



By Thomas Wash

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The AI Buildout: Profits, Productivity, and the Risk of Overcapacity

Famed investor Charlie Munger once said that “the great lesson in microeconomics is to discriminate between when technology is going to help you and when it is going to kill you,” adding that most people do not get this straight in their heads. That lesson is especially relevant today.

Investment related to artificial intelligence (AI) has dominated the United States economy in 2026. [At an estimated \\$1 trillion](#), AI-related capital expenditure not only exceeds any prior investment cycle in nominal terms as well as any since the railroad boom as a share of gross domestic product, but it also surpasses the annual GDP of most countries. To fund this spending, companies have relied on a combination of debt, equity, and their own cash reserves as they race to dominate the sector in what is shaping up to be one of the largest bets in economic history.

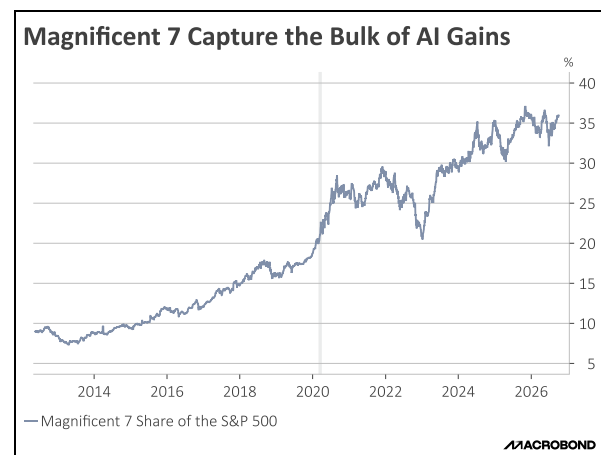
These companies are willing to take on such an enormous undertaking because they want to own the technology that will define the future. The hope is that AI will deliver both higher productivity to bring down costs over time and substantial earnings for the firms that build it. However, history suggests only one of these outcomes is likely.

In this report, we examine why it’s difficult for technology to deliver both higher

earnings and lower inflation. We then look back at the internet bubble of the 1990s, when the firms that built the internet's infrastructure largely failed while those that used it thrived. Next, we apply those lessons to AI, assessing the risks posed by foreign competition and slower-than-expected demand as well as what makes this cycle different, particularly the government’s support for the industry. Our goal is to give investors a clearer understanding of how AI is likely to evolve over the next few years. As usual, we conclude with a summary of the potential market implications.

The Fallacy of Composition

A technology that helps one company won’t necessarily help every company that adopts it. Economists call this the fallacy of composition: What is true for one participant is not necessarily true for all of them. New technology tends to benefit firms most when only a few can use it, and it loses much of that value as it becomes widely available.



A firm’s ability to grow earnings and its ability to lower prices are in a constant tug

of war. On one side, a firm that can use a certain technology in ways its competitors cannot tends to gain a point of differentiation, which allows it to charge higher prices. On the other side, if that new technology is widely accessible and competitors can replicate how a firm uses it, the result is a race to the bottom as everyone cuts prices to compete for market share.

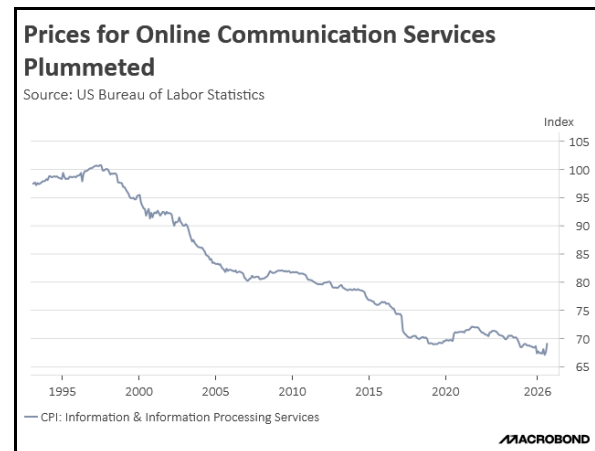
Historical Review: The Internet Bubble

The internet bubble offers a useful case study of how the fallacy of composition can hurt investors. During the 1990s, it was widely assumed that the internet was the future. Many believed it would make firms more cost-efficient as it helped them reach customers, make sales, and boost worker productivity. As a result, telecom companies launched what was then considered the largest capital spending boom on record, building out the infrastructure needed to meet the expected surge in demand.

During the buildout, several companies competed to become the leading telecom provider. Carriers such as WorldCom and Global Crossing reached very high market valuations on the assumption that every company competing in the same industry, offering the same or similar products, would benefit from the rise of the internet. That same optimism propelled equipment makers such as Cisco and Lucent Technologies, which sold routers, switches, and other gear to these carriers and sometimes lent them the money to buy it.

Despite hopes that the internet boom would lift all boats, reality proved otherwise. Convinced that the internet represented the future, these firms built aggressively. When demand grew far more slowly than expected, the result was massive overcapacity, and companies were forced to cut prices to compete for customers. What followed was a wave of bankruptcies and

some of the largest write-downs in US corporate history. Equipment makers fared little better. As orders dried up and loans to struggling carriers went bad, they had to absorb enormous losses. This collapse, often called the telecom bust, unfolded alongside the broader bursting of the dot-com bubble.



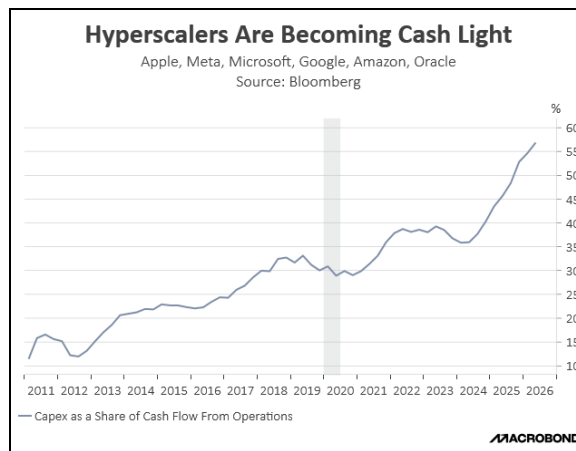
Even though the buildout failed to sustain the leading telecom providers of the time, there were still winners. The excess capacity, much of it sold off cheaply in bankruptcy, drove down the cost of moving data and became the foundation for the next generation of tech companies. Firms such as Google, Amazon, and Netflix built businesses in search, e-commerce, cloud computing, and streaming that depended on cheap, abundant bandwidth. They were able to grow by passing much of the savings on to their customers.

Unlike the carriers, whose product had become a commodity, these companies built platforms their competitors could not easily replicate. We expect a similar pattern with AI, where the biggest winners may be the companies that use the technology in ways competitors cannot easily copy.

AI and the China Problem

The rise of AI echoes many of the key themes of the internet boom. A small group of companies — the hyperscalers — is

racing to build out the capacity needed to meet expected demand. Equipment makers, meanwhile, are investing in and financing their own customers to keep orders and earnings rising, helping sustain sky-high valuations across much of the sector. One key difference this time around is China.



Hyperscalers and AI labs face far more competition than the telecom carriers of the dot-com era. Carriers had to build their networks locally, so they competed mainly with domestic rivals. AI models, by contrast, can be delivered from anywhere. Although US providers such as Amazon Web Services, Microsoft Azure, and Google Cloud hold most of the global cloud market, Chinese companies such as Alibaba and Tencent are expanding abroad and backing Chinese AI labs. As a result, businesses can now choose between American and Chinese models.

Although there are clear differences, it is difficult to say who has the advantage. US models generally lead on performance, but Chinese alternatives are significantly cheaper. Since many of the Chinese products are released as open-weight models, companies can customize them and run them on their own servers. The Chinese competition, therefore, limits how much US providers can charge, which benefits customers but raises the risk of price wars

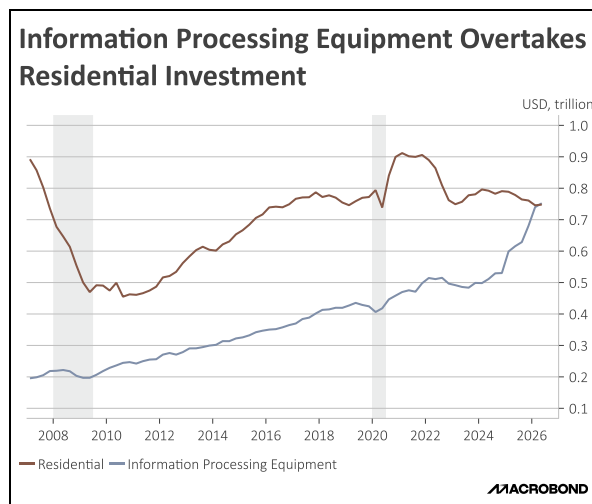
and overcapacity for the companies making the largest bets.

However, competition is only half the risk. As the telecom bust showed, the bigger danger is demand failing to keep pace with capacity. US labs have pushed hardest at the frontier, giving their models stronger reasoning capabilities and a wider range of potential applications. Yet most businesses still use AI for relatively simple tasks, well below what these models can do. That gap suggests demand may be slower to catch up than the current buildout assumes, raising the risk that overcapacity will eventually become a problem.

National Champions

There are growing signs that AI is spreading through the economy much as the internet did in the 1990s, though this time the potential upside may be greater for the companies leading the buildout. One reason is that they appear to have more active support from the government than their dot-com predecessors did. The White House is increasingly treating many of these firms as national champions, giving them a degree of policy support and protection that internet companies never enjoyed.

Hyperscalers have benefited the most from this relationship. The One Big Beautiful Bill Act restored 100% bonus depreciation, allowing companies to deduct the full cost of qualifying equipment in the year it is purchased. By lowering the after-tax cost of building data centers, the tax break has helped fuel a sharp rise in spending on information processing equipment, which now exceeds residential investment for the first time.



The White House has also used trade negotiations to push for looser rules on US tech companies abroad and to secure commitments to buy US chips. For example, Canada rescinded its digital services tax in 2025 amid trade talks with Washington, which has long argued that such taxes unfairly target US tech firms, much like a tariff. In its 2025 trade framework with the US, the EU also said it intended to purchase \$40 billion worth of US AI chips.

US AI labs are also likely to benefit from this special treatment. Washington has grown increasingly wary of foreign competitors, particularly from China. Restrictions so far have focused mainly on government use, such as bans on Chinese AI apps on official devices, rather than on private businesses. But if Chinese models make further inroads in the US market, broader restrictions could follow, helping US companies protect their market share.

However, government protection has a downside, one that falls mainly on consumers. By shielding US firms from foreign competition, government policy could reduce the alternatives available to businesses and give the largest providers more pricing power. If that happens, the AI providers could earn higher profits and

remain profitable far longer than their predecessors from the internet bubble, but at the cost of higher prices for their customers and less of the disinflationary benefit that AI might otherwise deliver.

Government protection, however, cannot guarantee demand, and it carries its own risks, since policy can restrict as easily as it can promote. Whether AI's gains flow mainly to the companies building it or to the consumers and businesses using it will depend on which forces prove stronger: policy support and pricing power on one side, or foreign competition and slower-than-expected demand on the other.

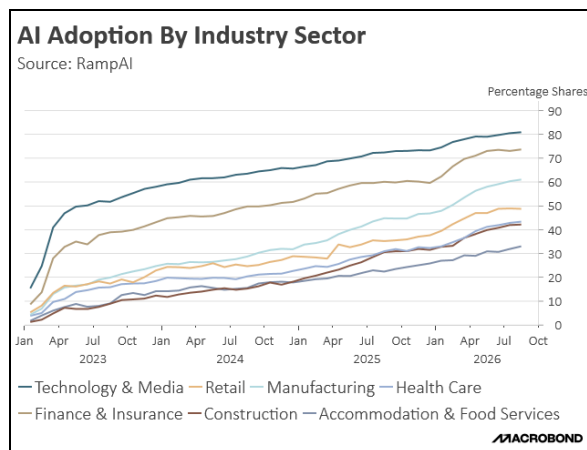
Investment Implications

While there is a lot of talk about a possible bubble in AI, the real question may be who will benefit from the technology and current investment boom and who will not.

In our view, the answer comes down to which of two promises these companies can follow through on: delivering disinflationary gains to the economy or simply generating higher earnings for themselves.

As previously stated, a technology that helps one company won't necessarily help every company that adopts it. That divergence is gradually spreading through the business world, though at an uneven pace across industries.

The latest Ramp AI Index data shows that 80.9% of Information Technology businesses and 73.1% of Finance businesses now pay for AI tools, suggesting the window for differentiation is closing quickly and limiting the remaining upside. By contrast, sectors where adoption has been slower, such as Health Care and Retail at 43.4% and 48.8%, respectively, may still offer room for gains.



the businesses and consumers that use it. We therefore think that the best strategy for investors may be to look beyond the companies building AI and focus on the sectors where adoption is still early.

As with the internet, the biggest long-term winners may be the companies that use the technology in ways competitors cannot easily copy, rather than those who build it. Munger's lesson still applies: The key is knowing when technology will help you and when it will hurt you.

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In our view, the builders face too many headwinds — from foreign competition to uncertain demand — to count on government support alone, making it more likely that much of AI's value will flow to

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