Trick or Treat: Balancing the Potential Promise and Peril of AI

- The AI investment boom represents a multi-trillion-dollar transformation driven by genuine technological breakthroughs. But capital is flowing at a pace and scale that has created significant concentration risk and historically high valuations.
- Revolutionary technologies often generate speculative manias that end badly for investors who overpay, even when the underlying technology eventually transforms the world. Radio, railroads, and the internet all created both enormous value and spectacular losses.
- We believe investors need to prioritize disciplined risk management in preparation for the potential potholes ahead.

It's hard to believe that Open AI's ChatGPT is just three years old given the massive impact it's had – and right out of the gate. Just two months after its public launch on November 30, 2022, it had 100 million monthly active users. The world had never seen anything like it.

ChatGPT then unleashed bullish sentiment for generative AI not seen since the Dot Com era.

As capital floods into AI infrastructure at unprecedented levels and valuations approach historical extremes, prudent investors must balance the technology's transformative potential against the lessons of past speculative manias.

We believe risk management strategies in portfolios become even more essential amid today's AI investment zeal.

The Scale of the AI Investment Surge

Generative AI's newfound utility has sparked an arms race among competitors, driving global AI infrastructure spending into the hundreds of billions annually.

UBS projects approximately $375 billion in AI-related capital expenditures for 2025, rising to roughly $500 billion in 2026 for hardware, data centers and power buildouts worldwide. Looking further ahead, McKinsey estimates that AI-focused data centers will require about $5.2 trillion of capital through 2030, underscoring the multi-year scale of this investment cycle.

With eye-popping forecasts like these, it's no surprise investors have gone all in. The best example is AI poster child, Nvidia, whose specialized semiconductors proved uniquely suited for the massive computing power necessary for large language models.

Moreover, job creation has become increasingly concentrated in secular growth sectors like healthcare and social assistance, while cyclically sensitive industries have begun contracting - a pattern typically observed in the early stages of economic downturns.

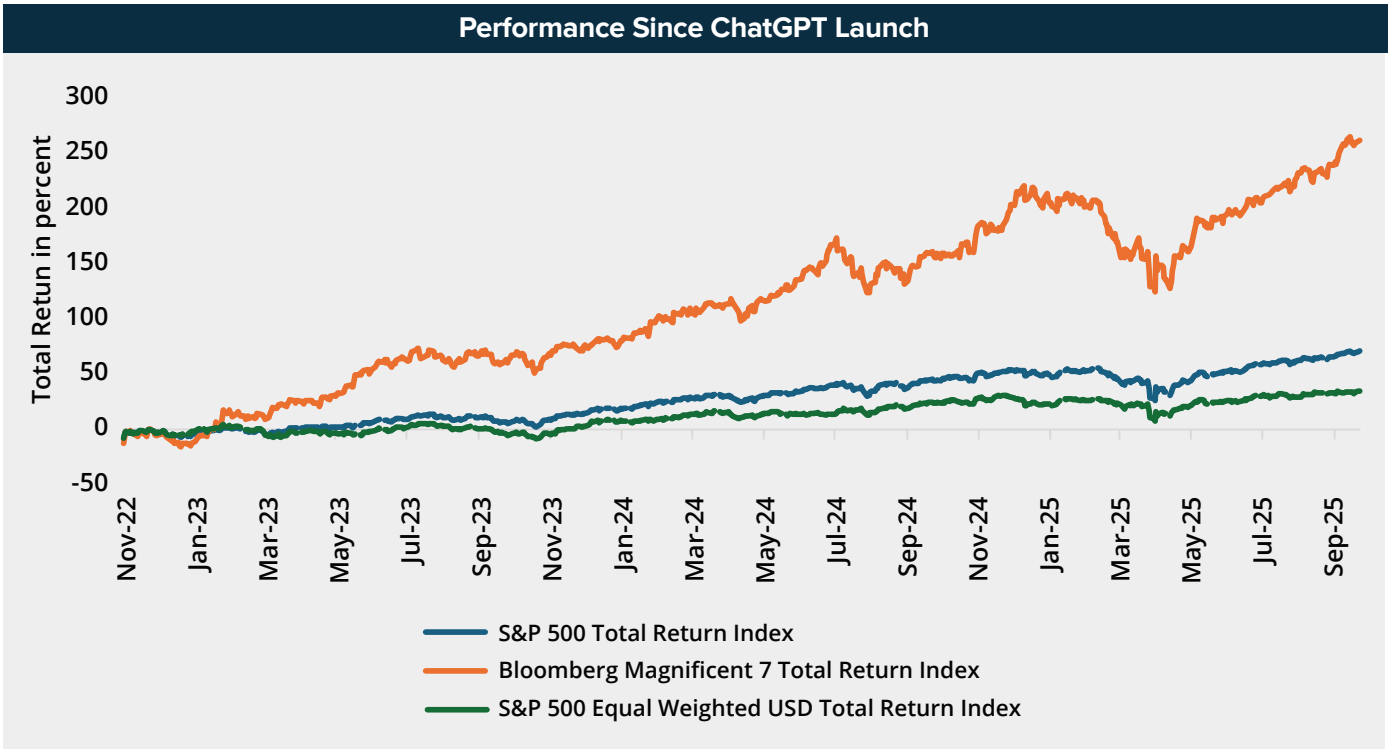
Nvidia became the world's largest company by market capitalization after appreciating more than 1000% since ChatGPT's launch. The semiconductor giant now commands a market value exceeding $4.4 trillion, representing approximately 7.3% of the S&P 500 Index.

In addition to Nvidia, technology giants Microsoft, Meta, Google, and Amazon are seen as key beneficiaries of the AI revolution, and their stock prices have soared. Together with Tesla and Apple, this cohort became known as the "Magnificent Seven," representing the companies deemed best positioned to capitalize on emerging technology trends.

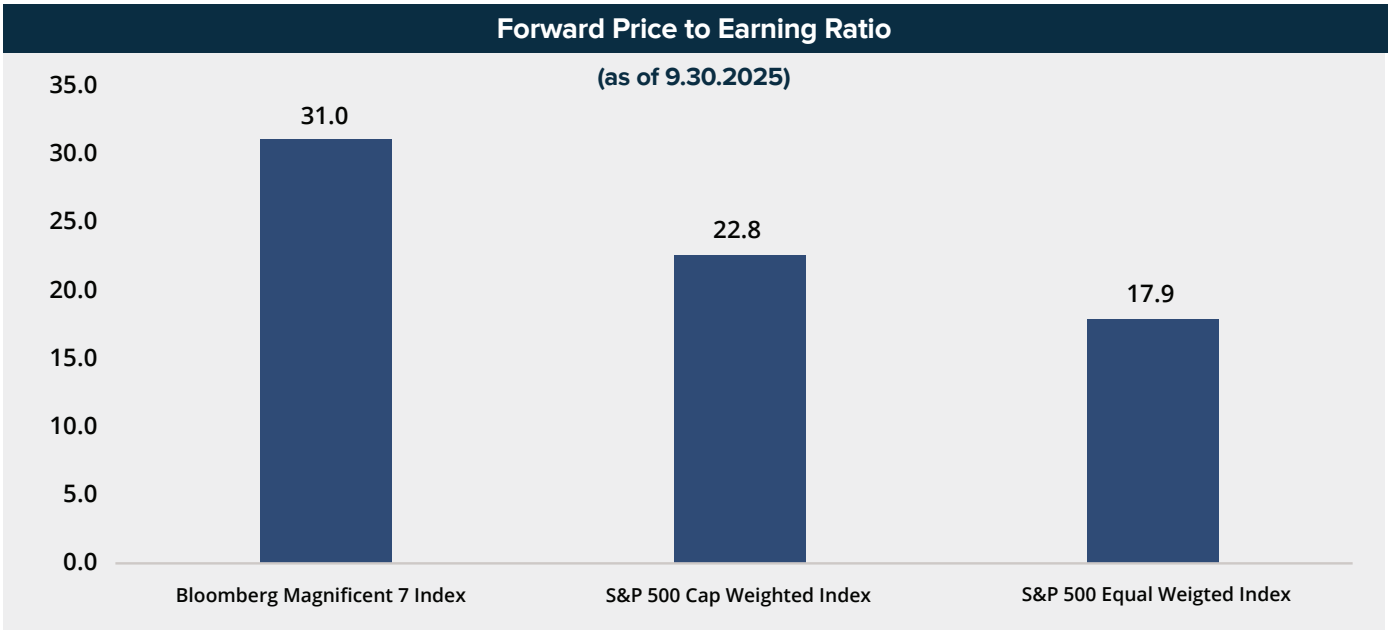
The Concentration Risk in Today's Market

From December 2022 through September 2025, the Magnificent Seven, as measured by the Bloomberg Magnificent Seven Index, appreciated more than 260%. During this same period, the average stock in the S&P 500, measured by the equally weighted version of the index, gained just 35%.

This extraordinary outperformance has resulted in the Magnificent Seven accounting for over a third of the total market capitalization of the S&P 500 Index today, a level of concentration that creates downside risk in the market.



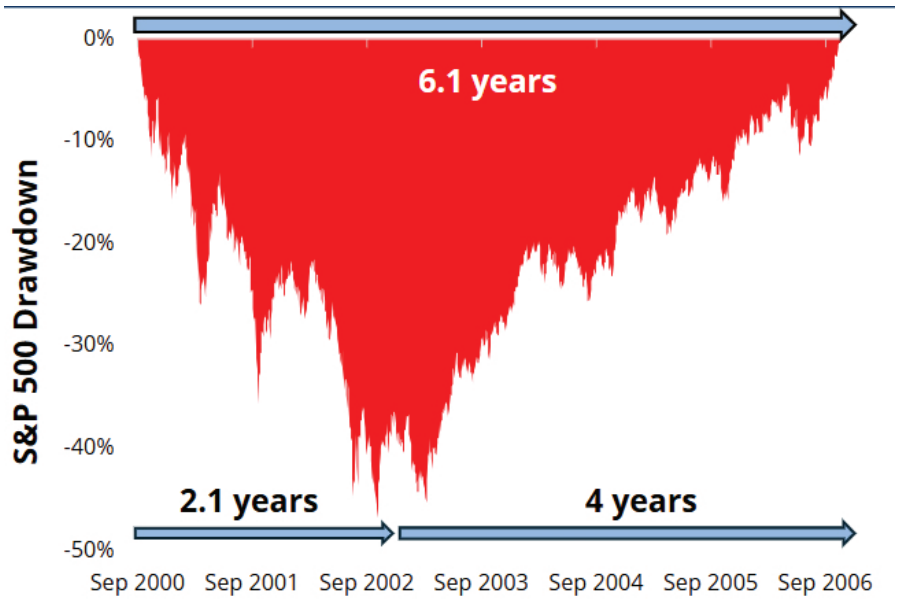
The higher growth rates commanded by these companies have driven premium valuation multiples, pushing the index's forward price-to-earnings ratio to approximately 23x - territory that has investors drawing comparisons to the Dot Com era. As valuations near historical extremes, concerns about a potential "bubble" have become increasingly common among skeptics who believe AI growth expectations could come up short.



Technology Manias Past

Financial market history provides numerous cautionary tales. Before the internet stock mania of the late 1990s, radio stocks in the 1920s captured investor imagination as RCA shares surged from $1.50 to $549, only to collapse to $15 by 1932. In the 1840s, British railway mania drove spectacular speculation, with Parliament approving 272 Acts to incorporate new railway companies in 1846 alone, many of which proved financially disastrous.

The Dot Com bubble remains the most relevant comparison. When the bubble burst, the S&P 500 Index fell 47% from peak to trough over two years following the March 2000 market peak. It would take an additional four years to fully recover those losses, resulting in nearly a decade of poor returns for equity investors. The Nasdaq Composite fared even worse, plummeting 78% from its March 2000 high to its October 2002 low. When bubbles burst, the damage unfolds quickly and comprehensively.



Is This Time Different?

Proponents of the AI trade are quick to distinguish today's environment from the late 1990s excesses. The major AI players possess strong balance sheets, robust earnings, and substantial free cash flow that has funded capital expenditures without heavy reliance on the debt and equity issuance common during the Dot Com era.

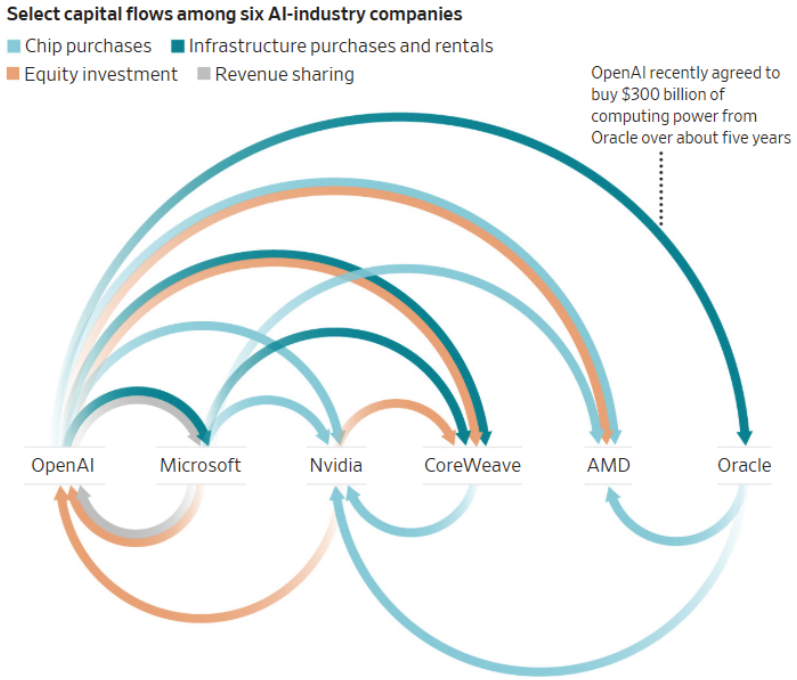
This financial strength may provide a margin of safety absent in previous technology manias. Unlike the speculative internet ventures two decades ago, companies like Nvidia, Microsoft, and Meta generate significant cash flows that substantiate at least some portion of their valuations.

However, justifying premium valuations requires ongoing validation of the prevailing narrative. The perceived winners must continue to grow at breakneck pace. For that to materialize, end user demand for AI must meet lofty expectations, and today's established leaders must maintain their competitive positions against an inevitable wave of new entrants.

The addressable market for AI technology remains open-ended, allowing speculation to flourish unchecked by current constraints.

Field of Dreams & Power Plays

Thus far, infrastructure spending on AI has been largely tech giants spending on each other. This so called "circularity" has become a defining feature of the AI economy. Major companies like Nvidia are investing billions in AI firms such as OpenAI while simultaneously selling them chips and services, creating complex webs of interconnected deals. Skeptics are rightfully concerned about the sustainability and ultimate return on investment of this ecosystem.



Note: Some chip purchases are through intermediaries. Some investments and other arrangements subject to conditions.
Sources: staff reports; Morgan Stanley
Nate Rattner/WSJ

If the demand for AI products and services fails to justify the massive infrastructure investments currently underway, the financial consequences could prove severe given the size and interconnectedness of these deals.

There are other reasons to be cautious.

One MIT study reports that 95 percent of organizations earn “zero return” on their investments in generative AI. Many firms are experimenting with the technology, but little evidence exists demonstrating that AI delivers durable productivity gains.

Even if demand ultimately meets or exceeds expectations, will today’s leaders sustain their competitive advantages? Unstable leadership remains a common feature of emerging technologies. The internet era produced dominant players like Netscape and AOL that faded into irrelevance as superior competitors emerged.

And even if the demand does materialize, bottlenecks could hinder supply.

Data centers consume enormous amounts of electricity, with their scale commonly measured by power load rather than physical footprint. According to technology and consulting firm ICF International, the United States alone will need to add 80 gigawatts of electricity generation annually to meet expected demand. Currently, only 65 gigawatts are in development, suggesting a significant shortfall.

Without adequate power infrastructure, the AI buildout may face physical constraints that limit growth regardless of demand or competitive positioning. These infrastructure limitations could emerge as binding constraints that derail even well-conceived investment theses.

Curb Your Enthusiasm

Even OpenAI’s CEO, Sam Altman, suggested caution when he told reporters, “Are we in a phase where investors as a whole are overexcited about AI? My opinion is yes.” When the chief executive of the company that sparked the current mania expresses concerns about excessive enthusiasm, prudent investors should take note. Yet does this acknowledgment of overvaluation mean a market collapse looms imminently?!

Alan Greenspan’s experience provides instructive perspective. In December 1996, the Federal Reserve chair questioned whether “irrational exuberance” had unduly escalated asset values. While the phrase entered the lexicon as shorthand for speculative excess, investors often overlook that this remark came more than three years before the March 2000 market peak.

Markets that appear overpriced often continue ascending, sometimes for extended periods. Howard Marks wisely reminds us that “One of the biggest mistakes you can make is to think that overpriced and going down tomorrow are synonymous; markets that are overpriced often keep going.”

Balancing Promise Against Prudence

The transformative potential of AI appears genuine and may well justify a revaluation of market leaders over the long term. However, today’s elevated valuations leave minimal room for disappointment. Revolutionary

technologies have historically created enormous wealth, but they have also produced spectacular losses for those who overpay or concentrate within a narrow set of winners.

Maintaining a disciplined risk management process will prove essential to participating in AI's promise while protecting against inevitable setbacks.

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James St. Aubin, CFA®, CAIA®, is Chief Investment Officer for Ocean Park Asset Management. He has oversight of all Investment Management department activities, in collaboration with Co-founders David Wright and Kenneth Sleeper. An experienced investment management executive, his career of more than 20 years includes leadership roles in asset allocation, manager research and portfolio construction. James earned a Bachelor of Science in Finance from DePaul University and is a CFA® and CAIA® Charterholder.