an acceptable return—and in some instances may never become sufficiently profitable to justify the capital committed.

That analysis was primarily focused on valuation and capital efficiency. A recent Economist briefing on Nvidia adds another dimension to the discussion: the financing structure supporting the AI capital cycle itself.

The article describes Nvidia as increasingly functioning not simply as a semiconductor supplier, but as a source of financial support for the broader AI ecosystem. Nvidia has made substantial equity investments in AI businesses while also providing customer guarantees, purchase commitments and other forms of financial backing intended to help data-center and “neocloud” operators obtain financing and expand capacity. In some cases, according to The Economist, Nvidia has agreed to purchase unused computing capacity or provide residual-value support associated with equipment financing.

These policies can accelerate investment. They can also make the underlying economics more difficult to evaluate.

The Economist briefing walks the reader through a hypothetical financing scenario. Nvidia can invest in or support a company that raises capital to construct a data center. That company purchases Nvidia processors, generating revenue for Nvidia. Strong reported demand supports expectations for additional investment, which can attract still more capital into the ecosystem. None of this implies the demand is artificial. Rather, the important question is how much of that demand ultimately rests upon profitable end-user consumption and how much depends upon continued access to capital.

That distinction directly reinforces Sierra Ridge's earlier ROIC work. Our research cautioned that investors appeared willing, in some instances, to assign substantial valuations without a correspondingly clear relationship to realized returns on invested capital. The Economist effectively moves the analysis one step further: if returns on AI infrastructure ultimately disappoint, the consequences may extend beyond the companies that built the capacity to parties that financed, guaranteed or otherwise supported it.



History provides an instructive—but importantly imperfect—analogy.

Enron is a spectacular example of how esoteric off-balance sheet financing can increase risk at exactly the wrong time. While Enron's circumstances were fundamentally different than Nvidia's reported agreements: the SEC found that its special-purpose entities were used improperly to conceal debt and manipulate reported earnings, including transactions that materially understated Enron's indebtedness. Nothing in The Economist article suggests Nvidia is engaging in comparable accounting misconduct. Likewise, our investment committee is more focused on the potential implications of small changes in demand for semiconductors given the growing use of dealer financing being used across the industry.

The useful parallel is instead about economic exposure.

In both situations, understanding the company's risk required looking beyond ordinary reported borrowings and asking what obligations could migrate back toward the company under adverse conditions. For Nvidia, the relevant exposures described by The Economist include guarantees, capacity commitments, investments and residual-value support. They may not behave like conventional debt during normal conditions, but their economic significance could increase at precisely the point when customers encounter stress.

This matters because several risks could become correlated. If AI utilization disappoints, weaker data-center operators could experience declining revenues. At the same time, excess computing capacity could reduce rental prices, while rapid product cycles could reduce the resale value of older GPUs. Financing could then become more difficult just as collateral values weaken. Nvidia's customer support commitments could consequently become more valuable to counterparties—and potentially more costly to Nvidia.

The lesson is not that today's AI ecosystem is another bubble. It is that financial innovation does not eliminate economic risk; it can redistribute it and sometimes make its location less obvious.

That is why Sierra Ridge's original focus on ROIC remains important. Rapid revenue growth can demonstrate extraordinary demand, but revenue alone does not establish that the capital producing it is earning an adequate return. And when suppliers increasingly participate in financing the customers generating that demand, investors should consider not only how much revenue is being created, but also who supplied the capital, who bears the residual risk and what happens if expected returns fail to materialize.

The Economist article therefore builds upon the Sierra Ridge Investment Committee's earlier research. It provides an additional piece of corroborating evidence for the same analytical framework: in periods of extraordinary enthusiasm, disciplined investors should follow the capital—not merely the growth narrative.