WEEKLY STRATEGY
Perspectives

BMO | Private Wealth

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Musings on the State of the AI Trade

"Fear is a more dominant force in human behavior than euphoria – I would never have expected that or given a moment's thought before, but it shows up in the data in so many ways."
- Alan Greenspan, Chairman of the U.S. Federal Reserve from 1987 to 2006

The Through Line: Attention has quickly reverted to "all things AI" now that oil is once again flowing through the Strait of Hormuz and a path toward stabilization of the Mideast conflict is in sight. More specifically, investors – spooked and nervous over the market's strong year-to-date performance – seem set on finding ways to poke holes in the trade's sustainability. We highlight a handful of the debates, providing perspective on the loudest and most alarmist commentary.

Those frustrating, immutable lizard brains

The late Dr. Alan Greenspan, who passed away this week at the age of 100, can be forgiven for not fully understanding the fundamental investment concept of loss aversion: **investors – who are not perfectly rational – detest losses much more than they celebrate gains.** (The bulk of Dr. Greenspan's tenure as Fed Chair predated the more scientific exploration of behavioral finance, a field of economic study that burgeoned after the 2002 Nobel Prize in Economics was awarded to psychologist Daniel Kahneman). That key tenet of behavioral finance may explain why market participants spend so much time second guessing strong markets and obsessively fearing the next downturn (WSP - Profile of a Bubble (How Worried Should We Be?)).

Blame it on our ancient wiring – our so-called lizard brain. Survival instincts are hard-coded in the primitive parts of our grey matter, driving us to seek protection, comfort, safety and stasis. **Change is intensely unsettling and actively avoided if possible.** Those predispositions can make it incredibly taxing to parse the implications of the sweeping secular technological revolution now in its early stages. This is true from both an investment and a personal vantage point, complicating our attempts to absorb the fast-moving impacts on our daily lives and livelihoods. Yet, **change can also be exhilarating when approached calmly and thoughtfully, using the more advanced and deliberative parts of our brain**.

What, me worry?

It was bound to happen. After months of steady gains that drove markets up double digits (and some stocks/sectors up triple digits), trading in AI and AI-adjacent investments (e.g., semiconductor, software, services names) has been especially volatile this week. Eye watering double-digit single day moves in individual stocks whipsawed the most tech-dominated global indexes. The action has been exacerbated by a variety of related derivative vehicles created to amplify price changes in already volatile names. **Wide price gyrations scare investors in the short run, even if they don't reflect true change in underlying fundamentals.** At times like these, the best advice is often **"pause, breathe and let's look calmly at the issue from multiple angles."** We'll start the analysis by examining some of the questions that investors raise with max frequency:

The search for ROI (return on investment)

- The AI investment story has evolved from "who can spend the most on data centers?" to "who is getting a measurable ROI?" Markets by nature are forward looking, meaning they seek tangible proof that investments are adding to the owners' (shareholders') bottom line. Yet, it takes time for companies to deploy and experiment with models before shifting routines and nailing down quality, legal and regulatory matters. For the majority, it's a messy (and scary) process of trial and error. **Ironically, small and mid-sized businesses probably have a more naturally nimble path to rapid experimentation and use. The largest entities – a.k.a. the ones comprising the bulk of most stock indexes – will likely see change ripple through more slowly.**
- As the race to deploy AI has accelerated, cost bottlenecks are rapidly appearing. AI usage is measured in tokens (basically the price per bit of processed information asked for/received). Usage has spread and token usage has ballooned – maxing out annual corporate AI budgets long before the end of the year. Overspending anecdotes abound, from Uber (rumored to have spent its annual budget by April) to one consultant's client who amassed a half-billion-dollar cost in a single reporting period. Microsoft is withdrawing Claude licenses (Anthropic subscription use plans) and encouraging more strategic use of less sophisticated models.[i, ii]

Observation: messiness is to be expected in an industry moving this rapidly. Sitting on the sidelines or slow-walking participation isn't an option. Productivity and/or margins could actually be dinged in the early days while companies find their way and providers settle into profitable business models. We might see interim volatility in stock prices during the process of sorting out spending and margins for providers and end users alike. Thankfully, margins overall – and particularly margins in the tech industry itself – are starting from an incredibly strong base. The fact that all participants are hyper-focused on profitability (versus the free spend that went on through much of the dotcom era in the 1990s) is a distinct plus.

Data-center dynamics

- Aside from progress in developing the AI models themselves, spending on the infrastructure needed to train and run AI has preoccupied investors for many quarters; each earnings season has ended with a large leap forward in aggregate spending intentions. By the end of Q1 2026, the Mag 7 had announced future CapEx (capital expenditures) of more than $700 billion. Barely 50% of these announced plans have broken ground, however. A number of factors are involved: permitting; delays in approvals to attach to the electric grid; public pushback; and arranging funding. A recent Bloomberg article noted over $130 billion in Q1 alone was blocked/delayed.[iii, iv] Against a backdrop of rapidly approaching mid-term elections, the question of whether to allow or block data centers is becoming politicized in some locales.
- Discussion will eventually evolve into where the processing is done. Is the need for raw data-center build overestimated in light of the token-spending pushback outlined above? At this point, it is not a problem because every gigawatt of capacity that becomes available has a long list of potential users. Most of them have signed long-term contracts and functional capacity is a mere fraction of the number announced. Nevertheless, as quantity is completed and end users settle into more predictable long-term patterns, this dynamic will bear watching since some contracts do have opt-out clauses. It is also worth noting that at least some of the components of the data centers (e.g., chips) have shorter lifespans than, say, a manufacturing facility of the same size/cost. This implies a permanently higher trajectory of capital expenditure needed from the hyperscalers.

Observation: the decades-long underinvestment in infrastructure in the U.S. and elsewhere has come home to roost. Luckily, a handful of large, profitable technology companies is orchestrating the bulk of the initial spending. The process to bring capacity online could be contentious and expensive, yet ultimately well worth it. History shows that investments in capital stock generate increases in productive capacity far into the future.

Funding the spend with debt

- Many of the largest old-line tech companies have had very low leverage and generated tens if not hundreds of billions in annual cash flow. Much of that cash flow was ultimately transferred back to investors in the form of share buybacks. Data centers and other infrastructure investments may consume much, if not all, of that cash (at least in the near- to intermediate-term), recycling the excess funds through different economic channels. The ultimate goal: shareholders should benefit from the higher level of sales and profits that are facilitated by the capital investment.
- Aside from cash-flow funding, tech companies are beginning to tap global debt markets in a bigger way via public and private offerings denominated in a variety of currencies. Alphabet, for example, issued C$8.5 billion (US$6.24 billion) in investment grade (IG) debt just last month. Wall Street expects hundreds of billions in IG AI debt to be underwritten by the end of the year.[v] Media headlines breathlessly point at the large amounts issued without putting them in context of the sales and financial position of the issuers. Many constituents had essentially zero debt until the last few years; can borrow at low rates (in Microsoft's case even below that of U.S. Treasurys); and are providing diversification opportunities for global investors/asset classes that were previously unable to participate in the AI buildout.
- Investors are proving to be acutely discerning. Entities that do have higher leverage ratios are forced to pay higher yields and/or sell at shorter maturities. Another case in point: this week's floating of an issue from newly public SpaceX. On one hand, it was afforded an investment-grade rating by several ratings agencies, despite significant data-center expenditures and no earnings. Demand was heavy – nearly four times the $20 billion initially suggested that would be floated. But investors in the longer-dated debt demanded higher interest rates, suggesting investors are skeptical of the rating-agency view and/or want to receive extra payment for taking on a potentially more volatile situation for a longer time period.

Funding the spend with equity

- Participants have qualms about the market's ability to absorb recent and planned equity offerings. Google raised nearly $85 billion earlier this spring while SpaceX debuted a similar $85 billion in early June. Anthropic and OpenAI have both filed confidentially and are expected later this year or early 2027. SK Hynix, a South Korean semiconductor company, is readying an estimated US$29 billion offering for its South Korean-based shares that could hit the market in a matter of weeks. What gets lost in the initial summing, however, is that corporate buybacks are on track to reach over $1 trillion year to date, partially offsetting some of the issuance. The buyback activities could lessen in future years (due to the aforementioned increased CapEx). But this year it's so far, so good – which helps offset some of the resupply narrative. Then, too, a portion of each of the IPOs will create liquidity for additional insiders – and potential free cash to cycle right back into investments.
- Another factor directly impacting markets comes from rule changes over the past few years that facilitate the creation of additional classes of exchange traded funds (ETFs). Vehicles can be created to track the performance of

an individual stock (like NVDA or SK Hynix). They can also be a focused index like the much-watched Philadelphia Semiconductor Index (SOX). Additional vehicles can be crafted that actually lever the action (e.g., a 2X or 3X ETF). Leveraged ETFs on the semiconductor-dominated South Korean KOSPI index, for example, were partially blamed for the yardstick's 10% single-day slide earlier this week.[vi] **While vehicles like this allow traders to pursue their own objectives, they reflect little to nothing at all of the longer-term fundamentals but can contribute greatly to short-term volatility.**

Observation: tech-industry Chief Financial Officers (CFOs) are making deft use of multiple avenues of financing – and carefully monitoring margin-impacting activity within their companies. Markets are doing their part by demanding higher bond yields for longer-dated issues. In the long run, converting traditionally asset light balance sheets into more asset-intensive ones could impact margins and eventually earnings – but we are not there yet.

Implications for Investors

The through line on AI: investors have a lot to grapple with as they try to understand and make decisions about this rapidly expanding sector. The industry has moved rapidly from the "shiny object of interest" phase to a point where careful analysis and deliberation are required. Looking through the noise (and levered trading vehicles) that can disrupt daily trading, investors overall are doing a solid job of focusing on fundamentals, adapting to "new" news and holding management teams accountable. The long-term potential is huge; even so, individual winners and losers will definitely emerge during the process. Like it or not, the knowledge revolution will touch every aspect of our existence. We might as well buckle up and enjoy the ride.

Next week in North America

A lot of data for a holiday week. Key info on jobs consumer confidence and manufacturing activity.

Monday 6/29:	**U.S.** Dallas Fed manufacturing | **Canada** Bloomberg Nanos Confidence
Tuesday 6/30:	**U.S.** Consumer confidence, JOLTS surveys | **Canada** GDP
Wednesday 7/1:	**U.S.** Challenger jobs reports, ADP Employment reports, S&P Global manufacturing PMIs | **Canada** Independence Day Holiday
Thursday 7/2:	**U.S.** Initial jobless claims, Non-farm payrolls reports, Unemployment rate, Durable goods | **Canada** S&P Global Manufacturing PMI
Friday 7/3:	**U.S.** none scheduled – **U.S.** markets closed for Independence Day | **Canada** none scheduled
Saturday 7/4:	Happy 250th Birthday, United States of America!

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Precious metal investing involves greater fluctuation and potential for losses.

[i] Corporate America Is Starting to Ration AI as Cost Skyrockets - WSJ
[ii] Companies evaluate aggressive AI spending as costs pile up
[iii] $130 billion in data center projects blocked by protests so far this year - Ars Technica
[iv] US Construction Spending on Data Centers Eclipses $50 Billion - Bloomberg
[v] Big Tech's AI Debt Binge Tests High-Grade Market, Barclays Says - Bloomberg
[vi] South Korea's KOSPI plunges nearly 10% after regulator cautions on leveraged ETFs | Reuters