Needham Funds

Chris Retzler's Insights

Vol. 6

September 29, 2026

By Chris Retzler, Portfolio Manager, NESIX/NESGX and NEEIX/NEEGX

The Macro / Micro Divide

Macro Headwinds

All eyes are on the macro economy. A significant market correction in late July triggered the abrupt collapse of Situational Awareness, L.P., a $45 billion, highly leveraged, AI-focused hedge fund. The collapse forced selling of many technology hardware stocks that were winners in the first half of 2026. The result has been a notable dispersion of performance, as the first-half winners faced outflows from investors taking profits and reallocating into industries that had not yet participated. This rotation has been significant, even if the major indices do not display the churn beneath the surface. However, the fundamental physical bottlenecks constraining long-term technological growth remain unchanged.

The Yen has required intervention to stabilize its decline, and the "carry trade" that flooded global capital markets for decades appears to be at an inflection point. Meanwhile, the Federal Government's borrowing needs now face significant competition from corporate borrowers.

The Federal Reserve raised interest rates a quarter point at its last meeting, and we expect further increases in 2026. Inflation remains a significant risk, with oil prices above $90 [1] a barrel and diesel well above $6.00 [2] a gallon. Other commodity costs such as steel, copper and aluminum are also impacting inflationary pressures. These higher prices will affect both company margins and end customers. While the Fed raised rates to cool inflation expectations, rate hikes alone will not reduce global energy and commodity costs. A resolution to the Middle East conflict would do the most to reduce these spikes.

Consumer Spending and Capital Markets

Consumer spending is under pressure from higher energy and food prices. Housing is also under pressure, as transaction activity is limited by higher mortgage rates and homeowners' inability to transfer low mortgage rates to a new home.

Capital markets were strong early in 2026; however, activity appears to be slowing with higher interest rates and the postponement of certain large IPOs. While capital markets are healthier than a few years ago, the cost of capital has increased for those needing to access funding sources. Mergers and acquisitions remain active, although the higher cost of capital may slow activity in the near term.

Fundamental Strength at the Micro Level

However, the broader market's negative sentiment is not reflected at the corporate level, where the story is considerably more robust. The greatest fundamental strength appears to sit within semiconductor manufacturing and capital equipment. Here, top- and bottom-line growth continues despite high interest rates compressing technology valuation multiples. Chip design complexity is increasing rapidly, requiring a higher density of tools and subsystems per wafer. Semiconductor shortages remain significant opportunities for memory and logic manufacturers, and the immediate beneficiaries claim order visibility through 2027 and into 2028. We have never seen order visibility to this extent, nor have many semiconductor veterans.

[1] https://www.cnbc.com/quotes/@CL.1
[2] https://www.eia.gov/petroleum/gasdiesel/

Velocity of Expansion

The velocity of expansion among specialized suppliers appears historically unique. NVIDIA Corp. (NVDA), for example, traded sideways for about ten months, growing into its valuation through significant margin expansion. Even more telling, semiconductor capital equipment companies are growing revenue at a pace that shocks even industry veterans. Two drivers of the increased capital equipment requirements are wafer capacity additions, and technological advancement that adds process, measurement and test steps to fabrication. Semiconductor packaging is also a major opportunity as chips become denser and more complex. Chips will become an increasingly important topic over the coming years.

Supply Chain and Trade

Supply chain constraints remain a risk to specific industries, particularly around rare earth materials. China controls much of the raw and processed materials used in rare earth magnets, as well as specialty materials used in optical components. Tariff and trade negotiations continue, and good company leadership teams are managing their impact as best as they can in this environment.

Military Modernization

The hardware push extends directly into national defense, where military modernization has shifted from theoretical design to rapid inventory ramp-ups. Capital appears to be flowing heavily into autonomous systems, high-volume drone manufacturing, and directed-energy weapons. Geopolitical risk surrounding Taiwan reinforces this trend; should Taiwan's capacity ever be compromised, domestic chip independence may become an immediate national security mandate, possibly positioning Intel Corp. (INTC) as crucial to U.S. infrastructure. A change in congressional leadership could bring uncertainty to the defense budget. We believe, however, that military modernization retains bipartisan support as a means to reduce costs and save lives.

The Next Frontier

Demand for AI continues to accelerate as applications expand, and agentic AI inference is just beginning, which should sustain capital investment. Enterprise and sovereign spending are also increasing, broadening AI's advancement globally. Humanoid robots may be only three years away from meaningful commercial scale, with thousands of initial units expected to enter production lines. Specialized silicon providers developing advanced touch and edge processing capabilities that these machines require may be well-positioned.

Cybersecurity will be critical to the AI revolution. Likewise, the predicted death of software companies at the hands of AI is overblown; software will participate in AI's growth, though technological moats will separate winners and losers.

Data Centers and Power

Data center demand has not abated and likely will not slow for years. However, the November mid-term elections have made data centers a headline topic in multiple states, raising local concerns, a risk likely to persist through election season. These are long-tail capital investments, and we believe these concerns will be addressed locally and many projects ultimately built. "Behind the Meter" power generation will be critical for data center operators, requiring substantial infrastructure investment.

Outlook

Overall, the market appears to be climbing a massive "wall of worry." While headline risks like oil volatility and restrictive interest rates keep sentiment cautious, the underlying micro economy tells a different story. Domestic reindustrialization is moving forward, suggesting that for companies successfully expanding both top and bottom lines, long-term fundamental growth remains in sight. A divided Washington, D.C. may limit new policy uncertainty, giving corporations the predictability to invest long term with confidence. In this environment, investors should focus on companies with good balance sheets and strong management teams and boards of directors. Technological moats are critical for long-term margin sustainability.

Needham Funds Quick Links

Manager Commentary & Insights
Prospectuses & Fact Sheets

Definitions and Disclosures

The information presented in this commentary is not intended as personalized investment advice and does not constitute a recommendation to buy or sell a particular security or other investments. This message is not an offer of the Needham Growth Fund, the Needham Aggressive Growth Fund, or the Needham Small Cap Growth Fund (each a "Fund" and collectively, "the Funds"). Shares are sold only through the currently effective prospectus. Please read the prospectus carefully and consider the investment objectives, risks, and charges and expenses of the Fund carefully before you invest. The prospectus contains this and other information about the Fund.

Current month-end performance and a copy of the prospectus are available at www.needhamfunds.com or by contacting the Fund's transfer agent, U.S. Bancorp Fund Services, LLC at 1-800-625-7071. Investment returns and principal value will fluctuate, and when redeemed, shares may be worth more or less than their original cost. Past performance does not guarantee future results and current performance may be higher or lower than these results.

Total return figures include reinvestment of all dividends and capital gains. Needham & Company, LLC, member FINRA/SIPC, is the distributor of The Needham Funds, Inc.

All three of the Needham Funds have substantial exposure to small and micro capitalized companies. Funds holding smaller capitalized companies are subject to greater price fluctuation than those of larger companies. Also, all the of the Needham Funds are permitted to engage in short sales, options, futures, and leveraged trading strategies. The Funds' use of short sales, options, futures strategies, and leverage may result in significant capital loss.

Needham Small Cap Growth Fund's ownership as a percentage of net assets in the stated securities as of June 30, 2026: NVDA: 0.00% and INTC: 0.00%.

The Russell 3000® Index measures the performance of the largest 3,000 US companies representing approximately 96% of the investable US equity market, as of the most recent reconstitution. The Russell 3000 Index is constructed to provide a comprehensive, unbiased and stable barometer of the broad market and is completely reconstituted annually to ensure new and growing equities are included. The Russell 2000 Growth Index includes those Russell 2000 Index companies with higher price-to-value ratios and higher forecasted growth values. An investor cannot invest directly in an index. Needham & Company, LLC is a wholly owned subsidiary of The Needham Group, Inc. Needham & Company, LLC, member FINRA/SIPC, is the distributor of The Needham Funds, Inc.