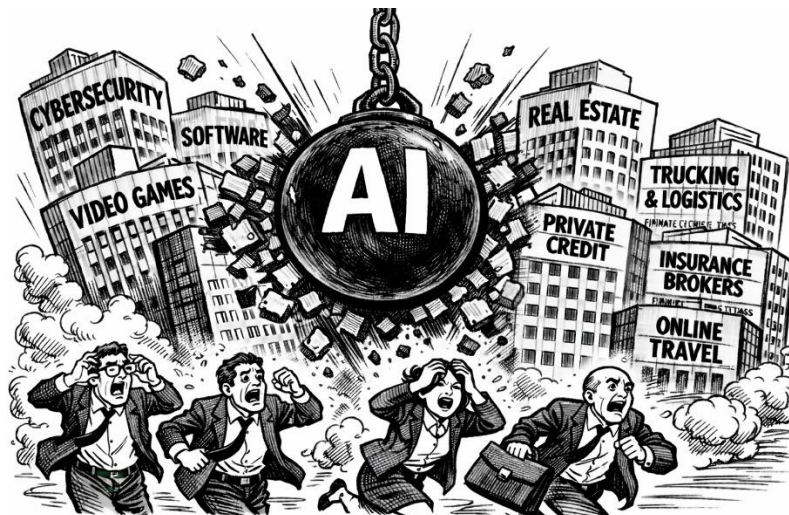


Investment Insight

THE AI PARADOX: OPPORTUNITY AS BEAR STORIES COLLIDE

Over the past year, the epochal innovation of artificial intelligence has sparked dramatic swings in markets. Investors are torn between concerns about overinvestment and fears that it will render entire industries obsolete. Both bear stories cannot be true at the same time. There will be winners and losers as the AI paradigm unfolds. Careful analysis and stock selection will matter most, and the resulting volatility creates opportunities for long-term investors.

Remember a year ago? The release of the Chinese AI model DeepSeek triggered a sharp sell-off in AI-related stocks, including Nvidia. DeepSeek introduced architectural and training optimisations that appeared to improve efficiency significantly. The obvious conclusion was that higher efficiency would translate into lower demand for compute capacity. The media quickly amplified this view and shares of Nvidia and other AI infrastructure companies fell sharply in the weeks that followed.



Source: J. Stern & Co. generated by AI

Not so fast, [we said](#) in an investment insight we published this time last year. These improvements are part of the natural progression of technological development. Efficiency does not necessarily reduce demand for compute capacity. On the contrary, it can expand it. Typically, lower costs and better performance increase adoption, not suppress it. That is what happened. Compute demand did not collapse. Instead, these stocks rebounded and ultimately flourished. It happens all the time in equity markets. Negative headlines spread quickly and investors shoot first and ask questions later.

Fast-forward a year and a similar dynamic is playing out again. We have lost count of the reports predicting gloom and doom. Recent advances, particularly from Claude, the generative AI tool created by Anthropic, have triggered a broad decline in share prices across software and many other sectors. The selling has been largely indiscriminate. Volatility like this is uncomfortable but it can also create opportunities for long-term investors.

The progress made by Anthropic and other large language model providers is impressive. They continue to improve at an astonishing pace and we are excited about what may be possible as models are increasingly trained and deployed on Nvidia's Blackwell architecture.

We have been positive about AI's long-term prospects for more than three years and continue to believe it represents the next industrial paradigm. Yet there is a curious paradox in the market today.

TWO CONFLICTING BEAR CASES

At the end of last year, the dominant concern was that AI infrastructure had become a bubble. Critics said that hyperscalers were overspending on capital expenditure without a clear path to adequate returns. Questions were raised about the accounting treatment of depreciation schedules and circular financing structures. The underlying claim was straightforward: enterprise adoption of AI is limited, so investments are excessive.

An oft-cited MIT survey from last summer suggested that 95% of enterprise AI projects had failed. The implication was that leading model providers such as OpenAI and Anthropic would struggle to justify their investment plans, leaving hyperscalers with underutilised data centre capacity. In short, the addressable market was deemed insufficient to support the current high level of spending.

This narrative has weighed on hyperscalers, neo-cloud providers and parts of the AI infrastructure supply chain. The drawdowns from peak levels reflect this shift in sentiment:

Company Name	Drawdown from Peak of Nov 2025
Astera Labs	-32%
Credo Technology	-49%
Broadcom	-25%
CoreWeave	-44%
Nebius	-43%
Microsoft	-22%
Amazon	-21%

Source: Bloomberg.

The second and more recent narrative is almost the mirror image of the first. It argues that large language models, particularly Anthropic's Claude with its new capabilities, are so powerful that they can replace large swathes of existing software infrastructure. Hundreds of billions of dollars in enterprise software market capitalisation were erased in a matter of weeks.

The contagion did not stop there. Cybersecurity software, electronic design automation, video games, data services and index providers, real estate, trucking and logistics, private credit, insurance brokers, wealth management and online travel have all come under pressure¹. A

¹ Since their year-to-date peak, cybersecurity was down -20% on average (including CRWD and PANW), EDA -29% (CNDS and SNPS), video games -43% (U and TTWO), data services and index providers -29% (RELX, WKL, VRSK, MCO and SPGI), real estate -22% (JLL and CBRE), trucking and logistics -16% (CHRW), private credit -28% (ARES, KKR and OWL), insurance brokers -17% (AJG, WTW, AON and BRO), wealth management -18% (STJ and SCHW), and online travel -27% (BKNG and EXPE).

broad range of companies is now perceived to be at risk of AI-driven obsolescence. Both narratives cannot simultaneously be true – we cannot be overspending on AI capacity for which there is no demand, while at the same time facing the imminent eradication of entire industries by AI. The coexistence of these views shows how susceptible markets currently are to bearish narratives at a time when they are at all-time highs and technological change is just one of many concerns.

ARE HYPERSCALERS BEING RECKLESS?

Put simply, we do not think that hyperscalers are allocating capital recklessly. We acknowledge that the scale of investment is enormous and execution will inevitably be imperfect. Building advanced data centres on time and on budget is a complex undertaking. Delays, cost overruns, or unforeseen engineering challenges are entirely likely.

We have seen similar reactions before. Nvidia experienced well-publicised design and thermal issues with early Blackwell deployments. These are normal challenges in cutting-edge chip design. Yet commentary from sources that seemed to be unfamiliar with how semiconductor development work lit up our screens and amplified these issues beyond anything warranted by the facts.

Heads up that something similar could happen in data centre construction. A delayed project might be extrapolated into a systemic problem. An isolated disruption could be interpreted as a structural weakness.

The key is that hyperscalers are building capacity based on visible demand and backlog. These companies have long track records of disciplined capital allocation and the investments are demand-led rather than speculative. This is fundamentally different from building capacity ahead of demand in the hope that if they build it customers will come.

IS AI ABOUT TO ERADICATE ENTIRE SECTORS?

The second narrative currently dominating the market is that AI will swiftly render large parts of industries obsolete, which we think is equally overstated.

At the start of the month, Anthropic's Claude demonstrated the ability to draft non-disclosure agreements and proofread contracts. This capability contributed to share price weakness in legal data providers such as Thomson Reuters and RELX, with knock-on effects across enterprise software. Google's Project Genie raised concerns about video game development by lowering barriers to engine creation.

Data services companies, including credit bureaus, insurance brokers, and wealth managers, have sold off amid fears that AI can replicate their expertise following demonstrations of AI tools. This also affected real estate companies like JLL and CBRE, as fears about white-collar employment levels and office demand weighed on the sector.

In a striking example, trucking and logistics companies like CH Robinson fell sharply after a micro-cap company that had previously focused on selling karaoke machines announced an AI-powered freight optimisation program. Episodes like this often look obvious in hindsight as moments when popular delusions are detached from any fundamentals.

HISTORICAL PARALLELS

We have seen similar overreactions before. The emergence of Amazon and e-commerce was widely expected to decimate the retail industry. Some retailers did struggle. Others, such as Home Depot, Lowe's, TJX, Costco and Walmart all adapted and thrived. Structural advantages, strong execution and differentiated positioning mattered.

More recently, the rise of GLP-1 weight-loss drugs triggered a sharp sell-off across food and beverage stocks amid fears of reduced consumption. Yet we see companies like McDonald's and others continuing to perform well, with shares close to all-time highs.

AI disruption is likely to follow a similar pattern. Some business models will weaken. Others will prove resilient or even stronger.

SYSTEMS OF RECORD VS WORKFLOW SOFTWARE

Software is one of the areas hardest hit. We have positions in companies, including SAP and Salesforce and believe that there are important distinctions between companies in the software industry.

Systems of record, such as SAP's ERP platform or Salesforce's CRM, serve as the authoritative source of enterprise data. They are deeply embedded in operations, tightly linked to compliance and regulation, and extraordinarily costly and risky to replace. Enterprise migrations from on-premises to cloud environments have taken years and many remain incomplete. The underlying data is sacrosanct. We do not think that firms will allow AI to interact with it freely without robust permissions, security and governance.

By contrast, workflow-oriented software, where value lies in guiding processes such as tax preparation or helpdesk management, may be more vulnerable. If the underlying data is less proprietary and the value lies primarily in applying logic or generating outputs, AI may replicate or augment those functions more easily.

Similar reasoning applies to other data and business services companies. Where competitive advantage rests more on expertise in applying widely available data rather than on ownership of proprietary data, AI may increase competitive pressure. We have seen this occur at credit bureaus, insurance brokers and wealth management companies.

A MARKET OF EXTREMES CREATES OPPORTUNITY

AI is moving quickly and the capabilities of next-generation models trained on Nvidia's Blackwell platform are likely to accelerate enterprise adoption. Some segments will face structural pressure, particularly those without differentiated offerings or durable competitive advantages.

We think the market is alternating from one bear narrative to another far too quickly. It is too simplistic and short-sighted to say that AI investment is wasteful because there is no demand and then switch to AI will destroy entire industries and erase trillions of dollars of market cap overnight.

Technological transitions are rarely linear. They create winners and losers, and mis-pricings as they progress. We think it is these periods of narrative-driven selling, volatility and fear

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that are just the times when active fundamental investors can add value. When markets treat entire sectors as either doomed or invincible, careful analysis and stock selection matter most. This is not a time of retreat but of investment.

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