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focus



AI: Market Grapples with the Unknown

AI is changing how businesses work, and demand for the technology continues to grow. Even so, AI-related shares have plunged in recent weeks. That can be unsettling but it's important to appreciate that swings between excitement and concern are to be expected with a fast-moving technology whose future is inherently uncertain. There are reasons to be optimistic about AI, alongside genuine risks.

FORSYTH BARR
INVESTMENT ADVICE
90 YEARS

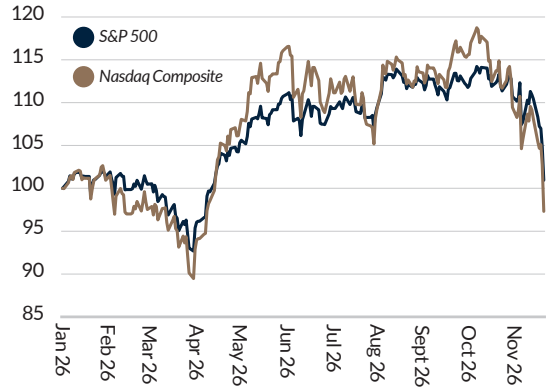


...Has the outlook for AI deteriorated as dramatically as share prices suggest?...

From excitement to concern

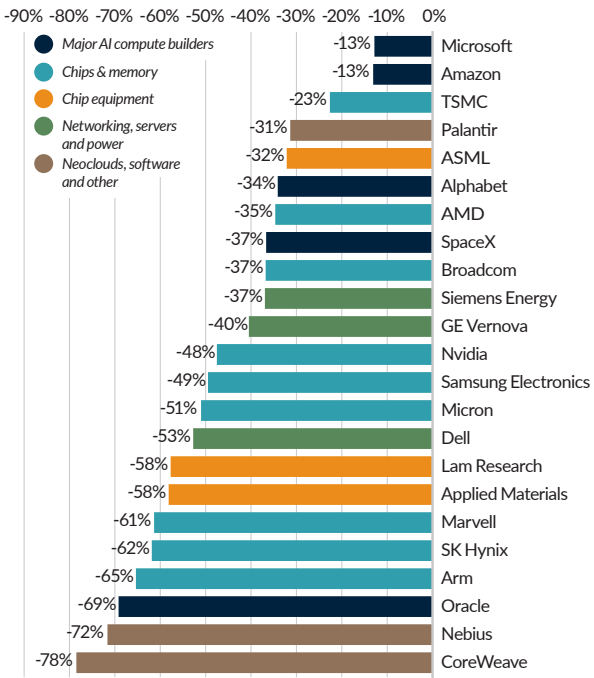
After a remarkable run, AI-related shares have had a bruising few weeks. As of 20 November, the S&P 500 was around 12% below its October high and the tech-heavy Nasdaq was 18% off its peak. The PHLX Semiconductor Index, which tracks chip companies, was around 43% below its June high. It is a sharp reversal for the stocks that have driven so much of the market's returns in recent years.

CORRECTION OVER THE PAST TWO MONTHS LED BY TECHNOLOGY STOCKS



Source: LSEG, Forsyth Barr analysis

PREVIOUSLY HIGH-FLYING AI LEADERS HAVE FALLEN SHARPLY: SHARE PRICE VS. ALL-TIME HIGHS



Source: LSEG, Forsyth Barr analysis

So what has changed? Has the outlook for AI deteriorated as dramatically as share prices suggest?

Companies are still investing heavily, businesses continue to adopt AI, and recent corporate results show substantial demand. But important questions remain unanswered. How widely will AI be used? How much computing power will it need? Which companies will capture the profits, and when will today's investment pay off?

Why the mood has soured

Several concerns have emerged at once, raising questions about the pace and profitability of AI investment.

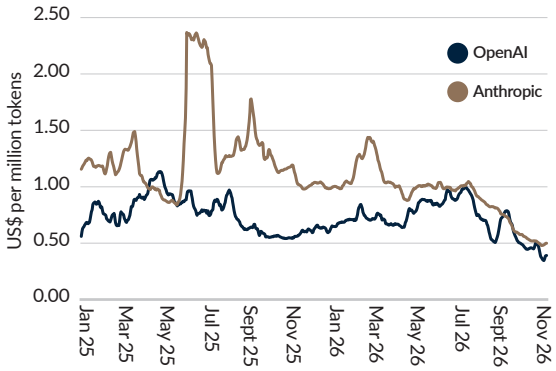
Financing is becoming harder. Building data centres and buying advanced chips require vast amounts of capital. Higher interest rates and greater scrutiny from lenders have raised borrowing costs, particularly for heavily indebted neoclouds, which rent out AI computing capacity. Investors worry that a squeeze in funding could delay projects and reduce demand for chips.

Politics could slow data-centre development. Democrats made sweeping gains in the US midterms, including in several races for state governor. Texas governor-elect Gina Hinojosa, for example, campaigned for a pause on new data-centre approvals until protections for local communities are in place. Investors are weighing the possibility of longer approval processes and higher costs. The extent of any policy changes remains uncertain.

Nvidia faces an unexpected leadership void. Jensen Huang resigned as chief executive on 12 November following revelations of improprieties including an affair with a woman suspected of working for Chinese intelligence. Huang was more than Nvidia's chief executive. As co-founder, he helped build the company into the leading supplier of AI chips and became the public face of the AI boom. Many investors viewed him as central to Nvidia's technology roadmap and network across the industry. He also made Nvidia an important source of capital for other AI companies. His departure raises the possibility that Nvidia will provide less funding, adding to financing constraints and potentially slowing the broader AI rollout.

The price of using AI models is falling. AI companies commonly charge for tokens, units used to measure model usage. Among businesses tracked by payments provider Ramp, the average price paid per million OpenAI and Anthropic tokens was around 11% lower in the week to 15 November than four weeks earlier, even as usage rose. Anthropic has also disclosed that price cuts and customer discounts partly offset its recent revenue growth. Cheaper AI could encourage wider use, but the question for investors is whether that growth will more than make up for lower prices.

TOKEN PRICES HAVE BEEN FALLING



Source: Ramp AI Index

Speculative positions are being unwound. The gains in AI-related shares attracted some investors betting on further short-term rises. As prices fell, some cut their positions, while momentum trading strategies that sell when markets fall added to the pressure. This likely amplified the sell-off. Share prices can fall further and faster than changes in the underlying businesses' prospects alone would suggest.

Strong arguments from both the bulls and the bears

In theory, a share's value reflects the cash a company is expected to generate in the future. Those cash flows are always uncertain, particularly for a new and fast-evolving technology such as AI. When the range of possible outcomes is wide, investors can reach very different views of what a company is worth.

The bull case on AI begins with real demand. Businesses are using AI for coding, research, customer service, and a growing range of other work. Nvidia's latest quarterly revenue more than doubled from a year earlier. Anthropic reported US$33 billion in revenue for the first nine months of 2026, compared with US$2.5 billion in the same period last year. These are substantial businesses, not merely promises of a future market. As AI becomes cheaper and more capable, new uses could expand demand considerably.

The bear case is that the enormous investment being made may not earn an adequate return. Businesses and consumers may not find enough valuable uses to support all the computing capacity being built. Even if usage grows, competition between AI models could drive prices down faster than demand rises. Today's leaders may also have to keep spending heavily to stay ahead. AI may deliver substantial benefits, with much of the value flowing to its users rather than to the companies financing its development.

We can form opinions on the outlook, but nobody knows for sure. That leaves a lot of room for investors' expectations, and share prices, to change.



...We expect AI to remain an important long-term investment theme...

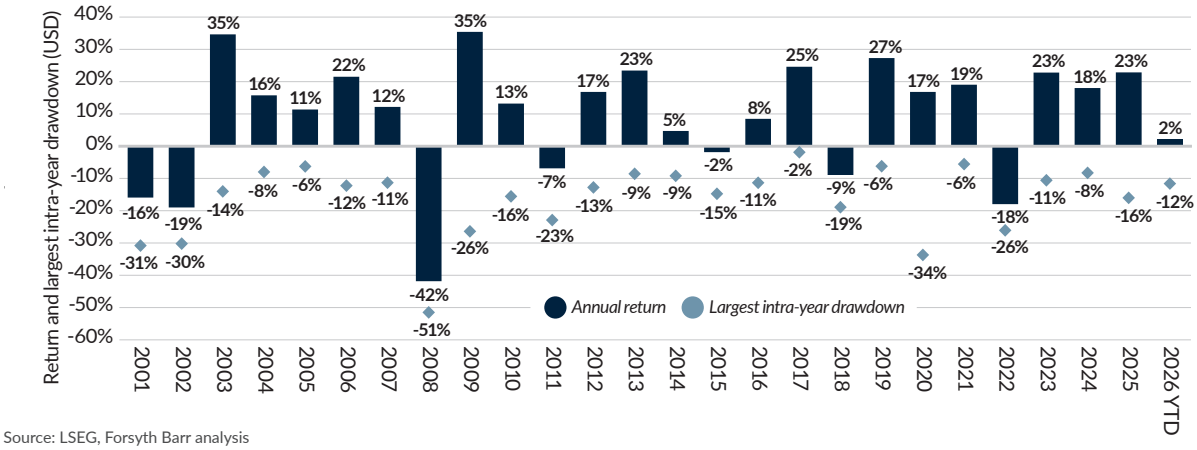
(Unfortunately) volatility is part of the ride

Sharp falls in share prices are unsettling, but they are a normal part of investing. The market experiences a pullback of 5% or more almost every year, and a pullback of more than 10% two years out of three. Since 1950, the largest fall within a year has averaged around 14%.

When markets fall, it can be tempting to sell and return once the outlook feels clearer. That requires getting two difficult decisions right: when to leave and when to come back. Many questions about AI could take years to become clear. Investors rarely get rewarded for waiting for certainty.

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VOLATILITY IS NORMAL: MSCI ACWI ANNUAL RETURN AND LARGEST INTRA-YEAR DRAWDOWN



Source: LSEG, Forsyth Barr analysis

For most long-term investors, the right response is to stick with their investment plan. Lower prices may offer opportunities to buy good businesses at more attractive prices. If the fall has exposed an uncomfortable reliance on AI or more risk than expected, an adjustment may make sense. Any changes should reflect their longer-term goals and not the mood of the market.

We expect AI to remain an important long-term investment theme. We also expect more surprises, bursts of enthusiasm and disappointments. For long-term investors, the key is to hold a portfolio that can participate if AI fulfils its promise, while remaining diversified enough to withstand the uncertainty and volatility along the way.

If at any time you want to discuss investment options and opportunities, your Forsyth Barr Investment Adviser is available to provide you advice and assistance.

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