



VMF's Strategic Asset Allocation

Key Takeaways:

- . The market has already paid for the visible AI winners: semiconductors, memory, data centers, and power.
- . Our strongest AI-related winners have become a portfolio-management lesson: when a thesis works, discipline becomes just as important as conviction.
- . The next opportunity may sit in China's AI application layer, where visibility is lower but valuations are much cheaper.

"The worse a situation becomes, the less it takes to turn it around, and the bigger the upside."
George Soros

"The riskiest moment is when you're right."
Peter Bernstein

Where the AI Trade Goes Next

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Welcome to May's issue of *VMF's Strategic Asset Allocation*. Last month, we argued that the market's first reaction to the AI shock had become far too blunt. In its rush to price disruption, it had stopped distinguishing between what was genuinely fragile and what was merely exposed. It had treated large parts of the software complex as if obsolescence were already a settled verdict, when the sober reality looked much more nuanced.

Since then, **price has started to confirm that view.**

The market has begun to recover nuance. Some of the areas most aggressively punished by AI fears have rebounded sharply. At the same time, some of the most obvious AI winners, especially those tied to the hardware and infrastructure side of the buildout, have moved with such force that the job is no longer simply to be right...

It is to manage what happens after the market finally agrees with you. That is where discipline becomes essential.

Because when the market can see the earnings bridge clearly, it usually pays for it. Memory. Semiconductors. Data-center infrastructure. Hardware supply chains. These are the parts of the AI story where the growth path is easier to understand, the capex cycle is more visible, and the beneficiaries are already being rewarded.

In some cases, rewarded parabolically.

But markets rarely stop at the obvious winners. Once the first layer of a theme has been recognized, capital begins to move outward. It rotates. It broadens. It starts looking for the next pocket of asymmetry... the place where the thesis is still alive, but the valuation has not yet caught up.

That is where this month's issue begins. Because if the most visible AI trade has already been discovered, the more interesting opportunity may now lie in the murkier parts of the stack: **the application layer**, where the visibility is lower, the uncertainty is higher, and the earnings bridge is far less obvious... but where the valuations are also far more forgiving.

Following that trail takes us to a familiar, uncomfortable place: **China.**

An **Earnings Bridge** is the analytical link between a big thematic idea and actual company profits. In this issue, the theme is AI. But a theme only becomes investable when we can trace how it flows into revenues, margins, earnings, and cash flow. For AI hardware, that bridge is now clear: more AI usage requires more compute; more compute requires more semiconductors, memory, data centers, and power; and that demand is already showing up in the sales and earnings of the main beneficiaries. That is why the market has been willing to pay for these companies. The earnings bridge became visible.



Not because China is easy. It is not.

Not because the macro backdrop is clean. It clearly is not.

And certainly not because investors have been pessimistic for no reason. They have had plenty of reasons: a brutal property downturn, weak consumer confidence, deflationary pressure, regulatory scars, foreign-capital exhaustion, geopolitical risk, and a persistent distrust that Chinese innovation will translate cleanly into shareholder returns.

That is the **bear case**.
And we take it seriously.

But serious investing often begins precisely there: with the problems everyone can already see. The task is not to deny them. It is to ask whether they have been priced with discipline or with despair.

For years, investors have looked at China through the same bruising lens: a deflating property bubble, excessive leverage, intrusive policy intervention, weak confidence, geopolitical friction, and disappointment... lots of disappointment.

Those scars are real. But while the market has been busy discounting the *old China*, *another China* has continued to evolve beneath the surface.

The country remains one of the most important technology ecosystems in the world. Not necessarily because it has overtaken the United States at the frontier-model layer, where America still enjoys deep advantages in leading labs, hyperscale infrastructure, venture capital, and advanced semiconductors. But because China may be unusually strong where AI has to become commercially and economically visible: applications, e-commerce, logistics, industrial automation, robotics, mobility, payments, consumer platforms, manufacturing workflows, and the difficult process of embedding technology into daily economic life.

That is the part of the story we believe the market may still be underpricing. So, this month, the question we want to ask is not whether China is clean, comfortable, or without risk. It is not.

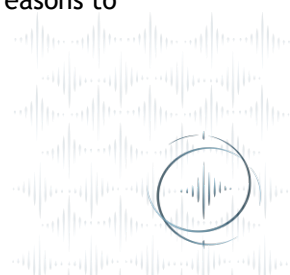
The better question is this:

What if the next AI opportunity is not where the story is cleanest... but where the discount is deepest and the market still refuses to look?

That question becomes even more relevant once we recognize that China is not only a technology story right now. It is also one of the major economies most exposed to the shock still unfolding in the Middle East.

The Iran war, the uncertainty around energy flows, and the strategic importance of the Strait of Hormuz all matter deeply for a country that remains structurally dependent on imported energy. But that vulnerability cuts both ways. If the crisis continues to escalate, China remains exposed. If it begins to de-escalate, China may become one of the clearest beneficiaries.

Lower energy stress would help an economy already struggling with weak confidence and deflationary pressure. Improved geopolitical optics could ease part of the risk premium still attached to Chinese assets. And the possibility of a Trump-Xi meeting would add another layer to the setup... not as a guarantee of resolution, but as a potential pressure valve at a moment when both sides have reasons to prevent the shock from spreading further.



None of this makes China easy.

But it does make the setup more interesting... and possibly more catalyst-rich than the market currently assumes.

At the same time, the energy complex itself continues to send a message we cannot ignore. Despite a geopolitical backdrop that should have favored oil and energy equities, the sector has struggled to sustain leadership. That does not invalidate the old **Debasement Trade**.

But it does force us to refine it, because when the asset class that should be leading starts to lag, the market may be telling us that the next opportunity lies somewhere else.

And refinement is the real theme of this issue.

April was about recognizing that the AI panic had gone too far.
May is about asking where the next opportunity now sits.

The answer may not be in the cleanest story, the most comfortable geography, or the most obvious AI winner. It may be in the place where the problems are visible, the valuation discount is large, and the market still refuses to pay for optionality.

There is a lot to do.

The Visible Side of the AI Boom

There are moments in markets when a thesis stops being controversial and starts becoming obvious. That is usually a good thing. But it is also the moment when the job changes...

At the beginning of a trade, the real challenge is conviction. The evidence is incomplete. The narrative is uncomfortable. The market has not yet fully recognized what is happening. **That is where the opportunity usually lives.** Later, once the market begins to agree, the challenge is no longer to see the opportunity. It is to manage what happens after everyone else starts seeing it too.

That is exactly where we now find ourselves with two of the cleanest AI-related



bottleneck trades in our Model Portfolio: **South Korean equities** through **EWY** and **uranium miners** through **URNM**.

When we added South Korea in January 2025, the logic was already there. The AI buildout was going to require an extraordinary amount of compute. And compute would not only require **NVIDIA** GPUs. It would require memory... a lot of memory! High-bandwidth memory. Server DRAM. Enterprise SSDs. Advanced packaging. The entire physical stack behind the intelligence layer.

In other words, the market was already learning to worship the *AI model makers* and the *GPU suppliers*, but it had not yet fully appreciated the broader supply chain that would have to scale with them.

That was the opportunity.

Because AI may feel weightless to the end user, but it is not weightless at all. It is one of the most capital-intensive technology waves the world has ever seen. Gartner now expects global semiconductor revenue to grow 64% in 2026, with memory revenue expected to **triple**, DRAM prices rising 125%, NAND prices rising 234%, and AI semiconductors representing roughly 30% of total semiconductor revenue this year.

Gartner Forecasts Worldwide Semiconductor Revenue to Exceed \$1.3 Trillion in 2026

STAMFORD, Conn., April 8, 2026

Overview

- **Semiconductor Revenue to Grow 64% in 2026**
- **DRAM Prices to Increase by 125% in 2026 and Storage Crisis to Extend into 2027**

Table 1. Semiconductor Revenue Forecast, Worldwide, 2025-2027 (Billions in U.S. Dollars)

	2025	2026	2027
Memory	216.3	633.3	748.1
Nonmemory	589.0	686.9	806.4
Total Market	805.3	1,320.2	1,554.5

Source: Gartner, April 8 2026

That is not just an upgrade.
That is an industrial buildout.

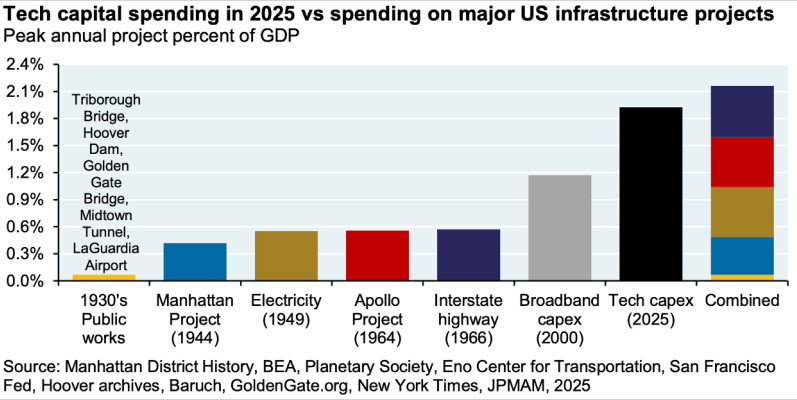
And the numbers across the winners now confirm it. **NVIDIA's** full-year revenue rose 65%, while its fourth-quarter data-center revenue increased 75% year over year. **Broadcom's** AI semiconductor revenue grew 106% year over year. **TSMC's** first-quarter revenue increased 35%, while net income and diluted EPS both rose 58%. Even **ASML**, the irreplaceable lithography supplier to the leading-edge semiconductor ecosystem, raised its 2026 sales outlook as AI demand continued to outstrip chip supply.

These are not normal cyclical numbers...

They are the financial footprints of a capex supercycle.



The chart compares today's tech capital-spending boom with previous U.S. infrastructure and innovation buildouts, measured as a share of GDP. The message is clear: this is not a normal upgrade cycle. The current wave of tech capex is already larger, relative to the economy, than several landmark projects and past investment booms, including the Apollo Program, the Interstate Highway buildout, and the dot-com broadband cycle. In other words, AI is not just changing software. It is forcing one of the largest physical infrastructure buildouts in modern market history.



Source: J.P. Morgan, Michael Cembalest ("Eye On The Market"), January 2026

But our edge was not simply recognizing that AI hardware would benefit. By early 2025, that was already becoming increasingly clear. The harder question was where that visibility had not yet been fully priced.

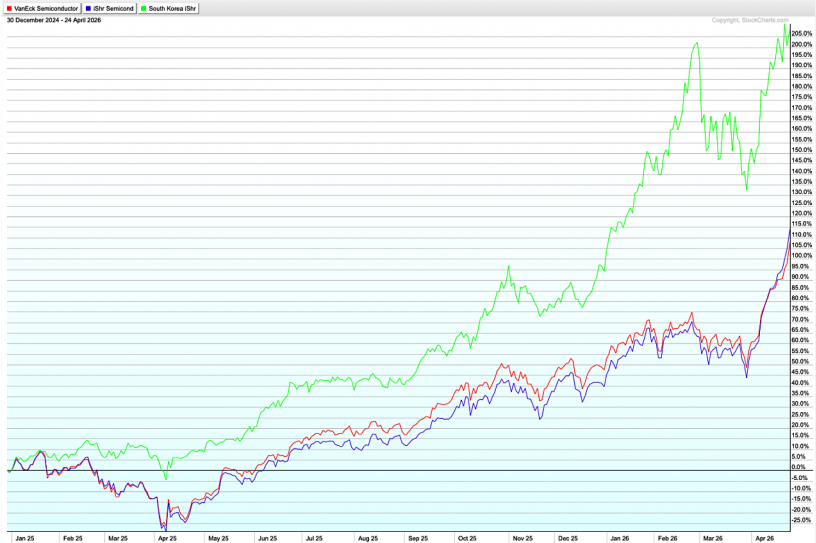
Our answer was South Korea.

Because if AI compute was going to grow exponentially, memory demand was going to follow. The market could not keep treating memory as just another cyclical commodity if high-bandwidth memory, server DRAM, and enterprise SSD demand were becoming structural bottlenecks. South Korea, through **Samsung Electronics** and **SK Hynix**, sat directly in the path of that change.

That is now being confirmed with force.

Samsung's latest quarter showed a **43% sequential increase** in consolidated revenue, with its Device Solutions division posting an **86% sequential sales increase**, as the memory business set new quarterly records and management pointed directly to AI-related demand, HBM, DDR5, SOCMAM2, and enterprise SSDs. SK Hynix, meanwhile, delivered record quarterly results, with revenue rising roughly **60% sequentially**, operating profit nearly doubling versus the prior quarter, and management explicitly attributing the performance to strong AI infrastructure demand and higher sales of high-value-added products such as HBM, high-capacity server DRAM, and enterprise SSDs.

That is the earnings bridge the market is now paying for.



And, as you can observe in the chart on the previous page, once that reality became impossible to ignore, the market paid for it aggressively.

Since the beginning of 2025, EWY (green line) has not merely kept pace with the semiconductor trade. It has dramatically outperformed two of the most popular semiconductor ETFs, SMH (red line) and SOXX (blue line).

The green line tells the story: South Korea became one of the cleanest expressions of the AI hardware cycle precisely because the market had initially underappreciated how much operating leverage the memory giants could capture once the demand surge became undeniable.

The chart on page 3 makes the portfolio-management lesson even clearer. We recommended EWY when the opportunity was still underappreciated and, above all, inexpensive.

That is the crucial point.

The sales and earnings momentum now being delivered by Samsung and SK Hynix sits in the same broad neighborhood as some of the most celebrated AI winners in the U.S. and global semiconductor complex. Yet, because the market had not initially priced South Korea as an obvious AI winner, the price response has been far more explosive. EWY has almost doubled the performance of the semiconductor ETFs where those more fashionable AI names command the largest weights.

In our **May 2 Weekly Update**, we recommended closing half of the remaining EWY position at \$162, locking in a 206.5% total return on that tranche.

Still, when the market began to recognize the story, we took our first partial profit at the beginning of November. And now, after another extraordinary move, we have taken a second partial profit, closing half of the remaining position at \$162 and locking in a 206.5% total return on that tranche.

That decision is not a rejection of the thesis...

It is the thesis working.

And just as importantly, it is our Investment Process working. The goal is not to fall in love with a position after the market has finally discovered it. The goal is to keep moving capital toward the best risk/reward opportunities inside the same secular megatrend.

After a powerful advance, **URNM** has spent the past few months moving sideways, compressing into a symmetrical triangle defined by lower highs and higher lows. This suggests consolidation rather than a completed reversal. Because triangles usually act as continuation patterns when they appear after a strong prior uptrend, our base case is for an eventual upside resolution. Still, confirmation requires a decisive breakout above the upper boundary of the pattern.

Until then, the message is clear: **URNM** is digesting its gains, and a point of decision is approaching.

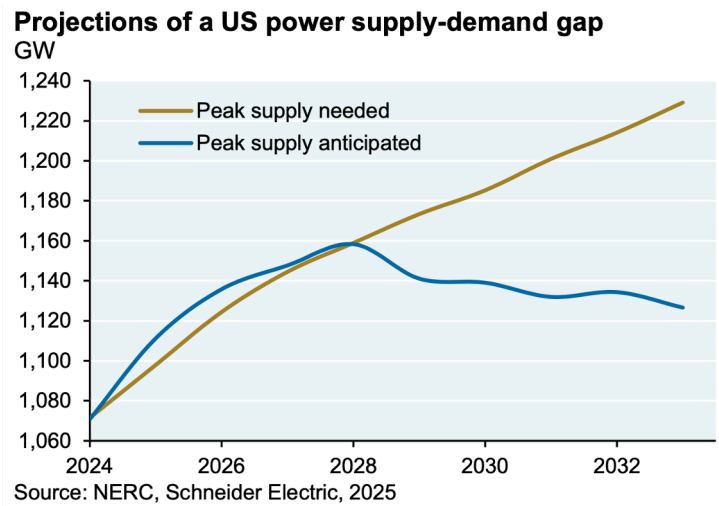


But before we move to the pockets of opportunity that now look more attractive, we need to address our other obvious AI winner. Because the same broad logic we applied to EWY also applies to URNM.

The difference is that this trade is not yet as mature.

For a long time, nuclear energy was discussed mostly as a political, environmental, or commodity story. Today, it is increasingly being pulled into a very different conversation: AI infrastructure.

The reason is simple.



Source: J.P. Morgan, Michael Cembalest ("Eye On The Market"), January 2026

The AI buildout does not only need chips. It needs electricity. Reliable electricity. Scalable electricity. And, most importantly, electricity that can be delivered where and when data centers need it.

That is becoming one of the most important bottlenecks in the entire AI stack.

OpenAI alone has announced partnerships requiring 30.5 GW of new power. To put that figure into context, that is roughly 75% of the peak level of nuclear capacity the U.S. completed over any five-year period during the nuclear buildout era.

And that is just one company in the AI ecosystem...

That comparison should stop us in our tracks.

Because the market has become comfortable talking about AI as if the limiting factors are mostly models, chips, and capital. But the physical world is now pushing back. The entire U.S. added only 25 GW of capacity in 2024 after adjusting for intermittency and reliability, while the projected gap between peak supply needed and peak supply anticipated continues to widen into the next decade.

In other words, the AI economy is trying to grow inside an electricity system that was not designed for this kind of step-change in load growth.

That is the gap nuclear is being pulled into.

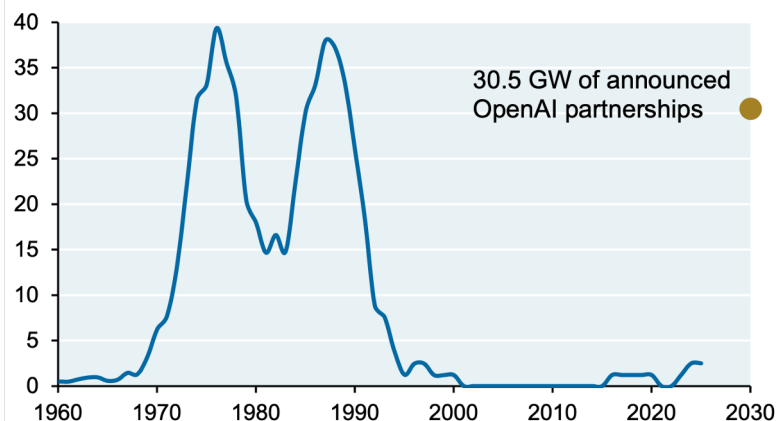
Not because nuclear is perfect. It is not. New plants are hard to build. Timelines are long. Permitting is painful. Small modular reactors still have a lot to prove. And only



The dot in the first chart represents only **OpenAI's** announced power partnerships. That alone is remarkable. These commitments already approach the peak levels of U.S. nuclear capacity completed during the 1970s and 1980s nuclear buildout. And OpenAI is only one company in the AI ecosystem. That is why the power bottleneck is becoming impossible to ignore.

US nuclear plants built by year of completion

GW, 5-year rolling sum



Source: Power Reactor System Database, JPMAM, September 2025

Source: J.P. Morgan, Michael Cembalest ("Eye On The Market"), January 2026

a very small number of decommissioned U.S. nuclear plants may realistically be restarted.

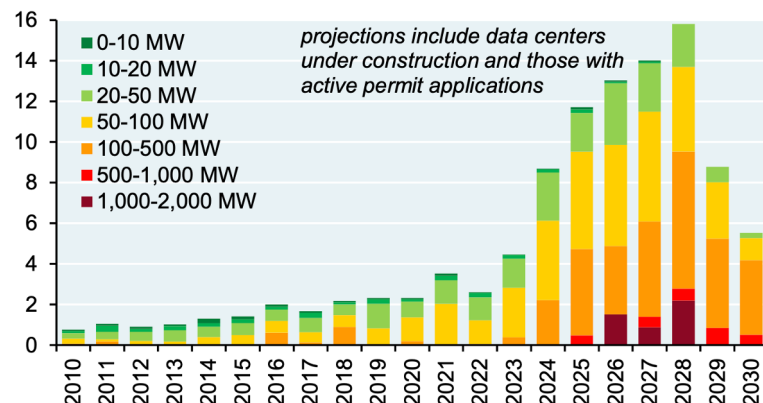
But that is precisely why existing nuclear assets, uranium supply, and the broader nuclear fuel cycle have become so interesting.

If power is the bottleneck, and if new nuclear supply cannot be created quickly, then the existing uranium ecosystem becomes far more strategically relevant. Not because it solves the entire data-center power problem tomorrow. It obviously does not. But because it sits inside the narrow group of solutions capable of providing the kind of reliable baseload power the AI economy increasingly needs.

This buildout is not limited to uranium or nuclear power. It also requires natural gas, grid equipment, cooling systems, electrical infrastructure, construction capacity, and specialized engineering. That is why, across VMF's Security Selection Model Portfolios, we have also recommended individual companies that benefit directly from the broader AI infrastructure boom.

US data center additions by size and year

GW, including hyperscaler and retail/wholesale colocation facilities



Source: Hiatt and Ryu (USC Zage Business of Energy Initiative), Q2 2025

Source: J.P. Morgan, Michael Cembalest ("Eye On The Market"), January 2026

And that changes the nature of the trade.

Uranium is no longer just a commodity story.
It is becoming another **AI bottleneck trade**.

That is why our URNM position matters. As the chart on page 6 shows, we are already up roughly 70% since adding the position to the Model Portfolio. Like EWY, it has dramatically outperformed our equity benchmark. And like EWY, it reflects the



same Investment Process: identify the bottleneck early before the market fully understands how visible the demand is likely to become.

But, again, maturity matters.

EWY has already entered the phase where the market has moved from recognition to something close to euphoria. **URNM is not there yet.** The position did briefly approach the 100% mark at the beginning of this year, but the move was too quick for us to formally monetize it through our publications. If it reaches that level again, we intend to close half of the position and lock in part of the gain. That is not because the nuclear thesis would be over. Far from it...

It is because our job is not merely to identify the right secular trend. It is to manage the position as the market increasingly discovers it.

This is the key lesson.

The market has now discovered the visible parts of the AI trade. It understands GPUs. It understands semiconductors. It is beginning to understand memory. And it is increasingly being forced to understand power.

Once a bottleneck becomes visible enough, capital begins to crowd into it. That does not mean the opportunity disappears overnight. But it does mean the risk/reward changes. And once that happens, the opportunity can move very quickly from underappreciated to overextended. That is why discipline now matters.

EWY and URNM have done exactly what we hoped they would do. They gave us exposure to the visible hardware and power bottlenecks of the AI buildout before that visibility had been fully priced. They rewarded us handsomely as the market caught up. And in the case of EWY, the move became stretched enough for us to harvest another part of the gain.

That is not a bad problem to have, it is the kind of problem good investing creates.

The Forgotten Application Layer

Now that the market has begun to reward the visible AI bottlenecks, we need to move to the less comfortable part of the opportunity set.

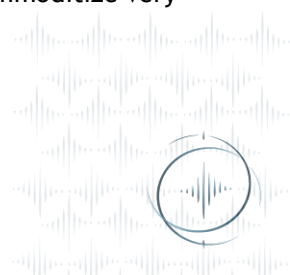
The application layer.

This is where the debate becomes much harder.

The hardware layer is comparatively easy to understand. If AI usage grows, the world needs more compute. If the world needs more compute, it needs more chips, more memory, more data centers, more electricity, more cooling, more infrastructure, and more capital. The chain of logic is not perfectly clean, but it is visible enough for investors to underwrite.

The application layer is different.

Here, the visibility is lower. The dispersion will be wider. The winners and losers will be harder to identify in advance. Some early leaders will fade. Some apparently obvious use cases will disappoint. Some business models will turn out to be little more than temporary interfaces sitting on top of capabilities that commoditize very quickly.



That is why the market has been more reluctant to pay for this part of the AI stack. And yet, this is also where the long-term upside may ultimately be far larger.

Because infrastructure is not built for its own sake. Chips are not bought for their own sake. Data centers are not financed merely to sit in the desert and consume electricity. They are built because intelligence is expected to move into the real economy: into software, commerce, payments, search, advertising, logistics, entertainment, healthcare, manufacturing, mobility, customer service, industrial automation, robotics, and daily life itself.

In other words, the hardware layer is where AI gets built.
The application layer is where AI gets used.

And that distinction brings us to China.
Not because China is easy.
It is not.

And certainly not because the market has been foolish to apply a discount to Chinese assets...

The discount exists for very good reasons. But before we get to those reasons, we need to recognize something that has become too easy to forget after several years of disappointment: **China remains one of the most important technology ecosystems in the world.**

Not necessarily because it has overtaken the United States at the frontier-model layer. The U.S. still enjoys significant advantages in leading AI labs, hyperscale cloud infrastructure, advanced semiconductors, venture capital depth, and the ability to fund world-class model development at almost unimaginable scale.

But that is not the whole AI story.

Because the next phase of AI will not be judged only by benchmark scores, training budgets, or the elegance of frontier models. It will also be judged by deployment. By commercialization. By how quickly intelligence gets embedded into the real economy. By how effectively it moves through consumer platforms, industrial systems, payment networks, logistics chains, factories, vehicles, robots, and everyday workflows.



KraneShares

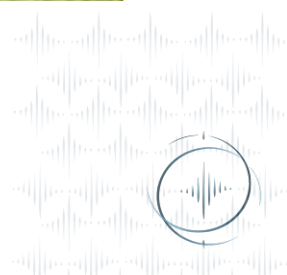
The China Internet Evolution

- China's E-Commerce market size surpassed the U.S. for the first time in 2013.⁴
- 80% of China's population has internet access compared to 93%² in the U.S.
- We believe there is potential for substantial continued growth in the Chinese internet sector.

China / US Internet Statistics	China	US
Total internet population	1.13B ¹	316mm ²
% of population with internet access	80% ¹	93% ²
Country's share of world internet users	20% ³	6% ³
E-Commerce market size 2025	\$2.2T ⁴	\$1.2T ⁵
Total retail sales 2025	\$7.2T ⁴	\$7.5T ⁵
Online retail sales as % of total 2025	26% ⁴	16% ⁶

1. Data from Data Reportal as of 12/31/2025.
2. Data from Statista as of 12/31/2025.
3. Data from The World Bank, Data Reportal, and Statista as of 12/31/2025.
4. Data from National Bureau of Statistics of China as of 12/31/2025.
5. Data from United States Census Bureau as of 12/31/2025.
6. Data from ITU as of 12/31/2025.

Source: Kraneshares, Investor Presentation, March 2026



And in that world, China is far more formidable than most investors now seem willing to admit.

This is where the conventional Western framing can become too narrow. Investors look at export controls, chips, sanctions, and the frontier-model race, then conclude that China is structurally behind.

At one layer, that is fair. China still faces serious constraints in advanced semiconductors and the highest-end compute stack. But at another layer, the story is very different...

China has already built one of the largest digital economies in the world. Its e-commerce market is larger than America's. Its internet population is more than three times the size of the U.S. equivalent. Online retail already represents a much larger share of total retail sales than in the United States, yet internet penetration is still meaningfully lower.

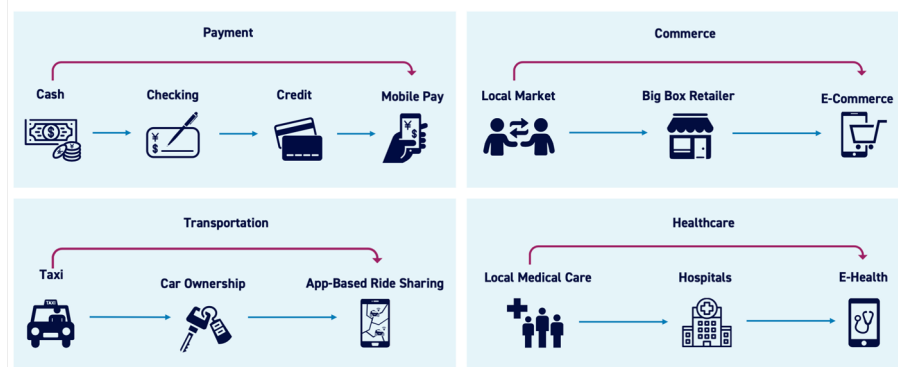
That combination is rare: enormous scale, deep digital behavior, and still some room for incremental penetration.

But the more important point is not just size. It is embeddedness.

China's technology platforms are not sitting politely beside the real economy. In many cases, they are the interface through which the real economy already operates. Payments, commerce, food delivery, travel, ride hailing, entertainment, healthcare, merchant services, logistics, advertising, cloud, and consumer finance have been pulled into digital ecosystems with a speed that more mature Western markets often struggle to replicate.



China's rapid adoption of new technologies has produced a "leapfrogging" effect.



Source: Kraneshares, Investor Presentation, March 2026

The **Leapfrogging Effect** describes how an economy can skip older stages of development and move directly to newer technologies. In China, this meant moving from cash to mobile payments, from traditional retail to e-commerce, from taxis to app-based ride sharing, and from fragmented local services to digital platforms. This matters for AI because societies already accustomed to rapid platform adoption may be better positioned to absorb new AI applications into daily life.

That is the **leapfrogging effect**.

China did not need to follow the same path from cash to checking to credit cards before reaching mobile payments. It skipped steps. It did not need to build the same big-box retail infrastructure before embracing e-commerce. It skipped steps. It did not need to preserve every legacy interface in transportation, healthcare, and local services before moving activity onto digital platforms.

Again, it skipped steps.

That is important because AI adoption may reward the same instinct.



A society already accustomed to using digital platforms as the operating layer of daily life may be unusually fertile ground for AI applications. The rails are already there. The users are already there. The merchants are already there. The data exhaust is already there. The habit formation is already there.

This is the part of China's technology story the market may still be underpricing.

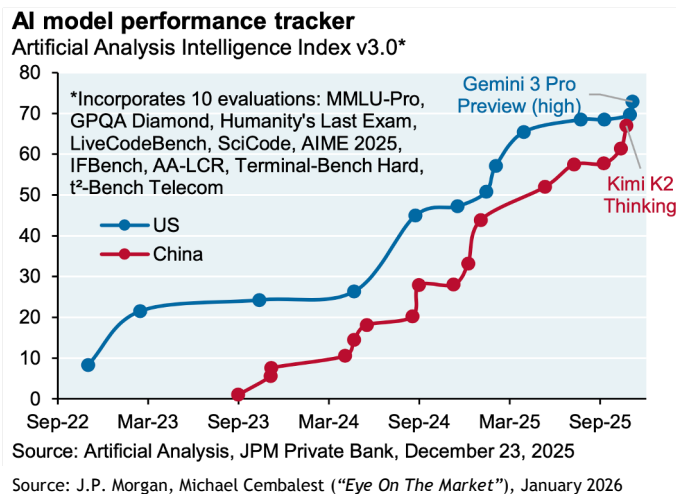
A Chinese consumer does not simply shop online. She pays, chats, orders food, books travel, hails cars, watches video, receives recommendations, interacts with merchants, manages services, and moves across platform ecosystems that are already data-rich and transaction-heavy.

A Chinese merchant does not merely advertise online. It lives inside platforms that touch inventory, payments, logistics, consumer targeting, financing, promotions, and customer acquisition.

That is not a narrow internet story.
It is an application-layer story.

And the more we study it, the more important the distinction becomes. Because if the next phase of AI is going to be about deployment rather than merely model training, China deserves to be taken seriously. Not sentimentally. Not ideologically. Not because we want the China story to work. But because the evidence no longer supports the lazy conclusion that China is simply a second-tier participant in this technology race.

The frontier-model discussion still deserves attention, but the gap is no longer as static as many investors still assume. The chart below makes that clear:



The United States remains ahead, with **Google's Gemini 3 Pro** still setting the pace in the broad model-performance rankings. But the more interesting observation is not simply who leads today. It is how quickly the field is compressing. And on that score, China's progress has been striking.

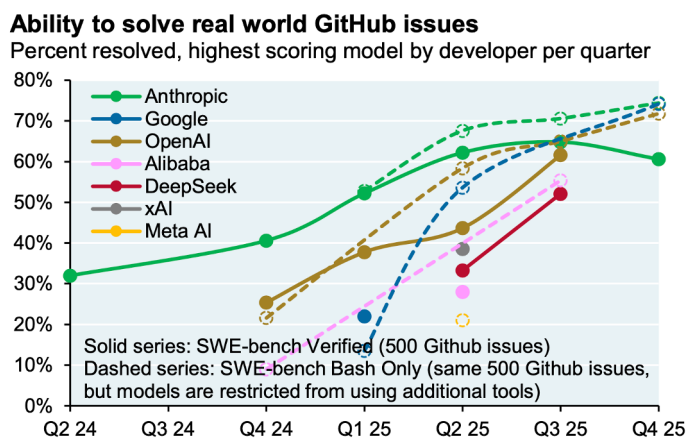
In barely two years, Chinese models have moved from near-irrelevance in these rankings to a level that now forces them into the same conversation as the global leaders. **Kimi K2 Thinking** may still trail Gemini 3 Pro, but it is no longer sitting in another universe.

The direction of travel is what we should be watching.



GitHub issues are real software-development problems submitted by developers inside code repositories. They can include bugs, feature requests, failed tests, documentation problems, or workflow improvements. That makes them a useful practical benchmark for AI models because solving them requires more than fluent text generation; it requires understanding code, context, instructions, and implementation details. Also note that **Alibaba**, one of the Chinese models represented in this comparison through *Qwen*, has long been a recommendation in *VMF's Security Selection Value Model Portfolio*.

The same pattern appears when we move from broad benchmarks to something more practical. On the chart tracking the ability to solve real-world **GitHub issues**, the American leaders still occupy the top spots, but the Chinese challengers are no longer spectators...

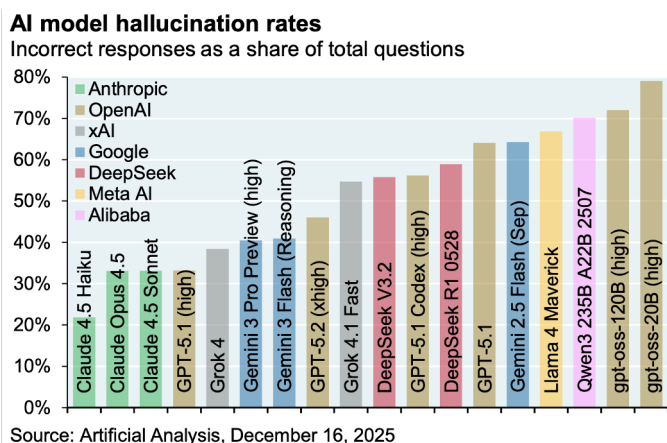


Source: Epoch AI, SWE-bench, JPMAM, December 17, 2025

Source: J.P. Morgan, Michael Cembalest ("Eye On The Market"), January 2026

Chinese models have entered the competitive set in a meaningful way. Their scores still lag the very best Western models, but they are now solving a material share of real coding problems, not just performing well on laboratory-style tests. That distinction is important because software development remains one of the clearest early use cases for AI in the real economy.

In other words, the question is no longer whether China can produce capable models. It clearly can. The question is how quickly those models continue to close the gap.



Source: Artificial Analysis, December 16, 2025

Source: J.P. Morgan, Michael Cembalest ("Eye On The Market"), January 2026

Reliability, however, is where humility is still needed.

The hallucination-rates chart shows that several Chinese models remain more error-prone than the best offerings from **Anthropic** and **OpenAI**. That matters because, in AI, intelligence without consistency still leaves a lot of value on the table. But even here, the lesson is not that China is absent from the race. It is that China is already *in the race*, just not yet leading it.

And for us, that is more than enough.



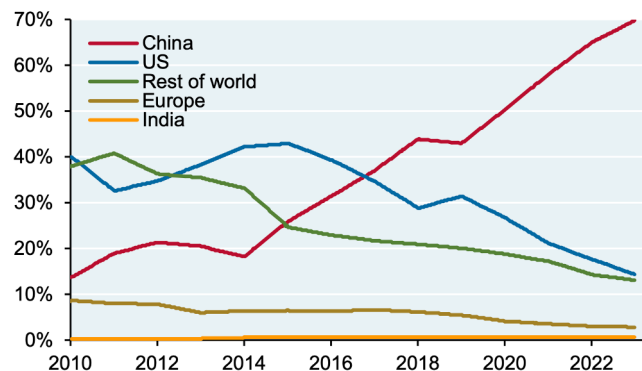
Our investment case does not require China to dominate the frontier-model layer. It only requires China to be good enough, to improve fast enough, and to sit inside an ecosystem that is unusually well positioned to commercialize AI at scale.

The patent data points in the same direction.

Now, we should be careful here. **Patents are not profits.** They are not moats. And in China, as elsewhere, they can sometimes tell us more about policy incentives than commercial outcomes.

AI patents by geographic area

Percent of world total AI patents



Source: Stanford AI Index Report, 2025

Source: J.P. Morgan, Michael Cembalest ("Eye On The Market"), January 2026

But when the trend becomes this large, it cannot be dismissed either.

China has been climbing the innovation food chain for years. It has broken into the top tier of global innovation rankings, its export complexity has converged meaningfully with the United States, and its share of global AI patents has moved from marginal levels a decade ago to a commanding position today. The same pattern appears in clean-energy patents and even in nuclear science and engineering research, where China has moved from the periphery to the center of the global research base.

That is not the footprint of an economy simply waiting to import the next technological wave.

It is the footprint of a country trying to build the entire stack.

Models. Applications. Robotics. Manufacturing. Power. Transmission. Nuclear. Clean energy. Industrial automation.

Some of this will be wasteful. Some of it will be subsidized. Some of it will produce poor returns on capital. That is what happens when the state pushes aggressively into strategic industries. But some of it will also work. And when it works, it can scale very quickly.

That is the real point.

The application-layer thesis is not just that China has a large digital consumer base. It is that China has the technological capacity to keep improving the models, the industrial capacity to deploy them, and the social infrastructure to absorb them into daily life faster than many investors expect.

Then comes the other bottleneck.



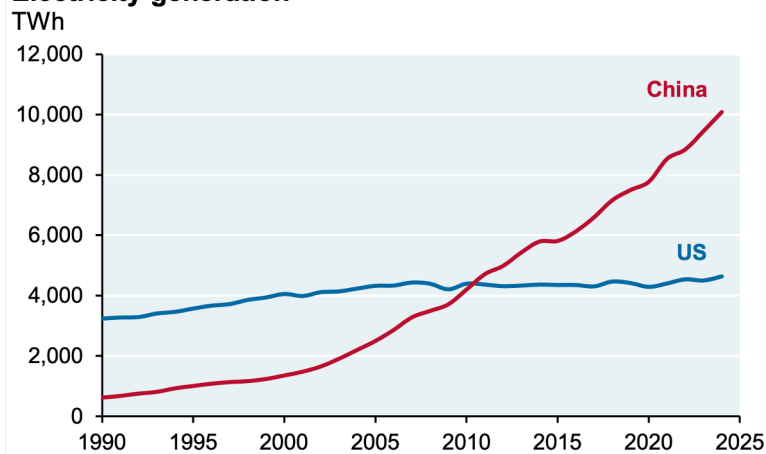
Power.

Because AI is not merely a contest of models and applications. It is also a contest of electricity. The country that wants to push AI into factories, logistics networks, robots, vehicles, cloud platforms, consumer services, payments, and industrial systems needs an enormous amount of reliable power behind it.

And here, China's position looks very different from America's.

The U.S. is discovering that power may be one of the hard limits of the AI boom. Data-center demand is rising into an electricity system that was not built for a sudden step-change in load growth. Peak supply needs are expected to keep rising, while anticipated supply is not keeping pace. The gap is enormous, as we highlighted on page 7.

Electricity generation



Source: Energy Institute, JPMAM, 2025

Source: J.P. Morgan, Michael Cembalest ("Eye On The Market"), January 2026

China, by contrast, has been increasing electricity generation at a scale that is difficult for the West to comprehend.

A **terawatt-hour (TWh)** measures electricity generation or consumption over time. One TWh equals one trillion watt-hours, so it is useful for comparing the scale of national power systems.

High-voltage direct-current (HVDC) transmission lines move large amounts of electricity over very long distances with lower losses than traditional alternating-current lines. This is crucial for China because much of its renewable and low-cost generation is located far from its biggest industrial and urban demand centers. In an AI economy, producing power is not enough; the power must also reach the data centers, factories, logistics hubs, and industrial systems that need it.

Based on Energy Institute data, Chinese power generation has risen by roughly **2,500 TWh since 2019**, compared with only 221 TWh in the United States and a decline of 110 TWh in Europe. And this is not merely a coal story. China has been adding generation across essentially every major source, electrifying final energy consumption faster than any other major economy, and leading the world in the deployment of high-voltage direct-current transmission lines, which are crucial for moving electricity across long distances.

That does not make China's energy system clean.
It is not.

Coal still plays a major role, and the environmental, efficiency, and capital-allocation questions are real. But from the perspective of the AI race, perfection is not the test. The test is whether China has the *ability* and *willingness* to build the physical capacity required to support a much more electrified, automated, and AI-enabled economy.

And on that question, the evidence is hard to ignore.

This is why the China application-layer thesis is more interesting than a simple "*cheap internet stocks*" argument.



China has the users.
It has the platforms.
It has the embedded digital behavior.
It has increasingly competitive models.
It has a rapidly expanding patent base.
It has manufacturing depth.
It has robotics ambition.

And it has a far stronger grip on the power side of the equation than the United States currently appears to have.

That combination is rare.

Scale. Embeddedness. Technological capability. Manufacturing depth. Power.

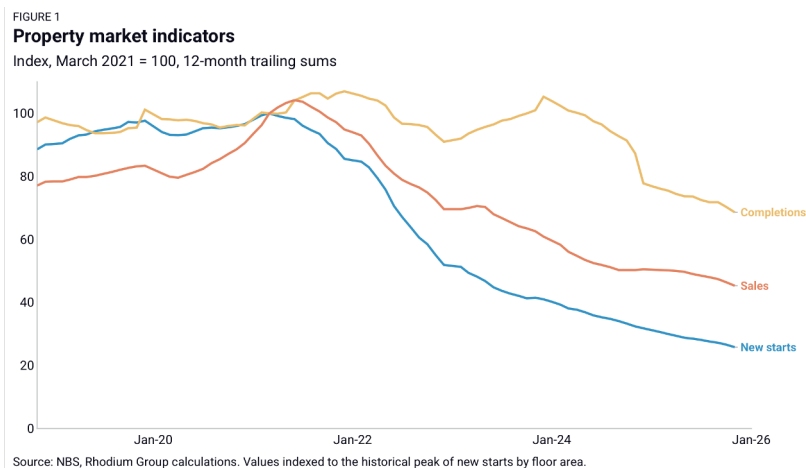
This is why China may be one of the most important application-layer markets in the AI cycle. Not because it is cleaner than the U.S. Not because it is safer. And not because it leads across every part of the stack. But because it may be good enough where it needs to be good, unusually strong where deployment matters most, and far cheaper than a market with these attributes would normally be.

Which brings us to the uncomfortable part of the argument:

If China has so much scale, capability, and strategic relevance, why are Chinese assets still so cheap?

To answer that properly, we need to do what we always try to do before increasing exposure to a hated market:

We need to make the bear case first.

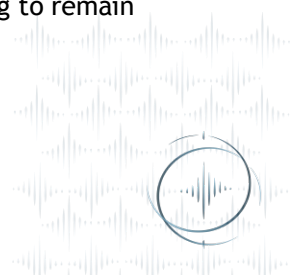


Source: Rhodium Group, "China's Economy: Rightsizing 2025, Looking Ahead to 2026", December 2025

Let's start with the obvious wound.

Property.

For years, real estate was not merely another sector in China. It was the household savings vehicle, the collateral engine, the confidence anchor, the local-government funding mechanism, and one of the main pillars of the country's growth model. So, when that machine began to reverse, the damage was never going to remain neatly contained inside the property market.



It spread into consumption.
It spread into confidence.
It spread into local-government finances.
It spread into the willingness of households to take risk.

And it created a **deflationary impulse** that is arguably larger, at least in balance-sheet and confidence terms, than the U.S. housing shock that preceded the 2008 crisis. The comparison is not perfect. China's bust is slower, more state-managed, and less brutally marked-to-market.

But property sits much deeper inside Chinese household wealth and economic activity: Brookings notes that average Chinese households hold about 70% of their assets in housing, while housing valuation is roughly five times GDP.

That is the macro scar.
And it is deep.

But it is also forcing a change in policy direction. If the old wealth engine was property, the new one increasingly has to involve financial assets, capital markets, technology, and consumption. Chinese authorities appear to understand this. Regulators have been encouraging insurers, pension funds, and mutual funds to increase equity exposure, while also reducing frictions in the fund industry to promote longer-term investment.

That does not solve the property problem overnight.
But it changes the direction of travel.

The second wound is **policy trauma**.

Global investors have not forgotten the crackdowns on internet platforms, fintech, private education, gaming, data, and other parts of the private sector. Nor should they. Those interventions did not merely reduce earnings forecasts. They damaged trust. And once trust is damaged, even good news gets discounted.

China's platform crackdown began in late 2020, when regulators halted Ant Group's planned IPO after Jack Ma publicly criticized the country's financial-regulatory system. What followed was not one isolated intervention, but a multi-year campaign across internet platforms, fintech, gaming, data, private tutoring, music rights, algorithms, worker protections, and platform competition. **Alibaba** was hit with a record antitrust fine. **Tencent** faced gaming restrictions, blocked deals, and limits on exclusive music rights. Game approvals were frozen for months. Major platforms were forced to open parts of their ecosystems to rivals. Some of these interventions had legitimate policy aims: curbing monopolistic behavior, protecting consumers, improving data oversight, and reducing systemic financial risk. But for investors, the lesson was brutal. In China, platform economics can be reshaped by policy faster than a discounted cash flow model can react.



SHANGHAI, Sept 13 (Reuters) - China's regulatory crackdown has ensnared sectors from technology to education to property, wiping hundreds of billions off the market capitalisations of some of its largest companies and putting investors on alert over who may be next.

Source: Reuters, September 13 2021

That is why the hardest question in China is not whether companies can innovate...

They clearly can. The harder question is whether shareholders will be allowed to capture enough of that innovation.

That uncertainty sits at the heart of the China discount.



The third wound is **geopolitics**.

The U.S.-China rivalry is no longer background noise. It runs directly through semiconductors, AI export controls, tariffs, sanctions, rare earths, capital flows, Taiwan, and investor access. The same technological ambition that makes China interesting also makes it strategically sensitive. And if China becomes more competitive in AI, robotics, clean energy, nuclear engineering, semiconductors, and industrial automation, the rivalry with the United States is unlikely to disappear.

It may intensify.

U.S. President Trump's renewed trade war with China

By Reuters
May 7, 2026 12:08 AM GMT+1 · Updated 14 hours ago



U.S. President Donald Trump delivers remarks on tariffs in the Rose Garden at the White House in Washington, D.C., U.S., April 2, 2025. REUTERS/Carlos Barria/File Photo Purchase Licensing Rights

BEIJING, May 7 (Reuters) - U.S. President Donald Trump is set to meet Chinese President Xi Jinping in May on his first visit to China in eight years.

Source: Reuters, September 13 2021

Then come the other familiar problems: weak private-sector confidence, deflationary pressure, demographics, youth unemployment, uneven corporate governance, currency risk, and years of foreign-capital exhaustion after too many false dawns.

So, we understand the pessimism.

In fact, we would be suspicious of any China thesis that did not begin there.

But this is also why we do not need to spend the rest of this issue re-litigating the entire China bear case. We have been covering it since the inaugural issue of *VMF's Strategic Asset Allocation*, precisely because we have been overweight Chinese equities from the beginning. The risks were visible then. They remain visible now.

What has changed is the opportunity set.

Back then, Chinese equities were cheap because investors had lost confidence.

Today, they are still cheap, but the application-layer AI case has become much stronger. At the same time, the obvious AI trades elsewhere have become much more expensive, while our South Korea position has already delivered the kind of return that forces us to ask where the next pocket of asymmetry may be hiding.

That is why we now believe the China opportunity may be even more attractive than South Korea was at the beginning of 2025.



Not because it is safer.
It is not.

Not because the visibility is higher.
It is not.

But because the market may be making a similar mistake in a different layer of the AI stack. In South Korea, it underpriced the hardware and memory opportunity. In China, we believe it may now be underpricing the application layer.

The opportunity is murkier.
The risks are higher.
But the valuation is much cheaper.
And the potential re-rating may be just as powerful.

The question that remains is simple:

How should we increase this exposure... and by how much?

Action

Let's not lose time... we are choosing KWEB (KraneShares CSI China Internet ETF).

And yes, it already sits in our Model Portfolio. But it does so for good reason: we believe it is the cleanest investment vehicle for the thesis we have built throughout this issue.

We also want to be very clear about what this is not.
This is not a generic *"China is back"* trade.

We are not buying broad China exposure simply because the country is cheap. We are not trying to own the old property-led growth model through the back door. And we are not making a blind macro bet on Beijing successfully reflating the economy.

We want exposure to the part of China that best expresses the argument we have just laid out: the public internet platforms through which commerce, cloud, search, gaming, local services, logistics, travel, digital advertising, online health, and AI-enabled consumer behavior are already moving into daily economic life.



The 3 & 5-year average revenue growth rates for China internet companies are like many U.S. internet companies.

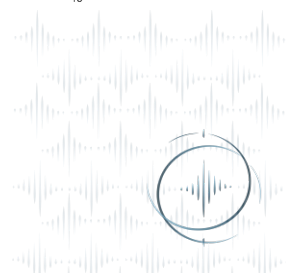
Top 10 KWEB holdings vs. their U.S. equivalents as of the latest earnings release Q4 2025).

Top 10 KWEB Holdings		Primary Business	KWEB Weight (%)	China Internet Companies		Comparable U.S. Business	US Internet Companies	
				3 Year Average Revenue Growth Rate (%)	5 Year Average Revenue Growth Rate (%)		3 Year Average Revenue Growth Rate (%)	5 Year Average Revenue Growth Rate (%)
Tencent	 腾讯	Social Media	10.09	11	9	Meta	20	19
Alibaba	 阿里巴巴	E-Commerce	8.93	5	15	Amazon	12	13
PDD	 拼多多	E-Commerce	8.78	53	51	Amazon	12	13
Meituan	 美团点评	E-Commerce	7.36	19	27	Amazon	12	13
NetEase	 网易游戏	Gaming	5.91	5	9	Activision Blizzard	6	2
JD.com	 JD.COM	E-Commerce	4.91	8	12	Amazon	12	13
KE Holdings	 贝壳	Online Real Estate Services	4.34	17	8	Zillow	10	20
Baidu	 百度	AI Cloud & Search	4.28	2	4	Alphabet	13	18
JD Health	 京东健康	Online Health Services	4.01	16	32	Teladoc	2	22
Full Truck Alliance	 满帮集团	Online Logistics Services	3.59	23	39	XPO	2	6
				Average: 16	Average: 21		Average: 10	Average: 14

The Fund's holdings are subject to change. Data from Bloomberg and KraneShares as of 3/31/2026. Please see the end of the presentation for definitions.

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Source: KraneShares, Investor Presentation, March 2026



KWEB is the cleanest listed vehicle we have found for that exposure.

The key point from KraneShares' latest presentation is simple: the companies inside KWEB are not low-growth value traps. On average, KWEB's top 10 holdings have grown revenues faster than their selected U.S. internet equivalents over both the last three and five years: **16% versus 10%** over three years, and **21% versus 14%** over five years.

And yet, they trade at a very different price.



Despite high growth rates, China's leading internet companies currently trade at relatively low multiples.

Top 10 KWEB Holdings	KWEB Weight (%)	Price to Earnings (P/E)	Forward P/E	Price to Book (P/B)	Price to Cash Flow (P/CF)
Tencent	10.09	17.4	14.1	3.4	12.7
Alibaba	8.93	26.4	23.5	1.9	20.5
PDD	8.78	10.3	8.6	2.4	9.0
Meituan	7.36	-	-	2.6	-
NetEase	5.91	16.9	12.0	3.0	N/A
JD.com	4.91	14.0	10.0	1.2	14.2
KE Holdings	4.34	38.0	17.9	5.4	-
Baidu	4.28	16.9	13.3	1.0	-
JD Health	4.01	25.4	22.4	2.3	13.4
Full Truck Alliance	3.59	13.4	12.6	1.3	-
Total	62.20	19.9	14.9	2.4	14.0

Data from Bloomberg and FactSet as of 3/31/2026. Fund holdings are subject to change. Please see the end of the presentation for definitions. Forward P/E is based on future 12-months average analyst estimate.

Source: KraneShares, Investor Presentation, March 2026

KWEB's top 10 holdings trade at an average forward P/E of **14.9x**, while the CSI Overseas China Internet Index trades at roughly **14.7x** earnings, compared with **28.5x** for the Dow Jones U.S. Internet Composite Index.

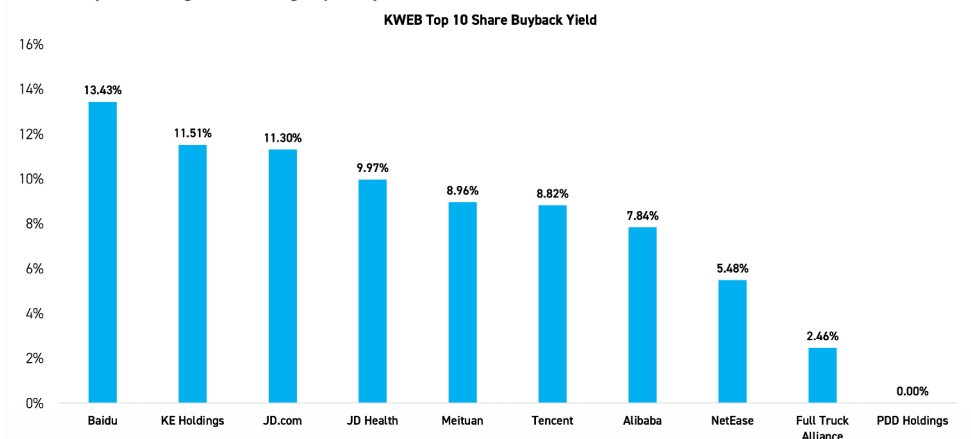
That is the asymmetry.

Faster growth than many U.S. counterparts.
A much lower multiple.

Far worse sentiment.



KWEB's top 10 holdings have strong buyback policies.



Data from Bloomberg as of 3/31/2026. Fund holdings are subject to change. Please see the end of the presentation for definitions. Please see page 25 for top 10 holdings.

Source: KraneShares, Investor Presentation, March 2026

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And, increasingly, management teams that are not waiting for the market to change its mind.

Buyback Yield measures the value of a company's share repurchases as a percentage of its market capitalization. In simple terms, it shows how aggressively management is using excess cash to reduce the share count. This is one component of what we often call **Shareholder Yield**, alongside dividends and debt reduction. And in deeply discounted markets, buybacks can be especially powerful: when companies repurchase shares at depressed valuations, remaining shareholders own a larger share of the business at an attractive price.

KWEB's holdings have roughly \$136 billion of cash on their balance sheets, and several of the largest constituents are repurchasing shares at a very meaningful pace. In fact, KraneShares' data shows buyback yields among KWEB's top holdings reaching double-digit levels in several cases, including **13.43% for Baidu**, **11.51% for KE Holdings**, and **11.30% for JD.com**.

That matters because one of the strongest objections to Chinese equities has always been the same: even if the companies grow, will shareholders capture the value?

The buybacks do not eliminate that concern.

But they do weaken it.

They show that boards and management teams understand the discount, recognize the opportunity created by their own depressed valuations, and are beginning to return capital in a way global investors can actually underwrite.

Technically, the setup is also becoming interesting:



After a steep drawdown over the past few months, KWEB is now trading above a material support zone that has already been tested several times. That does not guarantee anything. Support can break. But when a hated asset stabilizes above an important level, while the fundamental case is improving and short-term catalysts begin to appear, we pay attention.

And those catalysts may now be arriving...

Iran is reviewing a U.S. proposal that could formally end the war and reopen the Strait of Hormuz, while Trump has said Iran wants to negotiate and that a deal is possible. At the same time, Trump is scheduled to visit Beijing on May 14-15 to meet Xi Jinping, with trade, Taiwan, rare earths, export controls, and AI all sitting in the background of the relationship.

We will not overstate this.



By Reuters

May 4, 2026 9:04 PM GMT+1 : Updated May 4, 2026



U.S. President Donald Trump speaks during a Small Business Summit in the East Room at the White House in Washington, D.C., U.S., May 4, 2026. REUTERS/Kylie Cooper Purchase Licensing Rights

WASHINGTON, May 4 (Reuters) - President Donald Trump said on Monday he looks forward to seeing China's Xi Jinping later this month, saying he will remind his rival that the United States is leading in artificial intelligence as the two sides navigate tensions over trade and technology.

Source: Reuters, May 4 2026

But investing is not about waiting for certainty.

It is about identifying when the price, the pessimism, the fundamentals, and the catalysts begin to line up.

We believe that is now happening in KWEB. So, let's:

- reallocate the **2 percentage points** we removed from XLE in our April 25 weekly update into KWEB at **\$29.55 per share**.

What is needed are the tools for our health therapists. Several positions are now opening across the world, especially in the regions and alternative markets, and one of the best performers there are our graduates from our programs. We are also involved in a grant for the U.S. High Quality Colleges and Universities to provide up to the replacement of 20% that is a grant that is worth of about 100 million dollars.

[illegible]

Since then, the market has begun to recover some of that impact.

At the same time, our decision is generally consistent with the approach taken by the majority in *Shirley*, where the court, in the face of the fact that the majority of the shareholders of the corporation, including the wife, had agreed that the husband should be the sole owner of the corporation, held that the husband was the owner of the corporation.



It can be seen that the model has a higher correlation to the S&P 500 than the actual S&P 500. This is because the model is designed to be a better representation of the S&P 500 than the actual S&P 500. The model is designed to be a better representation of the S&P 500 than the actual S&P 500. The model is designed to be a better representation of the S&P 500 than the actual S&P 500.



VMF research

The script is free. The execution isn't.

What you see blurred below is the active, absolute-return Model Portfolio for Alpha Tier. It translates the long-form storytelling into position progress, asset weights, and concrete risk management.

Talk is cheap, but allocations aren't.

The strategy sample is open to everyone. The actual capital allocation belongs to our subscribers.

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Why?

Because the Model Portfolio weights are designed to be a better representation of the S&P 500 than the actual S&P 500. The model is designed to be a better representation of the S&P 500 than the actual S&P 500. The model is designed to be a better representation of the S&P 500 than the actual S&P 500.

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Source: From underappreciated to increasingly obvious, the guitar became more important.



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The use of a modified agency, an independent research center, or private, for-profit or public, nonprofit, organization as an intermediary between the state and the market, the private sector or civil society, has been a common trend in the development of the welfare state in the 1990s. The state is under increasing pressure to reduce its role in the provision of social services, and the market is under increasing pressure to provide social services. The state is under increasing pressure to reduce its role in the provision of social services, and the market is under increasing pressure to provide social services. The state is under increasing pressure to reduce its role in the provision of social services, and the market is under increasing pressure to provide social services.

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