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IS THIS TRAIN BOUND FOR GLORY?

If you get on the wrong train, get off at the next station; the longer it takes you to get off, the more expensive the return ticket will be.

- Japanese Proverb

Before 1840, it took approximately 5 to 7 days travelling by horse to make the 400 mile journey from London to Glasgow. Thanks to the completion of the Liverpool-Manchester Railway line connecting the two cities, the trip could be made in a mere 24 hours by train! To people who had never travelled faster than a horse could gallop, this miracle of technology was much more than a faster mode of transportation. This new invention appeared as a magical compression of time and space.

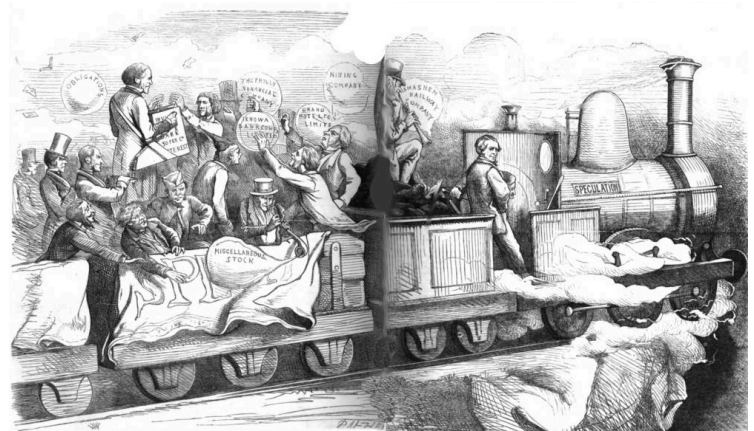
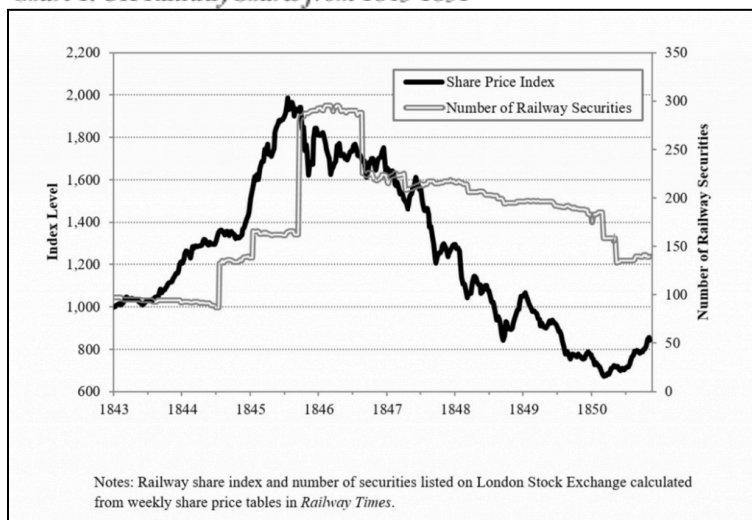


Chart 1: UK Railway Shares from 1843-1851



Investments in rails boomed. In just a three year period between 1843-1846, the British Parliament approved 263 acts for railway companies proposing 9,500 miles of track, nearly matching today's entire UK network. By 1846, railway companies comprised 71% of total stock market value, up from 23% eight years earlier. But history went on to show that even this transformative technology could not resist the gravitational pull of economic realities. Both corporate revenue and profit fell short of expectations and by 1850, railway shares had lost 85% of their value from the recent

peak. Over 200 companies went bankrupt. Though many investors had lost a fortune, the bubble provided invaluable infrastructure that became the backbone of the Industrial Revolution and continues to benefit individuals and businesses to this day.

Much like the dawn of railroads, many proponents of artificial intelligence (AI) today believe it is the most important new technology of this century. Both investors and corporations alike are getting on the AI train. The hope is AI will change the world by driving innovation across industries, augmenting productivity and efficiency and improving the human experience

through automation. According to Bloomberg, the four AI ‘hyperscalers’ - Microsoft, Meta, Google and Amazon - are expected to spend over \$320 billion in 2025 alone on AI infrastructure. It is little wonder that AI-related stocks have accounted for the gross majority of equity market returns, earnings growth and capital spending over the past 36 months. The 10 largest stocks in the S&P 500 now represent 42% of the Index. All of these elements have combined to make today’s current stock market more overweighted to, and dependent upon, one investment theme since railroad stocks in the 1800s.

But a recent study from MIT revealed that 95% of organizations in their research reported “zero return on their (AI) investments.” Why does this matter? Much like the rails of old, AI is in a race for time where investment returns need to catch up quickly with the investment dollars. It is too early to determine whether the financial benefits from AI will improve enough to keep the markets from careening over the rails.

CHART 2: Big Tech AI Cap Ex Spending Source: Bloomberg

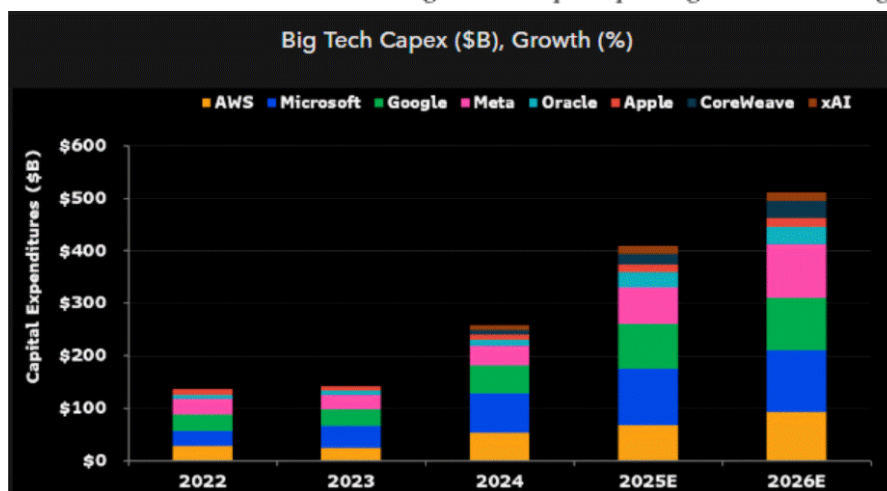
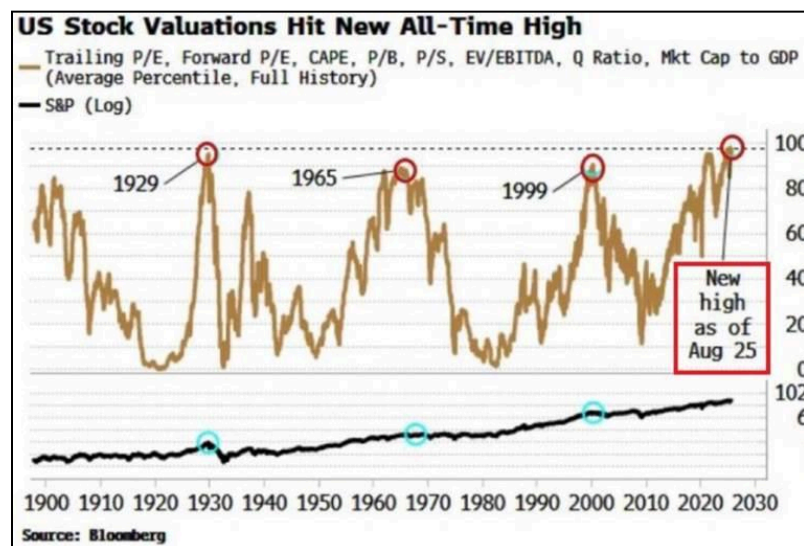


Chart 3: US Stock Valuations



All Aboard!

The current obsession with AI stocks is pushing valuation of the entire market to new frontiers. According to Bloomberg Financial Services, US stock valuations are at their highest levels since, at least, the late 1800s (see Chart 3). Today, the cyclically adjusted P/E ratio (CAPE) has reached its 98th percentile

over a 150 year period; the Buffet Indicator, which compares the total value of stocks to US GDP, is at a historically high level of 217%; and the 10 largest US stocks now represent a record 42% of the S&P 500 versus a Dot Com Bubble high of 26%.

Perhaps more significant than how overpriced stocks may be now is how important the AI theme has become to both the overall market and the economy. Kevin Smith, partner at Crescat Capital, suggests the 10 largest stocks in the S&P 500 now have an enterprise value to GDP ratio of approximately 76.8% versus 28.4% at the peak of the Dot Com Bubble peak in 2000 (Chart 4). JP Morgan Asset Management's Michael Cembalest believes the markets are even more concentrated than investors know. He recently stated "AI related stocks have accounted for 75% of the S&P 500 returns, 80% of earnings growth and 90% of capital spending growth since ChatGPT launched in November 2022" suggesting *these stocks are now the market*.

Chart 4: Internet vs AI

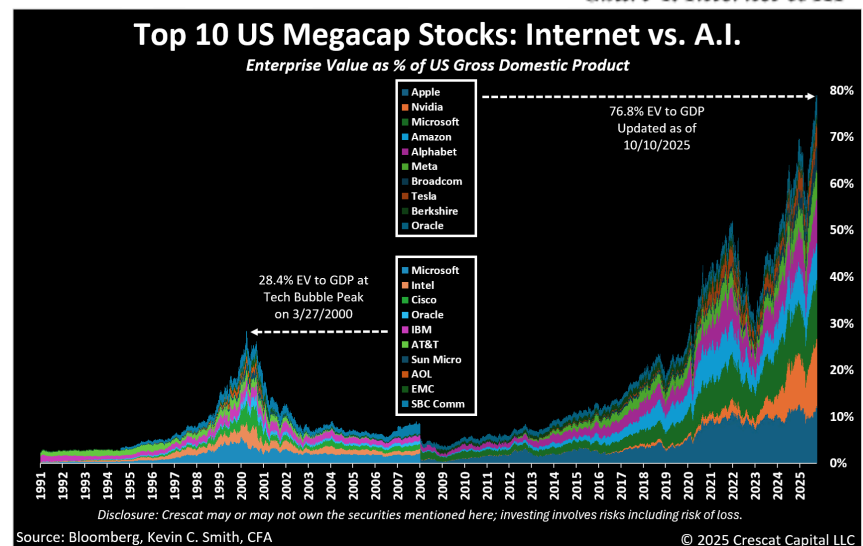
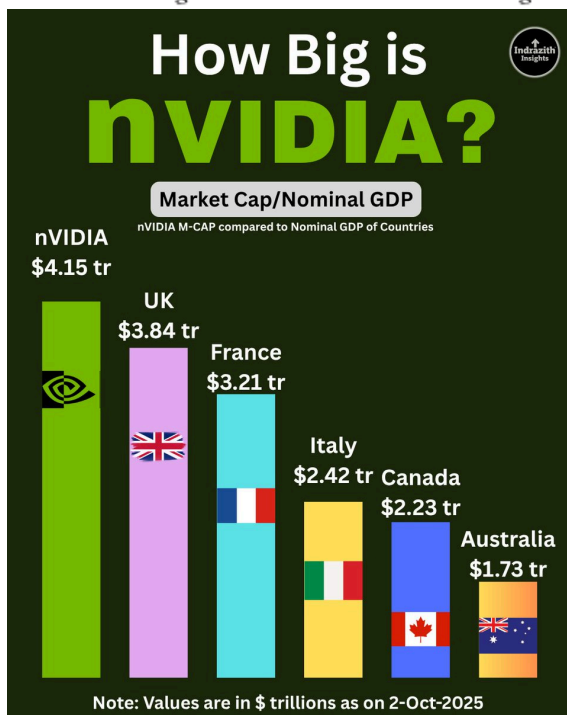


Chart 5: How Big is Nvidia? Source: Indrazith Insights



There is perhaps no single stock that helps put into perspective just how big AI stocks and AI capital spending have become, more than Nvidia. It is the single largest stock in the S&P 500 Index at about \$4.7 trillion in market cap. Just how big is \$4.7 trillion? **Nvidia is valued more than the GDP of all but two countries in the world and its market cap is equal to roughly 16% of US GDP.** There has never been a stock in modern history that has represented that large a percentage of the world's economic output. By comparison, Cisco Systems was the largest stock in the world in March 2000 at the peak of the Dot Com Bubble and its market cap represented 5.5% of US GDP.

What also makes much of this AI boom reminiscent of past boom and bust cycles is the circular dealing involved in many AI data center projects and infrastructure build. Since the investment amounts in data centers have become so large, many large firms have resorted to assisting smaller companies in

getting deals financed. Morgan Stanley compiled a chart that helps illustrate just how circular many of these project financings actually are (Chart 6).

It Takes a Lot to Laugh, It Takes a Train to Cry

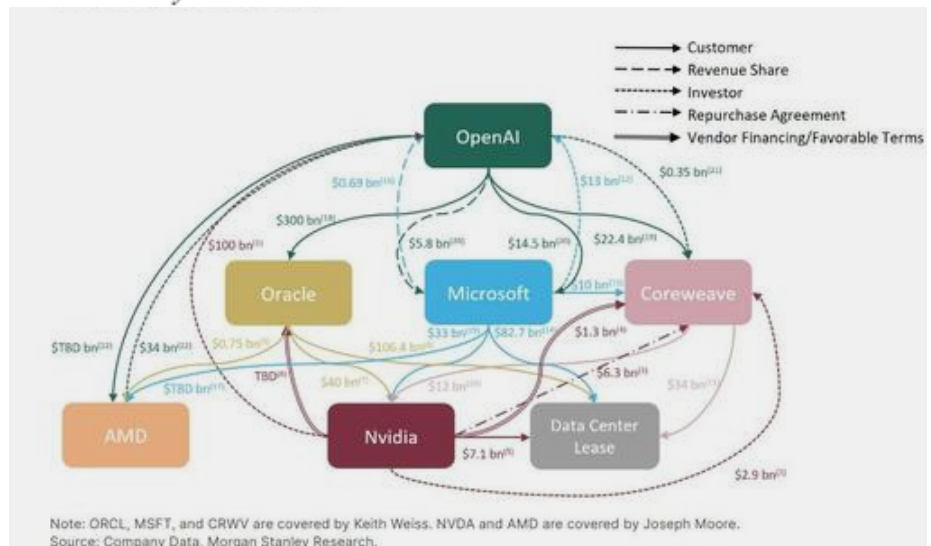
If AI cap ex spending continues growing at an accelerated pace, and revenues from these massive investments

begin to shine, these stocks can continue to rise. McKinsey & Company recently reported that the AI spend has only just begun. They estimate there will be a “cumulative total spending of \$6.7 trillion in data centers globally through 2030.” But David Einhorn of Greenlight Capital, in a recent letter to his investors, asked an obvious question to this pronouncement, “Where will the nearly \$7 trillion come from?” He suggests if you add all of several major sources of spending power together including total book value of the Magnificent 7, all dry powder from private equity and venture capital firms, 100% of all advertising spend globally and then added the revenue from all subscriptions in media, software, cloud and other sources, used the proceeds from a record year of debt issuance in non-financial debt markets, and spent the proceeds from the largest year on record for IPO issuances and secondary stock offerings, you would finally have enough cash to fund these data centers. Needless to say, there are train warning whistles beginning to blow when it comes to the AI spending to AI revenue gap.

Going Off the Rails or Staying on the Track?

AI cap ex spending has the stock market flying high, but significant corresponding revenues have thus far remained absent. Financial history is replete with examples of companies overspending and underestimating associated costs on new and shiny inventions. There was a significant amount of carnage in the market when railroad revenues did not ultimately live up to projections in a timely fashion, but the track laid in the 1800s still serves the economy of England today. However, silicon chip technology is changing so rapidly, it is not likely the infrastructure laid today in the AI world will have the same impact as the railroad tracks did after the mid 19th century stock bubble bust. The S&P 500 today is not giving investors the diversification they might expect and the market is now lopsidedly married to one narrow theme. If it turns out that AI revenues are too slow to materialize and the AI is taking investors down the wrong track, the return ticket will be much more expensive. All of this should have investors wondering if AI stocks will deliver on their locomotive valuations, or should investors prepare for AI stocks to run the market off its rails?

Chart 6: AI Ecosystem



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