AI Arms Race: Are Cloud Giants Overspending?

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(Disclaimer: These are my personal opinions and very preliminary conclusions from this weekends events.)

Every earnings season offers valuable lessons and insights. One of the highlights of this recent season was the cloud computing giants' executive teams share their perspectives on DeepSeek. Just the week prior, a Chinese AI lab had launched an open-source model that quickly topped download charts, putting U.S. companies, especially Amazon, Google, Microsoft, and Meta Platforms, on notice.

I was surprised by their collective reaction which can be summarized as… no biggie we'll keep spending

Let's examine their conclusion from both a bullish and bearish standpoint:

Glass Half-Full: The Optimistic View

The optimistic view suggests that the rumors are true: there's an insatiable demand for clients to build AI capabilities, both now and in the foreseeable future, along with an ever-increasing need for computing power to train next-generation models. We can simplify this point using the well-known "Jevons paradox," which states that as technological breakthroughs improve the cost-efficiency of providing AI tools, their usage will increase even more, leading to significant acceleration in growth and adoption. One could infer that these substantial capital expenditure decisions by astute management teams indicate a temporary, heavy need for model "training," and that these chips can ultimately be shifted to "inference" as Jevons paradox is realized in the coming years—a perfect hand-off scenario.

Glass Half-Empty: The Pessimistic Take

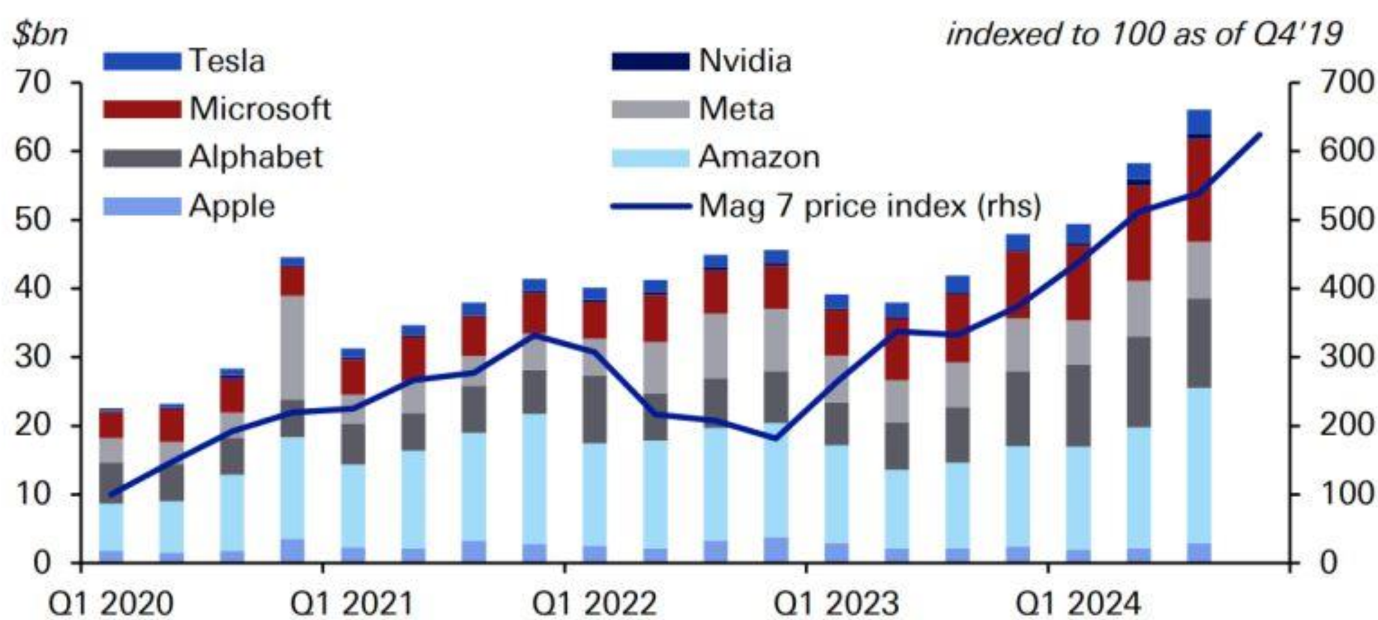
A pessimistic view of these hundreds of billions in spending is that it's a huge bet on the unknown. Nobody is quite sure what the payoff will be, but moderating spending for return on investment is too risky when competitors are running full steam ahead. We can call this uncomfortable situation the "prisoner's dilemma" of the hyperscalers. No one will risk scaling back from a potentially poor decision unless their peers do the same, but someone has to blink first. We have evidence of this from Google CEO Sundar Pichai's last earnings call, where he specifically stated, "the risk of underinvesting is much higher than the cost of overinvesting." It's not about hopes for agents, application layer build-out, or other practical AI applications in our daily lives; it's a race for AI leadership that requires increasingly dense and complex training clusters to build ChatGPT 5, 6, and push the architecture to its natural limits. Revenue visibility and returns are a conundrum for another day.

Taking a step back, I'm inclined to lean toward the "glass half-empty" perspective on all this spending, for now. We may still be early in the long-term journey, but there hasn't been a killer app or use case provided at scale to the masses; it's largely a bundling into established software. There are undoubtedly many trials taking place as we speak, but so far, the big adoption announcements are illusory.

This is the setup going into Nvidia earnings on Wednesday.

Have a great week!

Figure 1: Capital expenditure by Magnificent Seven cos. vs share price index



Source : Bloomberg Finance LP, Deutsche Bank.

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March Madness: Demystifying A Topsy Turvy Market

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In the fast-paced world of modern investment markets nearly over two years have passed since we have seen markets go through a genuine rotation and shift. Investors until recently have been handsomely rewarded to be maximally long high growth, high momentum US equities.....so what gives?

Let's dive in!

Big Tech, Big Questions: For the first time in years investors are having genuine debates about long-term franchise values and nature of spending across the big technology companies. What began years ago as F.A.N.G. (Facebook, Amazon, Netflix, Google) has now evolved into the Magnificent 7. Beyond the catchy slogans there are major questions being asked by investors across these firms on their capital spending plans with the gigantic capex intentions raising questions around too much hardware for too few use cases up to this point. In addition, the prospects of technological evolution such as AI does raise existential questions for the greatest cash cow businesses these big tech companies have. A few years ago, in the "FANG" era, it would have been viewed as unthinkable that you could challenge Googles competitive moat on search. We have shifted from the unthinkable to, most likely not?

Trade Disputes & Stagflation: Over the past few week's investors are digesting the prospects of a broader rebalancing of the global maritime rules based international order. There are profound academic, political and practical debates on this topic to be had but from an investor's perspective the only long-term question that matters is certainty. During this transition period markets are pricing in depending on the day a escalating trade conflict in service of re-shoring industry or a de-escalation towards a broader distributed global system. This ying-yang strategy may ultimately land in a benign place, but it has already changed the mentality of corporates that will over the medium-term think about sovereignty and tariffs instead of purely lowest cost jurisdiction to operate.

High Expectations: Lost in the headlines and macro & micro discourse is the most important point of all, elevated expectations. Investors have over the last two years been ramping up their belief in the future growth prospects of a wide cross-section of companies in the market and economic growth. We entered 2025 with valuations above their longer-term averages and earnings growth expectations that were materially higher than the past two years. The red-hot expectations in the last few weeks were met with the lukewarm reality of a slowing but stable economy and earnings growth. Good news but not good enough.

Beyond the headlines and debates of the day I see this as an opportunity to maintain a balanced posture between, style factors, geographies, and risk appetite. Market convulsions are an important moment to test as investors of all types ask themselves, am I diversified, have I got a strong core foundation?

Have a great weekend!

Rheinmetall: The Arsenal Of Democracy

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“There are decades where nothing happens; and there are weeks where decades happen.”

Those were the words uttered by the evil Lenin, to describe decades of pressure building in the Russian Empire which set the conditions for the communist take-over and the formation of the U.S.S.R.

As a history buff, I can’t help but see the events of the last few weeks as seismic in the decades long trans-Atlantic partnership between the United States and Europe. After spending nearly three decades demilitarizing and reallocating those funds to generous welfare programs across many European countries, this period is becoming a relic of the past.

So, what's going on here?

In the past few weeks, the leadership of Germany set into motion the largest re-armament program since the fall of the U.S.S.R.. We are also seeing active discussions amongst the broader EU to facilitate and repurpose existing funds to support further military spending. It might seem like this is coming out of nowhere, but the pressures have been building for a very long time.

For years, both Democratic and Republican presidents have urged Europe to become more self-sufficient in their national security by investing more in defense spending. Depending on the country, these requests fell on deaf ears and in some cases (i.e., Angela Merkel, Ursula von der Leyen) were outright mocked. Now that the US military is re-orienting its focus significantly to Asia, the pressure for Europe to pick up the slack has reached a tipping point. It's also a tacit acknowledgement that the US cannot protect both Europe and Asia without stretching themselves too thin, a speculation long held by military strategists.

We should expect for the foreseeable future that Europe will have to undertake a wholesale modernization and expansion program of its entire defense forces to meet the security risks of the current era. The Russia/Ukraine war and its extended grueling brutality has reminded leaders on the continent of the old Roman saying 'Si vis pacem, para bellum' (If you want peace, prepare for war).

This brings us to Rheinmetall. In a fraying trans-Atlantic relationship, the need to buy locally produced equipment leaves a precious few companies that can meet the moment. As the leading German equipment producer, they have a diversified set of platforms and capabilities that are well within the scope of what the continent is looking to rebuild. Given the long-cycle nature of these investments, this is a years-long endeavor filled with twists and turns.

Nonetheless, spending growth is expected to continue at a blistering pace until the modernization is complete, projected to be sometime in the early 2030s.

As we look ahead, when investors think of European companies, names such as Louis Vuitton, Hermes, Ferrari, Nestle, and Novo Nordisk come to mind. However, I would argue that Rheinmetall, the arsenal of democracy, should also be on that list.

Have a great weekend!

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