

[WHAT THE EXPERTS SAY]

# AI IN A BUBBLE?

ONE of our past articles, the one about Artificial Intelligence (AI) triggered a flurry of questions. People worry. They worry that it is just another fad. They don't really see the practical implications. They worry it's just another way for banks to push expensive products on them based on a new theme (which is true enough). Worse, they worry it could be another bubble.

As we wrote at length in the previous article, people should rather worry about China (and Germany), not about AI, the latest moves by China (which triggered a furious rebound in Chinese equities) notwithstanding.

We do believe, however, this investment theme, AI, is indeed one of the most important ones for the next five to ten years. We won't rehash what we wrote last time, but we have a better overall view of what is going on right now, especially after the Q2 earnings released by the likes of Microsoft, Meta, Alphabet and Amazon (the main buyers of AI semiconductors), as well as Nvidia (the main seller of AI semiconductors).

As a reminder, one of the conclusions we made a few months ago was this one: "Which is why we are using the Red Queen Paradox at the beginning of this letter. If all these big companies are in a winner takes all, no holds bar-

*red, race to offer a better product, they are all essentially running very fast just to stay in place. Again, one can only be impressed by the huge amounts of capex that being spent by all the big companies (Meta, Alphabet, Microsoft, in particular) but this means they are really starting to violently compete against each other and cannot afford to lose an inch in that race."*

In that sense, Q2 earnings announcements comforted us in that view, as all four continue their high amounts of capital expenditures.

And, as we wrote, this worries investors who have yet to see a return on these investments and fear none may be forthcoming. As one client asked us, "show me one company who has actually made money with this".

Well, as it turns out, there is at least one good example, which is Meta. Meta has been by far the most volatile of the magnificent seven (with Tesla) in recent years as its founder embarked on a disastrous campaign to create a Metaverse no one really wants (this included even changing the name's company from Facebook to Meta).

As you can see on the chart above, the metaverse bet was awful, with a peak to trough on the stock of -72%. But it was not only the metaverse. In 2021, the new iPhones that came out did not dis-

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close the owner's geolocation anymore, by default. This resulted in a dramatic fall in the accuracy of the targeted adds on Meta's platforms, Facebook and Instagram.

Having realized that the metaverse bet had soured, but having already ordered thousands of Nvidia semiconductors, Mark Zuckerberg, Meta's founder and controlling shareholder, turned around and asked his engineers to develop an AI tool that could bypass the iPhone and still approximately locate the person in order to improve the targeted ads. This worked extremely well, and from that program, Meta also developed its own large language model, Llama.

In addition, Meta now offers the possibility for small and medium enterprises that buy adds on its platforms to create those ads using only AI, which is also working well. So, yes, investments in AI can actually yield results. Whether other companies are also able to get comparable results from their investments is still an open question. As quarters go by, we will get a better feel for this.

Besides the return on investment question, the other recurring question is whether AI is in a bubble. It is important to realize, first of all, that bubbles are natural by-products of financial markets, so the question is legitimate. Over the past thirty years, we have had many small bubbles and two important ones: the Telecom/Internet equity bubble of 1995-2000 and the Financial Credit bubble of 2003-2007. The most important point is that equity bubbles leave productive improvements after they burst, while credit bubbles are incredibly destructive and leave only bad debt behind.

So, the good news is, even if AI is in a bubble, it will be an equity bubble, not a credit bubble. We don't believe AI is currently in a bubble. It could become one, but we don't think we are there yet.

