



Market Commentary  
November 14<sup>th</sup>, 2025

English Version

Insigneo Weekly Dispatch

# Speculation at Hyperscale: Between AI Bubbles and Capex

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## Speculation at Hyperscale: Between AI Bubbles and Capex

The current market rally is being driven mainly by a small group of dominant tech companies tied to the AI theme. Unlike the dot-com era, these firms have strong earnings and balance sheets, so today's concern is market *concentration*, not necessarily a speculative bubble.

Capital expenditures by major tech firms, mainly Amazon, Google, Microsoft, and Meta, are powering AI growth. These investments have been funded by robust cash flows rather than debt, signaling financial strength but also contributing to narrow market leadership.

While the market appears extended, broadening earnings growth beyond top firms and potential sector rotation could sustain a healthy rally. A moderate correction would help relieve excesses,

increase breadth, and prevent an actual bubble from forming.

Every day we are bombarded in the media by talk of a stock market bubble. Given the seemingly unstoppable move higher by equity markets over the past few years, it seems like a reasonable idea to consider. But are we really in a bubble?

Before we attempt to answer this question, let us start from the beginning by asking another one: *What is a market bubble?* **Most economists define market bubbles as instances when market prices rise far above an asset's fundamental value, driven mostly by speculation and herding behavior.** Herding behavior is when investors tend to make decisions based on what everyone else is doing, not necessarily on a sound fundamental basis. During bubbles, investors tend to pile in onto the market without much thought, *hoping* that they can sell their stocks higher to someone else than where they bought them themselves. Granted, as

investors, we all want to sell our assets at higher prices than where we bought them; however, most investors have a strategy behind their investment decisions that is not based on hope; hope is not a strategy. We have seen this type of behavior in previous instances throughout history, most recently in the Japanese stock market bubble in the 80's, and the dotcom bubble of the late 90's. During the latter two iterations of a bubble, Japanese equity markets rose close to 500% in the 80's and the Nasdaq rose close 100% in the six-month period between October 1999 and March 2000. In both instances, people were pulled in by the allure of easy money, wanting to capture a piece of the action, or because of fear of being left out. Regardless, they jumped into the markets without looking forward, and the outcome of those actions is now history.

It is not lost on us that the current market rally also has a strong element of investors entering the market for fear of missing out, or FOMO. It is true that people can be swayed into the markets by the latest fad or trend for fear of missing out. However, consider the predicament of institutional investors, such as mutual fund managers. The breadth of the current market rally has been so narrow, led only by a handful of companies, that mutual fund managers with portfolios that are benchmarked to the S&P 500 or Nasdaq have had to own concentrated positions in stocks like Nvidia, Alphabet, Meta, and the rest of the Magnificent Seven companies, or risk severely underperforming against their benchmarks. The high degree of market concentration has propagated, and to an extent almost justified, FOMO behavior by market participants such as mutual fund managers. Considering that the S&P 500's ten largest holdings currently represent more than 40% of this index and account for more than half of its value, it is easy to see why investors feel the need to own these stocks, so they are not left behind by the rally.

This is where we think that the current issue with the market rally lies, it is a “concentration problem”, more than a “bubble problem”. The heavy concentration in a small number of companies driven by the same underlying theme, artificial intelligence, clearly poses a level of risk. However, unlike the dotcom bubble, where most companies that drove markets higher peddled largely unproven ideas with little to no earnings or cash flow generation, the leaders in the current rally are some of the strongest companies on the planet, leaders in earnings growth and fortress-like balance sheets. Even though these companies make up over 40% of the index, they are also responsible for nearly one third of its earnings. Unlike the late 90's, the leaders of this market are also its strongest contributors to earnings growth.

It is worth noting that, although we believe that the current issue with the rally lies more with narrow market breadth than an imminent bubble, that is not to say that overconcentration in a handful of stocks could not lead to the formation of a bubble over time. However, we do not think that we are there yet. A dynamic that we are beginning to see, even more strongly during the recent third quarter earnings season, is the fact that companies outside the largest 10 in the index are also starting to experience earnings growth. As of this writing, approximately 85% of the companies in the index reported better than expected earnings growth, something not seen in a while. This could be a welcome sign that market breadth is widening out into the rest of the market, a crucial step in the evolution of a healthy rally and a step away from bubble territory.

Another crucial point to consider is artificial intelligence. As we know, AI has been the major theme underpinning the current rally. To this point, a question that we have begun to hear is “What if AI

is also reshaping how financial bubbles form?” While this is an intriguing thought, there is little evidence to suggest this is occurring. Back in March 2024, we published a piece titled “[Are We in a Bubble?](#)” and, with a few caveats, much of what we wrote then still applies today. Twenty months later, our view remains largely the same: we are not yet in a bubble. Still, several of the risks we highlighted back then continue to drive much of today’s market conversation.

### Capex, Capex and more Capex

AI is a fascinating phenomenon - everyone has access to it almost for free. When we discussed potential triggers for a market pullback back in early 2024, demand for AI did not seem to be one of them. Interestingly, the tariff war turned out to be the main trigger for the pullback we experienced shortly after our publication. However, the demand for AI does raise an important question: how can the biggest technological disruptor of the past twenty years keep advancing if no one is directly paying for it? This is where the hyperscalers come in. Hyperscalers are companies that operate massive data centers powering cloud computing. Firms like Amazon, Google, Microsoft, and Meta are effectively footing the bill for the AI boom. These companies’ results over this past earnings season showed an unwavering commitment to investing in artificial intelligence and the infrastructure to support it. To illustrate the scale: Meta raised its 2025 capex guidance to \$72 billion; Google increased its 2025 capex guidance to \$91–93 billion; Amazon expects about \$125 billion in capex for 2025, while Microsoft projects \$40–42 billion for the same period. To put this into perspective, the capex budgets of Google and Amazon alone exceed the GDPs of countries like Uruguay, Panama, or Croatia. What is even more incredible

is that many of these companies are not raising debt or equity to stay competitive in the AI race. In fact, they’re funding this expansion using only a portion of the massive operating cash flows they generate. On average, hyperscalers are spending roughly 50% of their operating cash flow on capital expenditure. Moreover, their balance sheets remain exceptionally strong, again, in contrast to what we saw during the dotcom bubble. As of 3Q25, Microsoft reported \$78bn in cash and equivalents, Meta \$47bn, Google \$118bn, and Amazon \$87bn. In other words, these companies are sitting on more cash than many countries generate in annual GDP. So far, investors have cheered heavy levels of capex investments, which was reflected by the strong stock performance of the companies leading the development of AI. In fact, within the S&P 500, tech firms that have invested the most in AI have delivered the highest returns in 2025.

### What has changed since the beginning of 2024?

As we mentioned before, not a lot has changed since we wrote our last bubble report early last year. However, there are a few exceptions. On one hand, as highlighted above, the amount of capex investment on AI infrastructure by the hyperscalers has meaningfully increased. Early last year, AI-related capex was expected to rise to approximately \$250–300 billion by the end of the year. AI infrastructure spending, including power generation, is now expected to rise to \$700 billion in 2026 alone. That large rate of change in spending is likely to begin to trickle down to other sectors of the economy apart from just technology, including power generation and distribution, construction, and industrial companies, among others. At the same time, the rate of implementation of AI is also increasing, which could prove beneficial to many

industries, although potentially impacting job growth in others. Additionally, and equally as important, the potential for sustainably lower interest rates, coupled with a more benign fiscal and regulatory environment, could increase earnings growth across the economy, hastening the expansion of the breadth of the market, decreasing market concentration, and lending support to the continuation of a healthy rally.

On the other hand, uncertainty surrounding tariffs, inflation, employment, consumer and business confidence, and monetary policy has also increased, any of which could derail the rally if they prove to be more acute than currently expected. At the same time, earnings expectations for many of the companies involved in the AI theme continue to move higher, driving valuations higher with them. Expectations for some of these companies have reached levels where some valuation metrics are pricing in earnings that are set to materialize two years from now, leaving the door open for potential pullbacks if these expectations fail to materialize in the near future. It would not surprise us if earnings growth for some of the large technology companies decelerated slightly into next year, ratcheting earnings expectations lower. This would not necessarily be an unhealthy condition for the market in general though, as long as any deceleration is not meaningful, and earnings continue to expand in other segments of the economy.

As we said before though, although the market could be in extended territory, we do not think that we are yet in a bubble. However, this does not mean that we will not see pullbacks in the market over the next year. In fact, over the past

fifty years, the S&P 500 has seen, on average, at least one pullback between 10% and 15% per year. **We believe that a garden variety pullback such as these would be healthy for the markets, as it would take some of the froth off and recalibrate investor expectations. Periods of recalibration tend to bring a level of reality back to markets and fend off bubbles. Such a period of recalibration would likely bring about a higher degree of rotation, with funds flowing out of concentrated parts of the market and into other sectors, increasing market breadth and broadening the base of the rally. We believe that such a rotation out of extended positions in large cap tech could benefit other sectors such as Healthcare, Financials, Industrials, and Utilities, as well as other asset classes such as mid and small cap companies, and even gold, which recently experienced a healthy pullback.**

A reduction in market concentration and broadening out of the market leaders would strengthen the underpinnings of the current rally. A normal pullback could be the pause the market needs to recalibrate and refresh itself. In a sense, the markets are like plants, sometimes needing some pruning off the top to stay healthy; otherwise, they can grow out of control and eventually collapse, much like the popping of a bubble. ■



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