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ELM RIDGE

“The New New New Thing, or AI from the Old Guy”

Third Quarter Report • September 30, 2025

“Graham and Dodd investors are people who place a very high value on having the last laugh. In exchange for the privilege, they have missed out on a lot of laughs in between.”

– Michael Lewis, *The New New Thing*, 2000.

ELM RIDGE	3RD QUARTER	2025	2024	2023	2022	INCEPTION-TO-DATE ANNUALIZED
NET PERFORMANCE	2.8%	1.4%	-5.6%	-15.4%	48.6%	5.5%
GROSS LONG CONTRIBUTION	7%	9%	1%	7%	15%	11%
GROSS SHORT CONTRIBUTION	-4%	-7%	-6%	-21%	25%	-5%
S&P 500	8.1%	14.8%	25.0%	26.3%	-18.1%	8.0%

“While we’ll probably still be dumb the next time we write...”

–Us, 3 months ago

“What he said.”

–Us, today

While we didn’t keep pace with the market, we made it through the summer doldrums – when individual investors have a greater impact on trading¹ – relatively unscathed. And to rehash and finish the quote we left with you with last time, “we think the risk of playing along to look smarter is just too high... and conversely, we think the return for holding out will be way worth it.”

The New New New Thing

“A computer once beat me at chess, but it was no match for me at kick boxing”

–Gary Kasparov

“You can’t teach an old dog new tricks — but he can tell you how it was done in his day.”

–Unknown

¹ So says ChatGPT, our arbiter of all things factual.

We've been quoting Michael Lewis' *The New New Thing*, written during the dot-com boom, for some 25 years now and we would guess *The New New New Thing*, about the AI craze, is likely in the offing for his fourth book on market excesses.²

"The artificial intelligence (AI) revolution has become one of the defining themes in financial markets today. Investors, companies, and policymakers alike view AI as transformative technology that could reshape entire industries, much like the internet did in the 1990s. Stock valuations of AI-related firms have surged dramatically, led by chipmakers, software companies, and startups promising to harness the power of machine learning. While AI is undeniably groundbreaking, the magnitude and speed of market enthusiasm have drawn frequent comparisons to the internet bubble of the late 1990s and early 2000s. Both periods share striking similarities: a genuine technological breakthrough, investor euphoria leading to soaring valuations, and the tendency for speculation to outrun reality... Today's AI boom echoes the internet bubble in three key ways: the rapid rise in stock prices beyond fundamental value, the widespread narrative of inevitable transformation, and the influx of speculative capital chasing uncertain long-term payoffs."

We love AI. It can do some great things. The paragraph above (and everything in quotes³ below) was and will be lifted practically verbatim (I scrapped a "we're going to argue" preamble). ChatGPT chopped the time spent gathering data for this letter by way more than half – even if it could benefit from a steadier diet of *Fast Times at Ridgemont High*⁴, *I'm Gonna Git You Sucka*⁵ and *F-Troop*.⁶ It will revolutionize certain kinds of data gathering, research and writing computer code, among other tasks, just as the internet became an indispensable tool following its stock market bubble. We have no issues with the technology. We're just skeptical that the Hyperscalers (AMZN, MSFT, GOOG, META, ORCL, for our purposes), can earn an adequate return on their enormous investments, and are even more doubtful that the stocks will pay off.

"The internet bubble demonstrated how markets can mistake 'potential' for 'certainty.' Many investors assumed that simply being online guaranteed future success. Today, the assumption seems to be that any company branding itself as 'AI-powered' will inevitably capture value. Just as few internet startups survived the 2000 crash, only a subset of current AI ventures may sustain long-term profitability. When stock prices run too far ahead of actual earnings power, history suggests a correction often follows."

We don't doubt that AI has lots of potential. It's just that no one has figured out how to earn enough money to justify the massive sums thrown its way. Even if the service is a giant timesaver, the sheer volume of investment chasing the dream should slash returns. The Hyperscalers are expected to spend more than \$400 billion on AI next year, about 2/3 of their total cloud revenue, with about 50% of that devoted to chips that have a 1–3-year life at best. They would thus need to earn around \$130 billion/year of cash for each of the next three years just to recover the '26 investment and will be layering on additional amounts each year following. Holding that spend steady, after three years they would have to earn that \$400b plus another \$150b every single year just to make a decent return, until they stop. Compare that figure to the \$20b or so of revenue (not profit) that AI is expected to generate this year.⁷

² *Liar's Poker*, on the euphoria surrounding the 1980s bond market and *The Big Short* (we got a cameo) on the housing and credit market boom and bust, being the other two.

³ Not sure we really need the quotes. Chat's the one with the stats and evenhandedness and I'm responsible for the anecdotes and trash talk.

⁴ <https://www.youtube.com/watch?v=Y1En6FKd5Pk>

⁵ <https://www.youtube.com/watch?v=tgHcYxKjwVE>

⁶ While this might resonate with the Little Feat fans, you try finding an inoffensive clip from this "Welcome Back Kotter" meets Cowboys and Native Americans. https://www.youtube.com/watch?v=yXP7JSmGr_4

⁷ See "Global Crossing is Reborn" Praetorian Capital 8/20/25 <https://pracap.com/global-crossing-reborn/>. While they use a longer depreciation schedule, they assume lower gross margins, so we come out near the same place.

While the industry is losing money at present, let's be generous and assume the Hyperscalers can get a 50% cash margin (after energy, R&D and sales). That means they will need to generate \$550 billion/50% or \$1.1 trillion/year in AI revenues – or 50x that of today – at just the current spend. With the US accounting for 50% of global tech sales (Chat says its 54%) that's \$550b in this country alone. While that figure does fall short of the \$850b DoD budget, it does equate to about \$1,600/person or \$6,400 for a family of 4, that the BLS tells us that typically spends \$3,400/year on recreation and \$3-4,000/on phones, internet and software. We recognize that the majority of that expense will be borne by businesses, but they will either have to sell that much more to their consumers or replace nearly 10 million workers (think New York or Florida). Maybe I shouldn't do this, but to quote Bill Cosby's Noah, upon getting told that he had to build an ark, "Right."⁸

Meanwhile, the Hyperscalers are copying the kingpins of the late-90s tech bubble, handing money to customers to move things along (ChatGPT stats, my indignation). Microsoft has invested approximately \$13 billion in OpenAI and in return OpenAI buys cloud capacity, storage and networking services and software from Microsoft. Amazon has invested \$8b in Anthropic who is expected to spend up to \$5b/year on Amazon's cloud services. Nvidia just agreed to buy \$6b of cloud computing capacity from Coreweave who will in turn use that money to buy Nvidia chips. Oracle commits to a \$300b deal to develop data center capacity with OpenAI who signed a \$300b deal for cloud computing services from Oracle. We could do this too. I'll invest \$2,000 in your venture. You then buy \$2,000 of my widgets and I'll go sell that revenue stream to some other schmuck investor for \$16,000 and we'll split the take. Who said money doesn't grow on trees?

Furthermore, while AI technology seems truly amazing to the general public, and us too for that matter, it's not clear that incremental investments are getting the same bang for the buck. "Yes, there are reports and user feedback claiming that ChatGPT-5 is not dramatically better than GPT-4 (or GPT-4o), in spite of expectations.... While reviewers observe faster responses, improved reasoning ability, lower error rates in many use cases ... the gains are not as massive as some marketing claims." If we have already hit the point of diminishing returns, the spigot and hype will slow in a heartbeat. The math doesn't work unless the spend comes down. But the stocks don't work unless the spend goes up.

AI from the Old Guy

*History's not a bore,
It's warnings by the score,
So pay attention,
Or you'll soon mention,
"We've seen this mess before!"*

-ChatGPT

*Santayana was a schmendrick
Was a good friend of mine
I never understood a single word he said
'Cept his forget-the-past-repeat-the-past line
And it's always been a mighty fine line*

-Us⁹

-Both sung to the tune of Joy to the World by Three Dog Night¹⁰

Twenty-plus billion spent¹¹ and that's all they got? Anthony Jeselnik has nothing to worry about.¹² Now we're going to take issue with our friendly bot. Chat seems to think that the last big bubble was restricted to those pie-in-the-sky dot-com companies, not the broader tech/telecom world as well. "One of the clearest parallels between the AI boom and the internet bubble lies in how valuations have outpaced underlying business fundamentals. In the late

⁸ <https://www.youtube.com/watch?v=bputeFGXEjA>

⁹ From our 3Q21 letter.

¹⁰ <https://www.youtube.com/watch?v=kyl1OImD7ow>

¹¹ Likely \$20-50b according to Chat.

¹² <https://www.youtube.com/watch?v=iTUNOw5bo48>.

1990s, internet companies such as Pets.com, Webvan, and eToys reached multibillion-dollar market capitalizations despite limited revenues and persistent losses. The promise of future growth fueled investor optimism, but in most cases that growth never materialized at the scale expected. Similarly, in today's market, AI chipmakers and software firms have seen stock prices soar to unprecedented levels. NVIDIA, for example, has become one of the world's most valuable companies on the strength of demand for graphics processing units (GPUs) used in training large language models. While NVIDIA's revenue growth is real, the valuations of many smaller AI-related firms rest more on speculative projections than on proven profitability."

Chat is missing the forest for the trees. While I do remember the dot-coms getting slaughtered in the spring 2000, it was the Four Horsemen of the internet (Cisco, Dell, Sun Micro and Intel), that era's Mag7,¹³ who powered the NASDAQ back to positive territory by the end of that summer. But when I asked what Chat had learned from the Horsemen, it responded with a blurb on Amazon, eBay, AOL and Yahoo!. I didn't think I was senile, so I asked about my four. "Ah! You're talking about a slightly different 'Four Horsemen' of the Internet than the consumer-focused one I mentioned earlier. In the late 1990s tech boom, CSCO (Cisco), Dell, Sun Microsystems, and Intel were dubbed the 'Four Horsemen of the Internet' because they were the key infrastructure and hardware enablers of the Internet economy... They were called the 'Four Horsemen' because, like the biblical riders, they were seen as unstoppable forces driving the rapid expansion of the Internet infrastructure, fueling the tech boom of the late 1990s. Unlike Amazon/Yahoo/AOL/eBay, they weren't selling directly to consumers—they were powering the Internet itself." Whew! It's¹⁴ not just a hat rack.

While there are some crazy price/concept valuations out there, it's the profitable megacap tech names (the Hyperscalers plus Apple, Nvidia and Broadcom) that are driving the markets, indices and your stock portfolios to record valuations, just like the Horsemen of 25 years ago. That crew also loaned to and invested in their customers (Chat can fill you in) and were making (reporting¹⁵) bank off the gold rush. The internet obviously worked out as a technology (we all lose our \$%^& when the Wi-Fi goes out), but the promised riches were another story.

"Between 2000 and 2010, telecom pricing moved from expensive, usage-based models toward cheaper, bundled, and increasingly data-centric models. Voice and SMS costs plummeted, [resulting in] flat to slightly declining ARPU [average revenue per user] over the decade, even as usage exploded." As their large customers (WorldCom, Global Crossing, Nortel, etc) went bankrupt, the Horsemen were forced to retrench as well. The companies did survive, with all but Sun¹⁶ around today. But if you bought their stocks during the peak – as I know some of you did – you got crushed. All four lost at least 70% during the ensuing couple of years and were still down 60-90% a decade later. "The decade illustrates that being a dominant infrastructure provider doesn't guarantee immunity from a speculative bubble."

"Finally, the AI boom and the internet bubble both reflect the role of speculative capital fueled by fear of missing out (FOMO). In the late 1990s, mutual funds, hedge funds, and retail investors poured money into internet stocks, driven by the belief that this was a once-in-a-lifetime opportunity. Venture capital followed the same pattern, backing unproven startups at inflated valuations. The eventual crash wiped out trillions in market value but also reset expectations to more realistic levels."

"Today, venture capital and public markets are again channeling enormous sums into AI. Startups developing large language models or AI applications routinely raise hundreds of millions of dollars at valuations that assume rapid adoption and profitability. Public investors likewise pile into a handful of AI-themed stocks, creating concentration risk in market indices. The dynamic is self-reinforcing: as prices rise, new investors fear being left behind and rush in,

¹³ Nvidia, Microsoft, Apple, Alphabet, Meta, Amazon and Tesla.

¹⁴ My head.

¹⁵ Are you really making money for your shareholders if your report huge profits but then spend it all to keep the flywheel spinning?

¹⁶ Oracle bought it in 2010 for just 5% of its peak market value.

pushing valuations even higher. This speculative loop closely mirrors the psychology of the dot-com boom and raises the risk of a sharp correction if expectations disappoint.”

But Chat needs to dig deeper. For one, it’s not just AI. Just as each new NFL receiver contract resets the scale for the rest, Mag 7 valuations are dragging all other companies with (sufficiently opaque profit centers that allow them to produce) the steady and non-career threatening earnings reports, that professional investors require, along for the ride. The S&P 500 now trades at all-time highs based on Market cap/GDP, Price/Book, Price/Cash Flow and Enterprise Value/Sales,¹⁷ leaving lots of room below if the current narrative falters.

More importantly for our purposes, Chat and the investing public are missing the other side to the demise of the New Economy Era – the rebirth of the old one. As their price/story methodologies failed them, investors were forced to look for real cash valuation support once again and they came shopping in our ~~pipe~~ bargain basement. Our long book earned more than 250% from 2000-03 compared to a 20% loss for the S&P and a 50% drubbing for the NASDAQ. While the Mag 7 might give you a shareholder yield (dividends plus buybacks) of just 1.5%,¹⁸ over half our holdings are paying us more than 10% today. Just think of stock prices necessary (2.5x) to bring those yields in line with the current sub-4% risk-free rate.¹⁹

“The AI boom in the stock market is not merely a repeat of the internet bubble, but the parallels are unmistakable. Both involve groundbreaking technologies with genuine long-term potential. Both have inspired investor euphoria, runaway valuations, and a narrative of inevitability. And both have attracted waves of speculative capital chasing uncertain rewards. The lesson of the internet bubble is not that technological revolutions are illusory — the internet did change the world — but that financial markets tend to overshoot in the short term. The same may prove true for AI: while it will likely become deeply embedded in the global economy, not every AI-labeled company will thrive, and valuations may eventually recalibrate. For investors and policymakers, remembering the history of the internet bubble offers a cautionary reminder that hype cycles can distort reality, even in the face of genuine innovation.”

What he said.

¹⁷ *Jefferies* “this week in US Equities” 9/26/25.

¹⁸ *Barron’s* “Shareholder Yields Are Better Than Dividend Yields. 10 Stocks That Fit the Bill.” 9/26/25.

¹⁹ While no one would call these yields risk-free, they offset this with the fact that these tend to grow over time.

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Past performance should not be construed as an indicator of future performance. Inception is January 2000.

(a) The performance figures are estimates and unaudited. (b) All returns presented are calculated on a time weighted, total return basis (include all dividends, interest, accrued income, realized and unrealized gains and losses and commissions). Gross Returns do not reflect the deduction of a 1.5% management fee, applicable fund expenses, or a 20% performance allocation. Net Returns include dividends, net interest, and reflect the deduction of a 1.5% management fee plus applicable fund expenses; they are also net of a 20% performance allocation, if applicable; (c) These returns are not GIPS compliant. These returns are not AIMR compliant as they represent only the performance of the Series A, Class 1 shares. Individual investor returns may vary due to several factors, which include but are not limited to: the timing of subscriptions and redemptions; differences in fee structures; individual investor account high water marks, and differences in tax treatment. Because of certain governmental regulations, not all accounts are New Issue eligible. New Issues contributed approximately 9.6% gross to the performance figures presented for the year 2000, 0.6% gross for the year 2001, 0.09% gross for the year 2002, 0.48% gross for the year 2003, 0.47% gross for the year 2004, 0.30% gross for the year 2005, 0.17% gross for the year 2006, 0.24% gross for the year 2007, 0.03% gross for the year 2008, 0.01% gross for the year 2009, 0.03% gross for the year 2010, 0.05% gross for the year 2011, 0.00% gross for the year 2012; 0.05% gross for the year 2013; 0.05% gross for 2014; 0.01% gross for 2015 and 0.00% thereafter; (e) All performance figures are before-tax returns. Actual after-tax returns depend on an investor's individual tax situation and may differ from those above. (f) All historical performance and exposure statistics reported in this letter prior to October 1, 2001 refer to Elm Ridge Value Partners, L.P., a 3(c)1 limited partnership. (g) All S&P 500 performance percentages are shown with dividends reinvested. The S&P 500 has not been selected to represent an appropriate benchmark to compare Elm Ridge Management's performance, but rather is disclosed to allow for comparison of Elm Ridge Management's performance to that of a well-known and widely recognized index and is not intended to imply that the fund's portfolio is comparable to this index either in composition or elementary risk. The S&P 500 Index is a market-capitalization weighted index containing the 500 most widely held companies chosen with respect to market size, liquidity, and industry. The index is calculated on a total return basis with dividends reinvested. (h) The Form 13F that is filed on a quarterly basis by Elm Ridge contains the required details concerning our portfolio.

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