

Thinking Out Loud



Two Sides of Different Coins

9/14/2026

Over the past several weeks, AI-related stocks have experienced a sharp deterioration in investor sentiment, resulting in meaningful price declines and underperformance relative to the broader S&P 500. One source of pressure has been rising interest-rate expectations, which increase discount rates and weigh on long-duration equities—particularly companies whose valuations depend heavily on future growth and capital appreciation. These concerns have been compounded by questions around AI monetization and whether the substantial capital being invested across the ecosystem will generate adequate returns. At the same time, recent warnings from AI researchers and industry leaders have intensified calls to slow or more tightly regulate AI development. The concern is that AI capabilities are advancing so rapidly that they could eventually become difficult to control, particularly as increasingly autonomous AI agents take on more complex tasks and potentially create broader safety risks.

While the AI infrastructure trade and the investment case surrounding frontier-model development and increasingly autonomous AI systems are related, we believe they represent distinct investment stories.

Our investment focus remains on the broader demand for computing power, data storage, networking, data centers, and electricity. From this perspective, the long-term infrastructure opportunity can remain attractive even if the most advanced AI models face tighter regulation, slower development, or lower-than-expected profitability.

Developing the next generation of AI models is only one source of demand. Computing capacity is also needed to run existing AI applications, support businesses using AI, power cloud services, process data, develop software, run simulations, and handle many other digital workloads. In our view, the long-term opportunity is therefore less dependent on the success of any one AI model or company and more dependent on the continued growth in overall demand for computing and digital infrastructure.

For example, Microsoft reported¹ \$175 billion of capital spending in 2026, with roughly two-thirds of capex directed toward shorter-lived assets such as CPUs and GPUs. In addition, Alphabet² expects to spend \$195–\$205 billion on capital investment in 2026, with roughly 60% of that spend toward servers.

We view the AI value chain in layers. As investors move higher in the stack toward frontier-model developers, regulatory, competitive, and profitability risks increase. Lower in the

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¹ Microsoft Fiscal Year 2026 Fourth Quarter Earnings

² Alphabet Q2 2026 Earnings Results

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stack, demand is supported by a broader mix of AI and non-AI activity, making these businesses less directly exposed to AI-specific concerns.

As shown in Exhibit 1, power, cooling, electrical equipment, and data-center construction sit at the lower end of the risk spectrum. Semiconductor companies sit in the middle, while frontier-model developers face the greatest regulatory and safety scrutiny.

Exhibit 1: AI Supply Chain Stack

Layer	Examples	Primary demand driver	Regulatory exposure	Key investment risk
Frontier models	GPT-, Gemini-, Claude-class models	Model scaling and capability gains	High	Regulation, safety, IP, economics
Cloud / AI platforms	Azure, AWS, Google Cloud	Enterprise workloads and AI consumption	Moderate	Returns on very large capex programs
Compute hardware	GPUs, CPUs, memory, networking, optical	Training + inference + cloud + HPC	Moderate	Obsolescence, competition, export controls
Data-center infrastructure	Data centers, electrical systems, construction	Cloud + AI + traditional compute	Low-Moderate	Capacity oversupply, financing
Power & physical infrastructure	Utilities, generation, transmission, transformers, cooling	Data-center load growth	Low	Overbuilding, permitting, power prices

Source: NEPCG

From our perspective, the bigger long-term risk is not simply that AI development could slow because of regulation or industry caution. It is that the industry may eventually build more computing and data-center capacity than demand can support. If that happens, utilization, pricing, and investment returns could weaken. For that reason, we believe overbuilding is the more important long-term risk to the AI infrastructure story.

Still, we admit the two risks are still connected. If progress in advanced AI models slows, businesses may adopt AI more gradually, which could eventually reduce demand for additional computing capacity. ***However, we believe investors may be treating these concerns as more immediate than they really are. Slower frontier-model development does not necessarily mean weaker near-term demand across the broader AI infrastructure ecosystem.***

We'd love to hear your thoughts!

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