AI Deflation

OPPENHEIMER

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The AI trade is retracing with declines in both share and bond prices. At several previous points since 2023, AI-themed share prices retreated brusquely only to recover and march yet higher. Some telegenic talking heads have expressed concern about a possible "AI Bubble,"so is this another passing correction or *the* point at which the speculative gravy train judders to a halt?

It is well to remember the old dictum that "narrative follows price." When stock prices rise, all the news is positive. When stock prices fall, the news flips the other way. The truth is always somewhere between.

For those who experienced 2000's Dotcom denouement there are enough parallels to make us wary, but enough differentiating positives to forestall unreasoned fretting. Corrections are taking place amidst uncertainty induced by the Iran conflict, which spurred rising oil prices, which spurred inflation and which moved financing costs and bond yields swiftly upward. That last is often enough by itself to correct a rising stock market. It did give us pause. Yet yield rises are not by themselves sufficient to bring on a *lasting* bear market.

> Across seven periods of rising yields since 1990, an equity market decline of at least 20% occurred only once, in 2022. Even some of the largest increases in yields coincided with positive equity returns.
> *Coutts, 12 Oct 2026*

Rising bond yields compete with stocks, but a long bear is more often signaled by an outlook of declining profits. That isn't the case. Profits have risen all year with estimates for future profits increasing throughout, based on positive guidance by companies in a wide range of industries. In the quarter thus far, the trend continues: ~60% of S&P 500 companies have reported and FactSet market data show 82% positively surprised as to profits with 70% surpassing estimated top line revenues. Profit growth annualizes at 30%, marking three quarters of growth greater than 25%. Those numbers stand out when the average post-WWII corporate profit growth rate has averaged 5-6%.

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Rapid profit growth has gone far to dispel the high PE valuation cloud that overhung us last year when S&P 500 traded as high as 23x. Now,

> The forward 12-month P/E ratio is 18.7. This is below the 5-year average (19.8) and the 10-year average (19.1).
> *FactSet, 30 October 2026*

Still, the rapid rise in bond yields during the late summer and apparent excesses in the AI theme caused us to reduce our clients' exposure to technology to about half the market's weighting—perhaps lower if we consider that AI exposure touches more than the S&P's formal 37% tech weighting.

> In back of the envelope terms, AI-related shares … represent more than 50% of market capitalization of the S&P 500.
> *Axios, 25 October 2026*

Until the last couple of weeks, the AI theme was holding up the market. Rising bond yields pressured a broad range of stocks from the summer into the autumn. The current AI decline seems an eventuality in a correction already underway.

The market had broadened in the first third of the year as investors finally began buying stocks in industries other than tech, a wholesome turn. Then, the Iran conflict redounded across the global economy. As bond yields rose, short-term traders shifted out of diversified allocations and channeled money back into the same few momentum stocks that dominated in 2023-2025. Meanwhile, what some financial writers termed a "stealth bear market" steepened from August into October.

> Roughly a third of S&P 500 stocks are down 20% or more from their highs—in bear market territory.
> *DataTrek Research in Investors Business Daily, 25 August 2026*

> Over 60% of the S&P 500 are now in bear market territory, down 20% or more from their highs.
> *Kobiessi Lettter 15 October 2026*

Again, we saw something commented on previously:

> …indexes like the S&P 500 are weighted by market capitalization. A trillion-dollar AI or tech leader moving up a few percentage points can easily cancel out double-digit percentage drops in hundreds of smaller or mid-sized companies.
> *Hellostake.com, undated*

When a well exploited speculative theme suddenly pauses for breath and corrects, the process can be messy. Great declines are followed by convincing bounces which then fade. Quality companies win out in the end but can be rudely jostled in the short term.

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Holding investments outside AI

When the market broadened during the first half of 2025, stocks in many industries benefitted. Then they languished as traders turned back to AI during the summer. The shares of GE Aerospace are down 2% year to date, despite a solid revenue and profit trajectory.

> GE Aerospace's revenue grew by 57.37% over the three-year period from fiscal year 2022 to 2025, representing a 16.32% compound annual growth rate.
> *Macrotrends.net, 30 October 2026*

Eleven days ago, GE reported 3rd quarter revenues up 17.6% year over year and forecast year-ahead revenue growth of 19-20%. The company took new orders for 1,800 jet engines at the July Farnborough Air Show alone.

In round numbers, we have a company that is growing its top line from 16% to 18% to at least 19%. That momentum is highly desirable in growth investing. GE is not cheap at 32 times 2027 earnings estimates, but it dominates the global aircraft engine industry oligopoly with a 55% market share. It rewards the shareholder with a 50.65% return on equity. How many other investments yield over 50%?

A company founded in 1892 may not command the zesty headlines of hot new ones, but it has a century of proven staying power. While we might one day see rechargeable electric air engines, and China may rob patents, commercial scale competition is decades away. And who's to say GE won't lead there again? It isn't an AI company, but as an engineering company will be an AI beneficiary. While one might be tentative about holdings in companies with as yet still emergent technologies, GE is a company that should handsomely reward patient long term owners, even if not top of the pops in the last few months.

Beware of leverage

We've talked about the risks in hyped speculative themes. Risks only magnify with leverage.

> US margin debt, what investors borrow from their brokerages to buy securities, rose 54% to $1.4 trillion in a year… Meanwhile, high-risk leveraged exchange-traded funds that double or triple the daily move of underlying stocks are growing rapidly…Buyers from hedge funds to teenagers on Robinhood have poured money into leveraged ETFs this year, helping to nearly double the assets to $220 billion
> *Wall Street Journal, 28 June 2026*

$1.4 trillion is a big number, but total US stock market capitalization is $75 trillion. Margin therefore equates to 1.9% of that value. A doubling of margin meant an increase of 0.85%.

These aren't huge numbers in one sense, but they are in another: speculators have keenly focused on the narrowest set of hot stocks (the non-thrilling majority of other companies are less likely candidates for gearing.) The trendiest stocks are where margin has concentrated. Trendy stock will

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ultimately experience correcting ebbs that are part of normal market action—even when those ebbs are postponed by enthusiasm. Leveraged traders must then reduce their holdings, tumbling the dominoes as selling by one levered trader drops the price, pressuring the next trader in turn. We saw this happen in late winter, again in July, and it is happening again in October.

When speaking of margin, we all tend to think of the borrowing ratio for individual investors, i.e. 50% of the value of their stock holdings. That is the least of it. Greater leverage lurks among funds and big speculators trading across borders. This is what happened in the July collapse of Leopold Aschenbrenner, a 24-year-old supposed wunderkind who made fabulous returns—for a time—by plunging into the most upwardly volatile AI stocks and leveraging to the hilt. His fund

> Situational Awareness, utilized 4x leverage (400%), borrowing an additional $3 to $4 for every $1 of investor capital (reportedly negotiating with lenders to push leverage ratios even higher, up to 10x)
> *Key Context by Tae Kim, 30 July 2026*

We know about Situational Awareness because the July AI correction triggered its downfall. Leverage in other hands is more certainly being liquidated again as the most popular speculative stocks decline.

It might be worth mentioning Korea, having previously spoken about the global phenomenon of mania for AI stock trading. The nation is home to two of the world's key semiconductor companies, Samsung and SK Hynix, the latter of which recently listed its shares in the USA. Korean investors speculated in those and in US companies.

> Large-scale forced selling is already taking place... Forced selling accounted for 7.2% of unsettled brokerage receivables... Since the beginning of October, shares worth 253.38 billion won have been forcibly sold at prices below prevailing market levels.
> *businesskorea.co.kr, 16 October 2026*

> South Korea's finance minister issued an apology after recent regulatory changes allowed retail investors to pile into single-stock leveraged ETFs, leading to widespread losses.
> *AP News, 29 July 2026*

It wasn't just Korean investors. SeekingAlpha reported that net purchases of US stocks and investment funds by various foreign investors surged 62% year over year to a record $426B in 2nd quarter alone.

Key AI Stock valuations are not unreasonable

Speculators and investors are selling AI stocks because their future profitability, once unquestioned, became subject to debate. The grandaddy of all AI stocks, the first to take off in 2023, is Nvidia. It traded then at exceptional ratios, triple digit trailing PEs and forward PEs in the

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50x-80x range. Today, Yahoo Finance shows a trailing (looking backward a year) PE ratio of 26x and a forward P/E ratio of ~13x.

To compare that to a 50-year market average (looking very long term to lessen the impact of the Dotcom and AI rallies)…

> The 50-year average for the S&P 500 forward P/E historically hovers around 14x to 19x.
> *LSEG Refinitiv, 2 December 2019*

I should say that one wants to buy a cyclical company when its PE is high because that is a low point in its order cycle and a low PE is the reverse—and, lest anyone forget, as many recently have, semiconductor chip companies are cyclical. That said, a 13x PE is cheap. Alphabet-Google also just corrected. Its forward PE stands at 17x. Its 20-year average PE is ~25x.

Valuations are not really the problem. The trouble is sudden investor concern over the capital expenditure (capex) rush as companies jockey to emerge as dominant players in AI. Eighteen months ago, the financial press was reporting that the large hyperscalers were funding capex from operating cash flows. Companies since upped the ante. They are borrowing billions to finance accelerating capex. Meta (former Facebook) just reported that its quarterly free cash flow fell to negative $2.12 billion--its first negative since its 2012 IPO.

At least one large Wall Street bank estimates that US hyperscalers will spend $1.4 trillion on capex next year. Expectations have been rising:

> US AI infrastructure investment could exceed $10 trillion between 2025 and 2032.
> *Stijn van Nieuwerburgh Columbia Business School, 29 October 2026*

The acceleration is something to behold. It has been a huge boon for Nvidia and chip makers. It has been a boon for Caterpillar which makes big yellow machines for constructing data centers and diesel engines for backup electrical power. It has been a boon for electrical equipment makers and construction-engineering firms and water firms and waste management firms.

Company	Capex 2022A	Capex 2023A	Capex 2024A	Capex 2025A	Capex 2026E	Capex 2027E
Amazon	$63.6B	$52.7B	$83.0B	$131.8B	$200.0B	$232.4B
Alphabet	$31.5B	$32.3B	$52.5B	$91.4B	$186.0B	$251.9B
Microsoft	$23.9B	$28.1B	$44.5B	$64.6B	$116.8B	$182.9B
Meta	$31.4B	$27.3B	$37.3B	$69.7B	$135.1B	$166.1B
Total	**$150.4B**	**$140.4B**	**$217.3B**	**$357.5B**	**$637.9B**	**$833.3B**

Source: Investors Business Daily

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Headlines have made fundamental investors cautious about debt assumed to fund this capex. There are also concerns about future contractual commitments between, for example, data center users and data center operators.

> Nine big tech companies have around $3T in off-balance-sheet commitments mostly tied to AI infrastructure,
> *Wall Street Journal, 17 August 2026*

While we have taken precautions on behalf of our clients, we need to be measured in our assessments. It should be remembered that Amazon was unprofitable in 5 of the years between 2000-2020 as it invested heavily in capex to become a player in several lines of business which it now rules. No one can predict with accuracy who will best profit from AI and there will be relative ebb and flow in incomes and expenses as technology progresses. Interim corrections will be part of the landscape around the path to profitability.

> The technology sectors have already seen 22 drawdowns in performance since 2024
> *Turning Point Market Research, 30 October 2026*

Things that make you step back for another look…

While we are not convinced there is an AI Bubble, some things remind us that being selective is as crucial as ever. Especially in some "hot" trades of 2025-26.

Once, no one spoke of "Neo Clouds." Microsoft posts that "a neocloud is a cloud provider built specifically for GPU compute and AI workloads rather than general-purpose enterprise applications." Put simply, it is a company that leases access to datacenters with Nvidia chips. Neocloud Coreweave came public 17 months ago and promptly rose 163%. It declined 44% in October. While its revenues have risen rapidly, it has a negative return on equity of -50%. It is heavily indebted and wants to borrow more. Its equity is worth $30 billion but its debt load is ~$52 billion. Much of the data center access it provides to hyperscalers is leased from other data center operators. You would think its founders were tech people. Wikipedia offers this:

> CoreWeave was founded…by three commodities traders. Originally known as Atlantic Crypto, it initially operated as a cryptocurrency mining company.

This is where speculators get burned.

So, hold some cash. Wait for some of the dust to clear. Look for good value in things that individuals, companies and governments will need next year and in five years, even if they don't seem sophisticated.

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