

ARTIFICIAL INTELLIGENCE: PRICING IN PERFECTION?

NOVEMBER 2025

Enthusiasm over artificial intelligence (AI) has been one of the most dominant themes driving market returns in the last three years. The rapid adoption of large language models (LLMs) has driven huge amounts of capital into the space and fuelled a rise in asset prices. This paper will discuss the implications of AI on the market and whether this constitutes a bubble.

Background

The origins of modern-day AI trace back to the 1950s and Alan Turing, who published his work “Computer Machinery and Intelligence”, which later became the Turing Test¹. Turing laid the groundwork for researchers to start creating systems that exhibit human-like intelligence. For the majority of the time since then, advancements in deep learning led to the creation of AI agents that perform specific tasks to a high degree of accuracy but were limited by a reliance on backend human input.

Various academic advancements in the early 2010s drove a progression towards generative AI, a subfield of AI that learns from statistical patterns embedded in large datasets to produce unique output. This in turn led to the development of large language models (LLMs), a type of neural network that can generate text, images, and videos indistinguishable from human-like creativity. Widespread adoption of LLMs has driven market enthusiasm for AI.

Are we seeing productivity benefits from AI?

Anecdotal evidence will point to AI, particularly as it relates to LLMs such as ChatGPT, as being revolutionary in people’s everyday lives. AI has the promise of rapidly improving automation in several areas, including but not limited to:

- Disease diagnosis & drug discovery
- Manufacturing & robotics
- Transportation
- Cybersecurity
- Predictive analytics
- Software engineering



However, the degree to which AI is driving efficiencies at an enterprise level is less obvious. There is a concern that LLMs are just sophisticated 'imitation engines' with a propensity to hallucinate, making them unusable for any task that requires 100% accuracy. Even in the currently most advanced models, such as GPT-5 and Claude 4.5 Sonnet, the error rate is high². Central to this is the concept of 'scaling laws' – the idea that models will become progressively more advanced through innovation, a foundational assumption behind the technology. If scaling begins to falter, so too will the appetite for companies to invest in AI at scale. A recent MIT paper shed light on how little AI adoption is flowing through into operating efficiencies, noting that just 5% of companies succeeded at integrating these systems into production at scale³.

It is worth noting that modern-day generative AI is relatively new, and it is difficult to know exactly how the technology will evolve. While many companies currently utilise third-party generative LLM agents, those that can feed large datasets into proprietary agents will likely emerge as the biggest beneficiaries of AI, as this is where the greatest efficiencies lie.

Dot.com comparison

The dot.com bubble was driven by exuberance around the commercialisation of the internet, which at its peak, saw the NASDAQ 100 trade at an average of 60x price-to-earnings (PE) versus the historical average of ~25x. This period of time was littered with examples of companies trading on excessive valuations, despite producing little to no profits. One of the more notorious examples was Pets.com, an emerging e-commerce player selling pet supplies online. Pets.com raised US\$82.5 million through its IPO in February 2000 before being delisted less than 12 months later⁴. As the bubble burst in 2000, only those companies with sustainable business models and resilient balance sheets survived, including the likes of Amazon, eBay, and Cisco. Companies without sufficient operating profits or cash on their balance sheet were forced to raise equity at multi-year lows, diluting shareholders and destroying equity value in the process.

This is distinctly different from today's market environment, where AI efficiencies are flowing directly into revenues and, to a lesser extent, free cash flows. Earnings are growing faster today than during the dot.com bubble, and this is being driven by the 'Mag 7' companies: NVIDIA, Alphabet, Amazon, Apple, Tesla, Meta, and Microsoft. NVIDIA alone reported a 63% YoY uptick in net income for the 12 months ending 31 July 2025, around \$86 billion. These seven companies are expected to grow earnings 1.6x faster than the S&P 500 over the next two quarters⁵. Looking forward to the next few years, Mag 7 companies are expected to grow EPS at ~15% CAGR versus only ~10% CAGR for the rest of the S&P 500.



2. OpenAI
3. MIT
4. Riskhedge
5. Morningstar

Chart: Expected Earnings Growth Mag 7 vs S&P 500

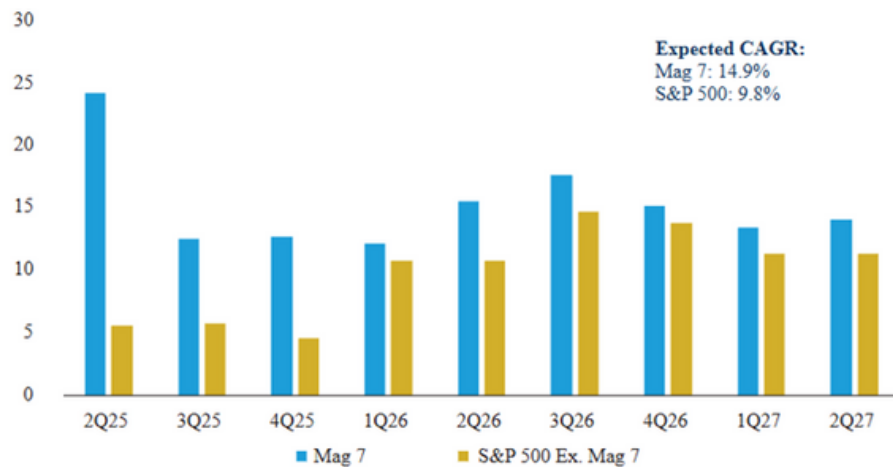


Figure 1. Source; UBS

Some winners, more losers

The demand for new computing power has benefited companies across the tech ecosystem, from chip makers to data centre builders. However, there is one parallel to the dot.com crash that is likely to play out: Revenue will gravitate towards companies with greater adaptability to changes in technology over time. The ‘arms race’ for market share will lead to diverging outcomes, and earnings growth will likely become more concentrated. This is particularly true for foundational model developers, such as OpenAI and Anthropic, where fierce competition demands substantial R&D investment to stay ahead⁶. Whereas public and private valuations are pricing in high growth rates for many of these companies, only a small group of winners will likely drive future output.

Are valuations stretched?

U.S. tech PE multiples currently trade above the historical average, but lower than at the height of the dotcom bubble.

Chart: U.S. Tech PE Multiples Over Time



Figure 2 Source; Reuters

6. Forbes

Adjusted for inflation, multiples in the U.S. are still lower today than during the early 2000s.

Chart: U.S. Cyclically Adjusted Price to Earnings (CAPE)



Figure 3. Source; Orbis

Valuations still have further room to grow, but recent earnings growth should be viewed with several caveats. The larger U.S. tech companies are using creative accounting to extend the useful life of their servers, which reduces reportable depreciation expense while boosting operating margins and net income. The useful life of NVIDIA GPUs is typically only 1-3 years, whereas the likes of Alphabet and Microsoft are reporting depreciation schedules of 5-6 years for these assets, drastically underreporting depreciation in their financial accounts⁷.

Large tech companies are also laying off staff, particularly at a junior level, where jobs are more susceptible to being replaced by AI. Just in October, the U.S. reported more than 150,000 job cuts, significantly above average⁸. Reduced SG&A expense will flow directly into higher operating margins, acting as a tailwind for earnings.

There is also the question of circularity: How much is revenue being driven by a handful of insider companies? The image overleaf shows how deeply companies within the AI ecosystem are financially intertwined.

7. The Economist
8. TechCrunch



How Nvidia and OpenAI Fuel the AI Money Machine

/ Hardware or Software
 / Investment
 / Services
 / Venture Capital
 Circles sized by market value

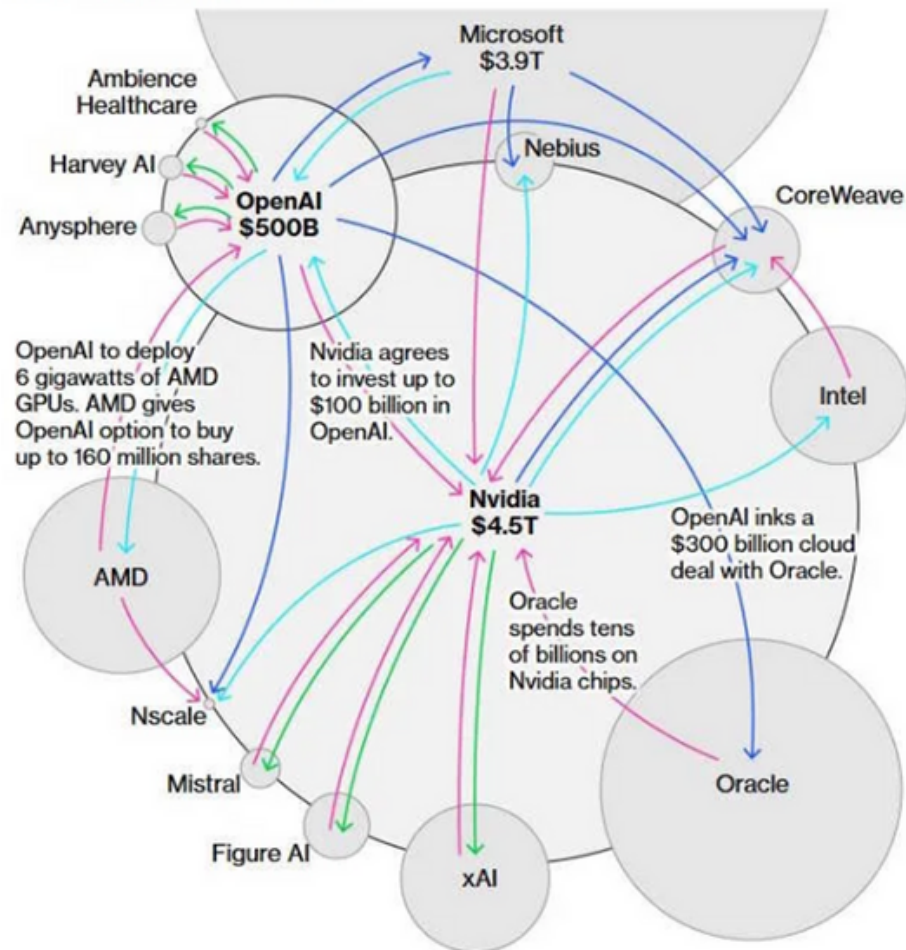


Figure 4. Source: Bloomberg

While there is nothing directly alarming about this, it does raise the risk of wider contagion should AI adoption rates start to plateau.

Macroeconomic outlook

There is a material divergence in the relative macroeconomic outlooks between today and during the dot.com bubble. Between early 1999 and May 2000, the Federal Reserve raised the funds rate from 4.7% to 6.5%, which, when combined with fears of a global recession, acted as a catalyst for risk assets to sell off. More recently, the Federal Reserve has commenced its interest rate cutting cycle, which will likely be supportive for growth assets in the near to medium term.

The equity market is top-heavy

The top 10 stocks in the S&P 500 currently account for nearly 40% of the total market capitalisation of the index, exceeding the previous record of 26% during the height of the dot.com bubble⁹. This extreme concentration can be seen in the MSCI World Index, where the U.S. now accounts for 72.56% of the constituency.

COUNTRY WEIGHTS

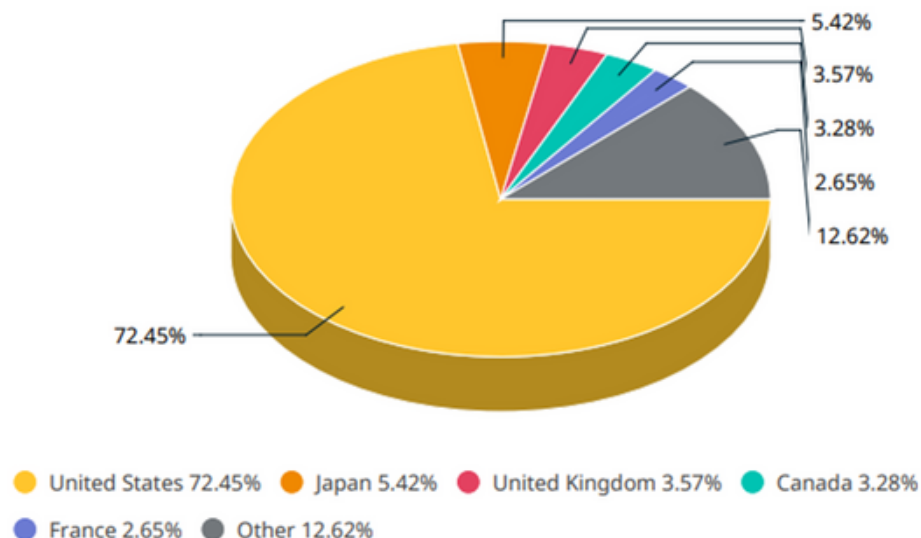


Figure 5. Source: MSCI

Broader junk rally

As with any emergent technology, new entrants will attempt to ride the wave of investor enthusiasm without any pathway to profitability, taking investor flows along the way. While the argument can be made that many of the larger AI names, such as NVIDIA and Broadcom, can justify elevated valuations due to their impressive earnings growth, capital has flowed into several smaller, unprofitable names with weaker earnings profiles and less sustainable business models. Over the last 12 months, ten loss-making AI start-ups have accumulated over \$US1 trillion in valuation, and we've seen a broad rally in junk (low-quality) stocks.

Some of the more egregious valuation examples include IONQ, which currently trades at a US\$20b equity value despite guiding to only \$91m of revenue in CY25, and Palantir, which trades at a \$430b equity value despite having only \$4b in revenue¹⁰. It is important to distinguish between which companies qualify as 'quality' and which as 'junk', as investors may be increasingly conflating the two. Many large tech companies, while exposed to the AI 'thematic', also have revenue streams outside of AI and are likely to withstand a market downturn, unlike many unprofitable names whose futures seem more uncertain. There are also several hallmarks of previous bubbles that we've yet to see: a surge in new IPOs, excessive amounts of new equity issuance, and highly leveraged M&A.

9. S&P
10. Company Reports

Capex supercycle

Just as today's internet relies on fibre optic cables, the progress of generative AI hinges on exponential increases in computational power and, by extension, the need for advanced data centres. LLMs rely on vast amounts of data, so capex is flowing beyond GPUs and into building developers, advanced nuclear reactors, semiconductors, etc.. Because AI now comprises a low single-digit percentage of U.S. electricity demand, utilities have also emerged as an AI-adjacent play¹¹.

Capex is being driven by the 'hyperscalers', namely Amazon, Google, Meta, Microsoft, and Oracle. These companies already operate global networks of data centres for cloud computing and have the greatest leverage to AI because they already own the infrastructure. They also have the balance sheet strength to invest at scale, having generated significant cash flows from SaaS and cloud computing.

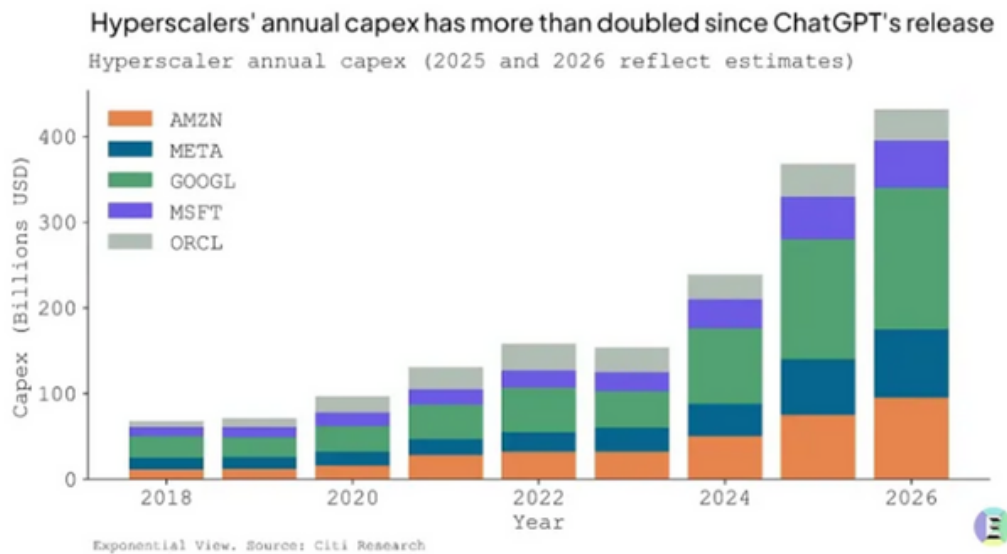


Figure 6. Source: Citi Research

Capex is being driven at unprecedented scale, and current projections point to \$6.7 trillion of investment needed by 2030 to support demand for AI compute power¹². However, projections show that free cash flows are struggling to keep up.

Hyperscalers CAPEX vs FCF Estimates (2024-2028)



Figure 7. Source: Fairlight

11. IEA

12. McKinsey

What could be the catalyst?

Market catalysts are difficult to predict, and timing a market downturn is even more challenging. Being early can be the same as being wrong, because the opportunity cost of not holding top-performing companies will almost inevitably lead to underperformance versus peers. Returning to the dot.com example, in 1996 the then Federal Reserve Chairman, Alan Greenspan, commented on the market showing signs of “irrational exuberance”, referencing the elevated valuations that many of these stocks were trading at. It took another four years for the market to crash, meaning those who adopted a defensive investment approach in 1996 suffered an extended period of relative underperformance.

Conclusion

There are concerns over the scalability of agentic AI and whether the current levels of capex being spent on AI infrastructure will translate into free cash flows over time. However, expected growth in proprietary LLMs will significantly improve efficiencies and likely encourage wider adoption of AI. These efficiencies should ultimately translate into higher profit margins and improve the way companies deliver their products and services.

Outside of some speculative areas of the market, tech valuations are lower than during the dot.com bubble. AI-related companies are also seeing significant earnings growth, and this is expected to continue into the foreseeable future. As companies compete for market share, we are likely to see a divergence in outcomes across companies.

Evergreen is of the view that we are likely in the early stages of a bubble, but we are not yet seeing the signs of “irrational exuberance” that were evident during the dot.com market crash.



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