DECONSTRUCTING THE AI TRADE: A MARKET RECKONING?

AI Builders, AI Suppliers, AI Products and AI Customers

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THE LEAD IN

- When I posted my valuation of Anthropic a few days ago, I **noted that turbulence lay ahead, both for the company and the market.** I did not expect that turbulence **to be this forceful and this soon**, but markets don't have an obligation to wait until it is convenient for investors, to adjust to new realities.
- With the election results on November 3 acting as a catalyst, investors initially responded positively with stocks up on Wednesday, but **reversed course sharply on Thursday, with the NASDAQ down close to 6% and the S&P 500 declining 4%.**
- The **AI trade, which has been a constant in market discourse this year again came into play**, and my reaction was that it was being used, as it has all through the year, as a shield against more productive discussions about both the AI business and the overall market.

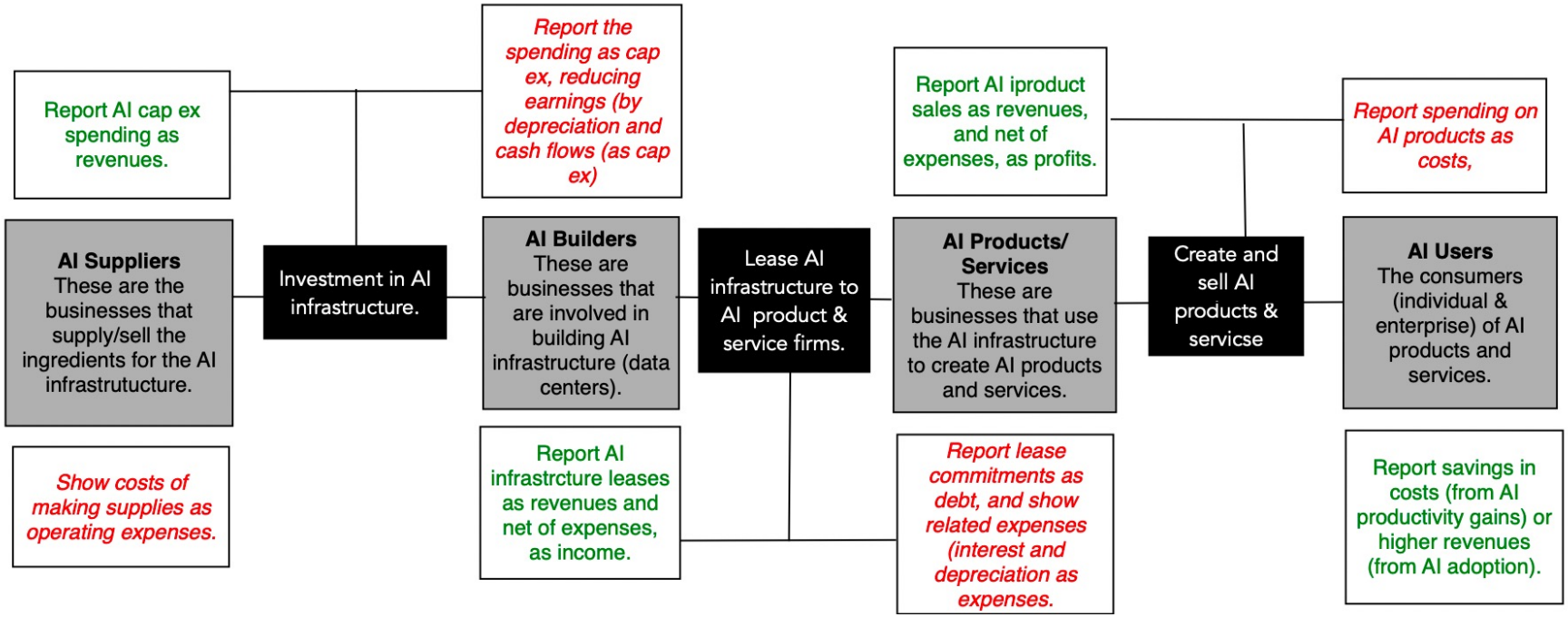
AI COMPANIES: A BREAK DOWN.

- There are **many players that are lumped together as AI companies**, from those spending the money **building the data centers** to the firms benefiting from **selling the builders the ingredients for these data centers** to the companies that are leasing these data centers for long periods and immense costs (with the LLMs in the lead) **to use to create their AI agents**, models and products.
- I will argue that while all of these groups benefit, at least in general, from AI's success at creating large and profitable markets, **we are reaching a point in the AI disruption, where their interests and payoffs will diverge, with implications for both the businesses and investors.**

MY NVIDIA HOLDINGS AND INTEREST IN AI!

- **My journey on AI started with a selfish and narrow intent**, which was to evaluate an investment I made in Nvidia in 2018, for reasons entirely unrelated to AI. I thought that Nvidia, at the time, was a innovative chip company with more pricing power than many in its peer group, and felt that it was undervalued, given its prospects.
- Since much of Nvidia's supersized success was being propelled by AI demand, that **required me to take my first look at how big the AI market** would be, and how well Nvidia was positioned to take advantage of that market.
- If you have read my multiple posts on Nvidia over the last three years, **you are aware of my decision to sell Nvidia in four installments**, with the last one happening earlier this year. As many of you have been quick to point out, my decision to gradually decrease my Nvidia position has led me to leave money on the table, but I have no regrets.

THE AI PLAYERS



THE TIMING OF PAYOFFS

	Suppliers	Builders	Products	End users
Hope & Hype	1st group to see revenues/ earnings	AI cap ex will have negative effect on both earnings and cash flows	Developing products & services. Pre-revenues, loss-making	Test users using AI products
Investment	Continued growth, albeit at slower pace, as scale up	Portion of the AI can be leased out, allowing for some monetization	Products introduced, and from small scale, growth can be exponential	Mix of early adopters and experimenters, in a subset of industries
Business Building	Have fully formed business models, but revenue growth rates will start to ease.	Revenues and earnings from existing investments	Jockeying for position in the market, looking for ways to differentiate themselves and preserve pricing powe	Receiving end of sales pitches for AI products and services

WHAT AI COMPANIES HAVE IN COMMON...

- There is one common element that holds them together **and that is the value of all of the players in the ecosystem ultimately will be determined by how big the AI customer group** becomes, and that is where much of the discussion of total markets and revenues converge.
  - As I noted in my earlier posts on AI, **if the end market for AI products and services is small**, either because of its imperfections as a tool or replacement for employees, regulatory restrictions or limited reach, the entire AI ecosystem (builders, suppliers and product businesses will all feel the pain.
  - Conversely**, if AI delivers on its promise as a powerful productivity tool that works across many businesses**, all of them benefit, albeit in different forms. In addition, if one of the groups faces growth and survival challenges, those pains will spread into the other groups as well.
- That may **explain why you see so much circular financing in the AI ecosystem**, where financially better- positioned and stronger players like Nvidia investing in or offer financing guarantees to players in the other groups, either to ensure survival or to provide an impetus for continued investment spending.

COMPETITION, AND TRADE OFFS…

- These businesses **also have competing interests**, but the expenses for one business become revenues for another, and bad decisions by one group can create benefit for others.
- Thus, **if AI builders choose to build too much infrastructure, too quickly**, it will hurt them and their shareholders, but that overbuilding will be a bonanza for the AI suppliers, as chips, equipment, power and real estate players all benefit from the overbuilding.
- Once built**, it is in the AI builders' interests to lease out the infrastructure for longer periods than merited, locking in their revenue stream**, but for the AI product companies, those long-term commitments can increase default risk.
  - **For much of AI's early existence, the commonalities have overwhelmed the competing interests**, with the groups tending to move together on news, mostly about the size of the AI market.
  - As the AI disruption moves through the disruption, it is inevitable that this will change, with the **market differentiating across groups, picking winners and losers.**

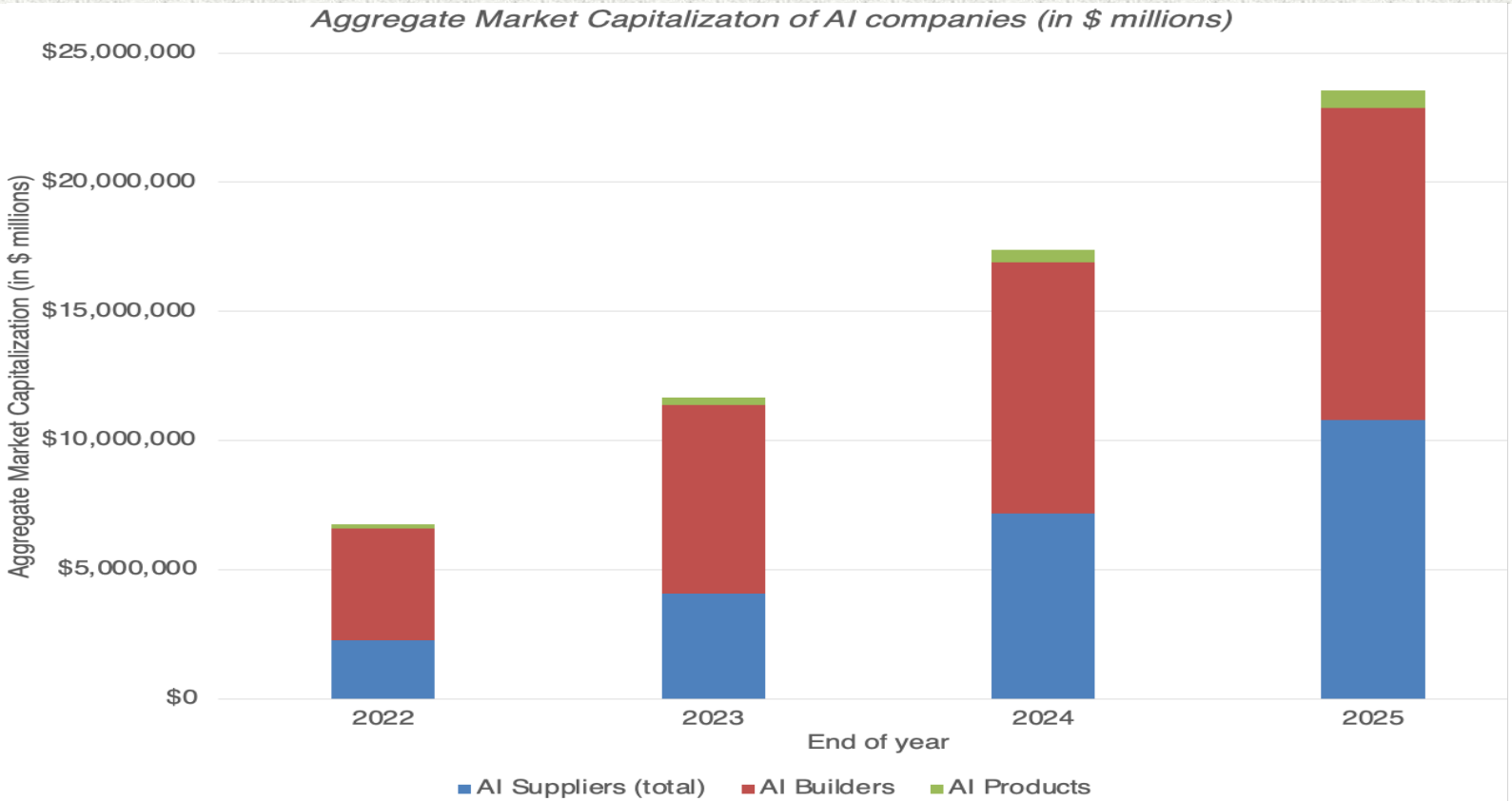
DECONSTRUCTING AI COMPANIES

- Public vs Private: Data availability and the requirement that there be a market price **restricts the sample to publicly traded companies**. That not only reduces the sample size and creates sampling bias, but it also has disparate effects across the different groups.
- Missed companies and changing sample: Since there is **no separate accounting categorization for AI-related revenues and expenses**, I relied on public descriptions of the largest companies operating in each of three AI groupings.
- Not pure plays: Most of the companies in this sample **operate in other businesses**, many of which pre-date their entry into AI. This is especially true of the hyperscalers, where Amazon, Alphabet, Meta and Microsoft have legacy businesses that generate large earnings and stand-alone market value
- In multiple groupings: Some of the companies in this sample can take issue with the grouping that I have included them or **operate in more than one grouping**. Meta, Alphabet and Microsoft, in addition to be major investors in AI cap ex, are working on their own versions of LLM (Muse for Meta, Gemini for Alphabet and Co-Pilot for Microsoft) to enter the product market.

MY AI SAMPLE

AI Chips, Cloud & Supplies	AI Power	AI Electrical	AI Hyperscalers
NVIDIA	NextEra Energy	ABB	Microsoft
Taiwan Semiconductor	Constellation Energy	Eaton Corp	Alphabet
Broadcom Inc.	Bloom Energy	Vertiv Holdings	Amazon.com
Samsung Electronics	Vistra Corp.	Delta Electronics	Meta Platforms
Micron Technology		GE Vernova	Oracle Corp
Advanced Micro Devices	**AI Real Estate/ Construction**	Schneider Electric Infrastructure	CoreWeave, Inc
SK hynix Inc	Equinix		**AI Products**
ASML Holding N.V.	American Tower Corp		SpaceX
Arista Networks, Inc.	Brookfield Asset Management		Palantir Technologies
Cerebras Systems Inc.	Digital Realty Trust		Salesforce
	Suppliers to AI Builders		
	AI Builders		
	AI Products		

A HISTORY OF AI MARKET PRICING!

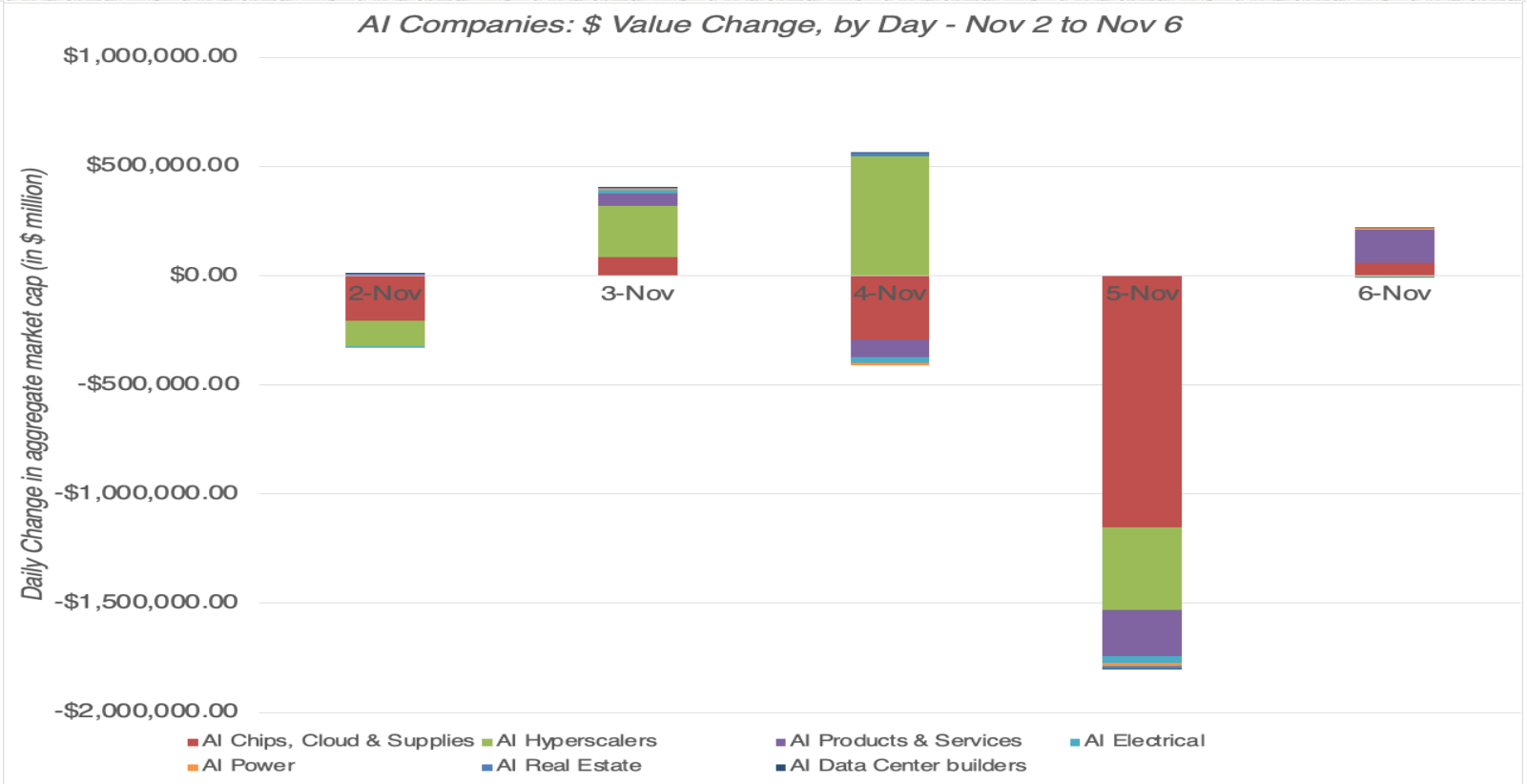


	Market Capitalization (in $ millions)				*Change over period*	
AI Group	31-Dec-22	31-Dec-23	31-Dec-24	31-Dec-25	$ value	% Change
AI Chips, Cloud & Supplies	$1,717,508	$3,430,224	$6,251,864	$9,550,267	$7,832,758	456.05%
AI Electrical	$152,600	$227,187	$403,183	$583,062	$430,462	282.09%
AI Power	$207,475	$179,042	$269,376	$352,728	$145,253	70.01%
AI Real Estate/ Construction	$199,146	$232,729	$258,248	$295,027	$95,881	48.15%
AI Suppliers (total)	**$2,276,729**	**$4,069,181**	**$7,182,672**	**$10,781,083**	**$8,504,355**	**373.53%**
AI Builders	**$4,326,108**	**$7,320,380**	**$9,708,419**	**$12,102,720**	**$7,776,612**	**179.76%**
AI Products	**$144,752**	**$292,081**	**$492,241**	**$671,877**	**$527,125**	**364.16%**
All AI companies	$6,747,588	$11,681,643	$17,383,331	$23,555,680	$16,808,091	249.10%

AND IN 2026

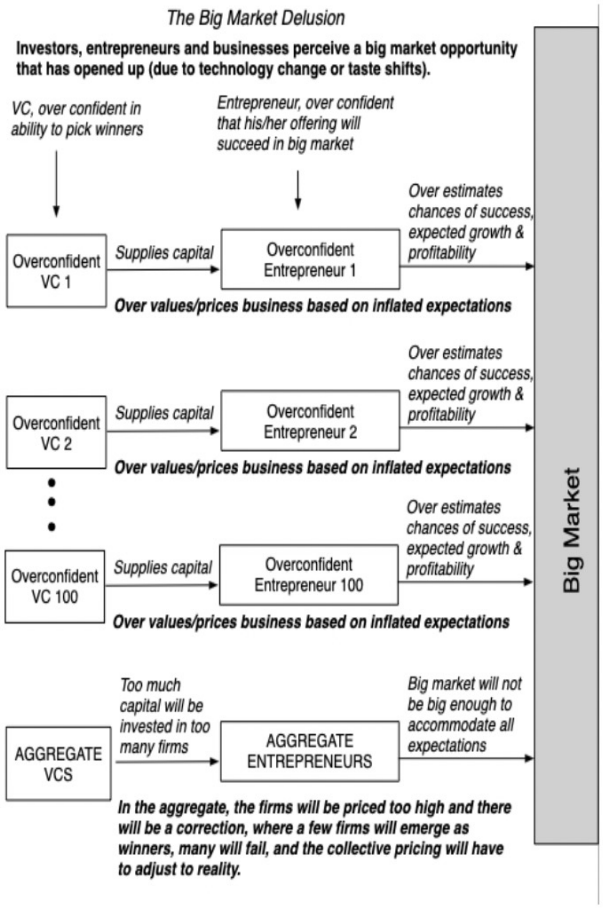
		Market Cap (in $ millions)			% Change in Market Cap		
Category	Number of firms	12/31/25	9/30/26	11/6/26	First 3 Qtrs 2026	Oct 1 - Nov 6, 2026	2026 YTD
AI Chips, Cloud & Supplies	10	$9,550,267	$14,617,294	$11,389,591	53.06%	-22.08%	19.26%
AI Electrical	5	$403,008	$589,163	$437,023	46.19%	-25.82%	8.44%
AI Power	4	$352,728	$376,007	$364,651	6.60%	-3.02%	3.38%
AI Real Estate & Construction	7	$325,293	$338,121	$365,351	3.94%	8.05%	12.31%
AI Hyperscalers	6	$12,102,720	$12,997,286	$12,187,851	7.39%	-6.23%	0.70%
AI Products & Services	3	$671,877	$2,686,024	$2,385,799	-4.98%	-11.18%	-49.66%
All AI companies	35	$23,405,892	$31,603,895	$27,130,266	35.03%	-14.16%	15.91%
Rest of the market	5,659	$49,008,750	$53,537,699	$53,795,442	9.24%	0.48%	9.77%
AI as percent of market		32.32%	37.12%	33.52%			

AND LAST WEEK...

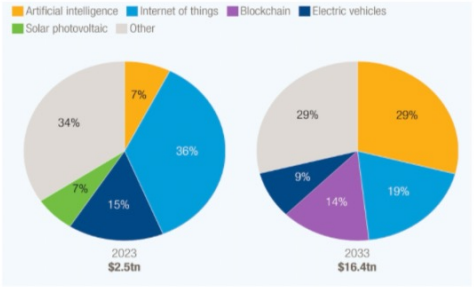


Category	2-Nov	3-Nov	4-Nov	5-Nov	6-Nov	Nov 2 to Nov 6
AI Chips, Cloud & Supplies	-1.59%	0.66%	-2.30%	-9.24%	0.51%	-11.72%
AI Hyperscalers	-0.99%	2.01%	4.55%	-3.00%	-0.04%	2.38%
AI Products & Services	0.25%	2.35%	-3.09%	-8.63%	6.73%	-3.04%
AI Electrical	-0.62%	2.86%	-5.86%	-6.61%	0.41%	-9.75%
AI Power	-0.63%	2.05%	-2.14%	-3.82%	1.86%	-2.77%
AI Real Estate	0.45%	0.70%	4.24%	-3.52%	-0.10%	1.64%
AI Data Center builders	1.32%	1.15%	1.16%	-2.74%	1.31%	2.15%
All AI companies	-1.13%	1.43%	0.53%	-6.27%	0.79%	-4.76%
Rest of US Equities	-0.99%	1.52%	0.16%	-6.39%	1.22%	-4.60%

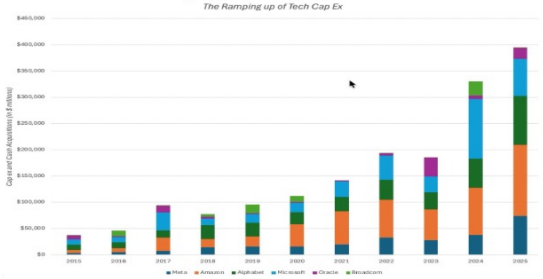
WHERE NOW FOR AI? A BIG MARKET DELUSION?



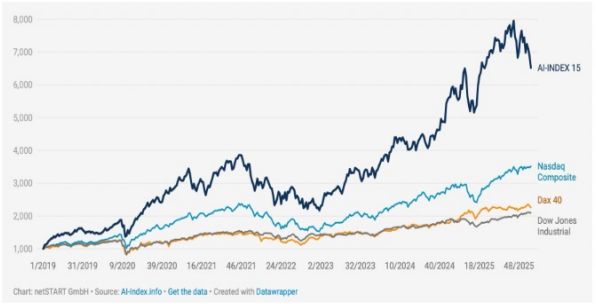
The Promise of AI: A "Huge" Winner(s)-take-alll Market



Draws big investments in AI



And Markets have gone along (for the moment)



WHERE IS AI?

- I am seldom certain about anything in markets, but **I am close to certain that there is a big market delusion in AI**, I think that AI, because of its reach and potential, almost certainly has led to over investment, by AI builders, over commitments to compute power by LLM companies and over pricing, by the market, at least in the aggregate.
- **The correction, when it comes, will cause pain**, but the pain will be distributed unevenly, and for those who believe that AI has potential but have found the companies in the space over priced, it will provide opportunities.
- Before you decide that this (the over investment, over pricing and subsequent correction) is a problem, **it is worth noting that this phenomenon is a feature, not a bug**, that is associated with uncertainty and big change, and that it is, in spite of the costs of the cleanup, is a pre-requisite for change.

ACTING ON THE BELIEF (THAT THIS IS A BIG MARKET DELUSION)

- *Uncertainty about correction (when and what form):* Even if you are right that investor and business overconfidence has lead to overreach, you need the market to come to agree with you, and **it is difficult, if not impossible, to try to predict when in will happen, and what form it will take.**
- *Catalysts for correction:* The catalysts that trigger the correction can sometimes be big news stories, but more often, it is a collection of small cuts that eventually leads to market adjustment. The **big market delusion is ultimately built on a behavioral characteristic** (over confidence) and the correction has as much to do with investor psychology, as with financial fundamentals.
- *Acting in the fact of uncertainty:* **If you are an investor of long standing in one of AI's winners, use each correction phase to sell a portion of your shares**. You will give up upside, by doing so, but you will not be completely exposed, when the correction happens. If you decide to buy AI stocks after the correction, don't wait for the bottom, since you may never hit it.
- *Go where it is darkest:* If you are an AI advocate, and you have generated supersized returns over the last four or five years from just buying companies in the AI space, in my views, **you are entering a phase, where if your AI optimism holds, you should prepare yourself for more periods like last Thursday, where the market mood on AI darkens, and use those periods to e more discriminating in your AI investment choices.**

THE AI TRADE UNRAVEL AND IMPLICATIONS FOR ANTHROPIC!

- As I noted in an earlier post, **IPOs are priced**, and after not hearing talk of annualized revenue run rates for a few weeks, there was a leak that Anthropic's ARR for October hit $80 billion, which was touted as both good news (by some) and bad news by others.
- The truth is that pricing is a **mood and momentum game**, and it is undeniable that the mood has darkened for not just AI but the market in the last two weeks. If you throw in **bankers who are terrified of over pricing a trillion-dollar plus offering** and picking up the pieces, the **pressures to lower the offer pricing only get stronger.**
- On the valuation front, it is not market mood that matters but **events that have changed the fundamentals Just to give you a measure of how sensitive the Anthropic valuation is to these changes,** increasing how much Anthropic will have to invest to add compute power in future years (by lowering the sales to cap ratio from 3 to 2.5) and increasing the drag on margins from regulation (from 5% to 7.5%) reduces the estimated equity value to $1.25 trillion, even if you leave the target revenues at a trillion dollars.

CONCLUSION

- I hope that we stop talking about "the AI trade", as a catch all for AI companies, and **start differentiating between the different groups "AI builder" or the "AI Supplier" or the "AI product trade**, for two reasons.
  - The first is that as the AI business starts to take form, there will be **developments that are good for one group and bad for others**; the election results clearly affected AI suppliers more negatively than it did AI builders.
  - The second is that when you have **crisis developments, the market may lose its head and mark down all AI companies indiscriminately**, offering you the chance to buy those that you believe should not have been marked down.
- I also think that it is time that we **hold off on making overly broad assessments of the AI business that reflect more our emotions and priors** than the facts on the ground.
  - Thus, if **you start with the presumption that the entire phenomenon is a "bubble",** your mind is already made up and no AI company, no matter what group it belongs to, will be worth its price.
  - At the other extreme, **if you are so dazzled by the technology that you see this as a sure win**, you are setting yourself for disappointment, because not only are there no sure wins in equity markets, but the pathway to AI nirvana will be come with challenges that test your faith.