GQG PARTNERS

Dotcom on Steroids: Part III

Earnings growth mirage

18 Dec 2025 GQG Research

Key Takeaways

- Hyperscaler AI CapEx spending is inflating S&P 500 earnings by creating artificial accounting profits through cascading revenue recognition and aggressive depreciation timelines, with significant risks of reversals as spending slows
- The growing weight of semiconductors in the S&P 500 introduces heightened cyclicality, making the index vulnerable to earnings corrections as AI-driven spend normalizes and hardware oversupply emerges
- Venture capital dependency and saturation in GPU markets signal unsustainable growth in hyperscaler revenues, threatening broader market stability and exposing mispriced valuations

WHY HYPER SCALER CAPEX IS DISTORTING S&P 500 EARNINGS

Recently, many investors have started to question the circularity of revenues in the AI universe—and rightfully so, in our view.[1,2] As AI Capital Expenditure (CapEx) spending cascades through the system, it generates multiple layers of revenues and earnings across the supply chain, inflating reported results, and giving what we believe is an exaggerated sense of profitability. This earnings multiplier effect arises from differences in the accounting treatment of revenue recognition (typically within a few months) versus depreciation (an expense spread out over many years). In our view, this cascade of *accounting* profits across the entire AI supply chain will likely create a significant downward earnings revision cycle when hyperscalers eventually reduce their CapEx plans (arguably preceded by markets becoming concerned with ever-increasing spending plans like we have started to see with Meta following their Q3 2025 earnings results).[3]

As long-term investors, we believe that understanding capital cycles is one of the most important aspects of investing. Indeed, eventually the longer-term math matters, similar to what we witnessed for a whole slew of software businesses some years back which we wrote about in our "Is Software the New Shale?" white paper.[4] As we try to understand the second-derivative implications of increased hyperscaler CapEx spending, one question is: How could this spending impact the earnings of other companies in the S&P 500? Conceptually, here is the dynamic: when a hyperscaler (Company A) spends $100 on CapEx, it records no expense on its income statement other than an incremental depreciation figure, which is spread over many years. For simplicity, assume this incremental $100 CapEx spend by Company A is fulfilled by Company B. This expenditure becomes incremental revenue for Company B, on which it earns a margin that boosts its earnings. In turn, Company B might have its own CapEx outlay that is then fulfilled by Company C, and so on and so forth.

Using a stylized model, and based on the assumptions below, we estimate AI-related CapEx will have contributed over a third of this year's ~$586B growth in operating income for the S&P 500. As shown in the table, start with the roughly known $540B in AI-related spend this year from hyperscalers and venture capital (~$395B in hyperscaler CapEx plus ~$145B in AI start-up investment that effectively drives compute demand). Let us further assume 70% of this spend converts into tier-one supplier revenues (such suppliers themselves being S&P members across semiconductors and networking equipment), earned at 40% operating margins or ~$151B in dollar terms (in our view a conservative figure as AI accelerators/networking names such as Nvidia, Broadcom, and Arista are expected to boast operating margins well above this).[5]

For the second-order effect, we estimate 50% of that first-order revenue (~$189B) at ~25% margins, or roughly $47B, flows into tier-two businesses involved in power supply, cooling, data center construction, among other things (at this level, more of the spend would leak outside to non-S&P foundry/memory names, but much of the economics are still retained by index members).

Taken together, we believe these first- and second-order effects distort index-level operating income through front-loaded revenue recognition and aggressive estimates on the useful life of AI hardware such as servers and chips. We believe this all creates an artificial accounting profit uplift with significant reversal risks as CapEx growth moderates and businesses realize the useful horizon for AI hardware is closer to two to three years and not the five to six many are baking in today.[6,7]

VC spending is creating a superficial layer of accounting profits in the index that we believe is at real risk of reversing

Distorting Earnings Cascade of Hyperscaler CapEx and Venture Capital (VC) Funding

AI-Related Spending (USD BN)	
Hyperscaler CapEx (Est. 2025)*	$395
AI Start-up Investment (Est. 2025)**	$145
Total spend driving demand	$540
First-Order Flows	
% Revenue flowthrough to Tier 1 (semis, networking, etc.)	70%
% Operating Margins of Tier 1	40%
$ Operating Income Contribution	$151
Second-Order Flows	
% Revenue flowthrough to Tier 2 (power supply, cooling, DC construction, EDA, etc.)	50%
% Operating Margins of Tier 2	25%
$ Operating Income Contribution	$47
Total $ Operating Income Contribution from Hyperscaler Spending & VC Funding	$198
S&P 500 Operating Income $ Growth (Est. 2025)***	$586
Est. % Operating Income Contribution	**34%**

Source: GQG Partners LLC (table). *BofA US Equity & Quant Strategy, FactSet; represents aggregated consensus estimates for 2025 across MSFT, AMZN, GOOGL, ORCL, and META (data). **Pitchbook (data). YTD through Q3 2025, venture funds have raised ~$167B, of which ~65% has flowed through to AI start-ups; annualizing the first three quarters yields ~$223B raised by VC and 65% of that to AI start-ups yields ~$145B. ***Bloomberg as of 5 December 2025 (data). Represents the difference between the sum of expected calendar year 2025 operating income and actual calendar year 2024 operating income across current index constituents. Actual results may differ from projections illustrated above. You cannot invest directly in an index. PAST PERFORMANCE MAY NOT BE INDICATIVE OF FUTURE RESULTS.

Indeed, it is not hard to imagine these dynamics playing out, considering recent Organisation for Economic Co-operation and Development (OECD) reports that absent such large-scale AI-related spending, real GDP growth in the first half of 2025 would have been negative.[8]

FRAGILE FOUNDATIONS

While the cascading impact of hyperscaler CapEx appears to have boosted earnings across the AI supply chain, we believe this dynamic is further amplified by the increasing weight of semiconductors in the S&P 500 Index, introducing the potential for substantially greater cyclicality of profits relative to history. Unprecedentedly, semiconductors now account for about 15% of the index, up sharply from their ~4% median weight over the preceding decade, underscoring their critical role as the first-order beneficiaries of hyperscaler AI infrastructure spending.

S&P 500 is more cyclical than it has been in decades due to significant weight of semiconductors

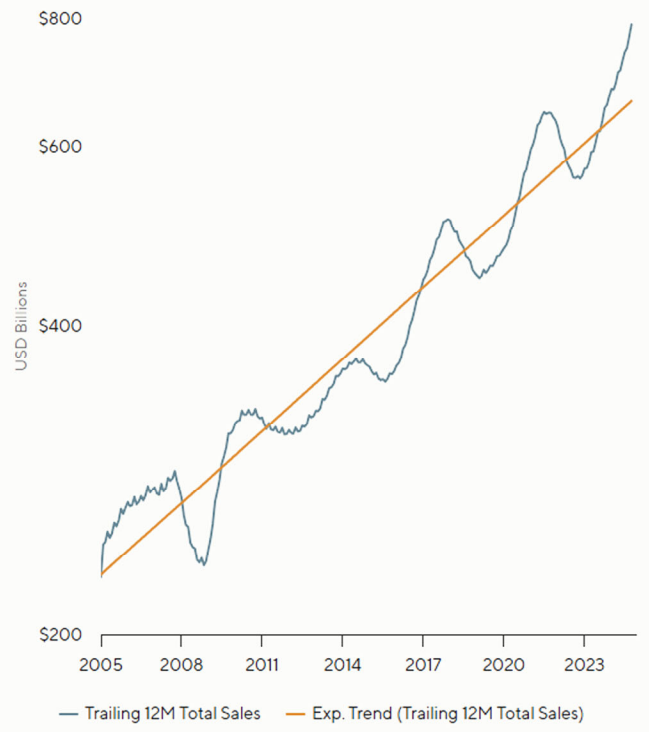
Spiking Cyclicality of Index from Semiconductors

Source: GQG Partners LLC (chart); Bloomberg (data). From January 1990 through October 2025. Semiconductor classification according to the Bloomberg Industry Classification Standard (BICS).

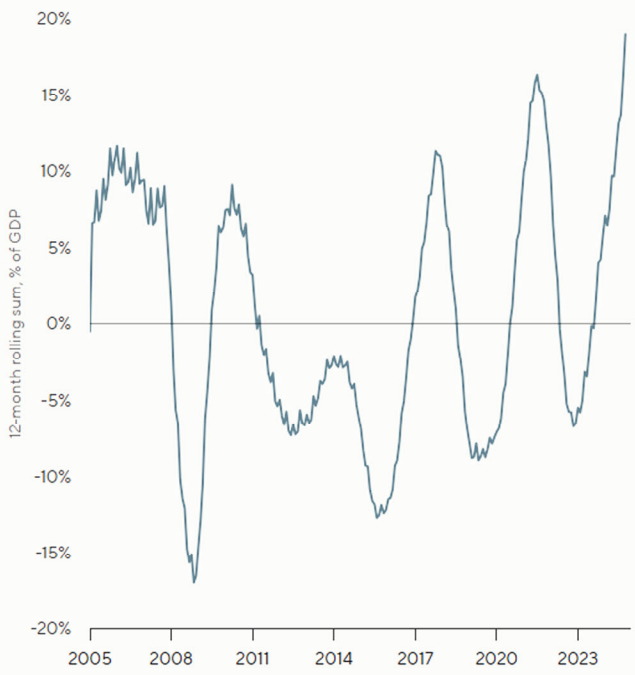
While this concentration has undoubtedly been a tailwind for index-level earnings during the current CapEx boom, we believe it also creates vulnerabilities. Relative to their long-term revenue trends, global semiconductor sales are far above historical norms (50%+), driven by demand spikes that we think are unlikely to persist indefinitely. As hyperscaler CapEx growth slows, the over-earnings in semiconductors will likely reverse as revenues normalize, exposing the index to heightened earnings growth corrections.

Semiconductor sales are far above trend, posing a correction risk that could drive broader index earnings normalization

Global Semiconductor Sales



Global Semiconductor Sales: Actual vs Trend

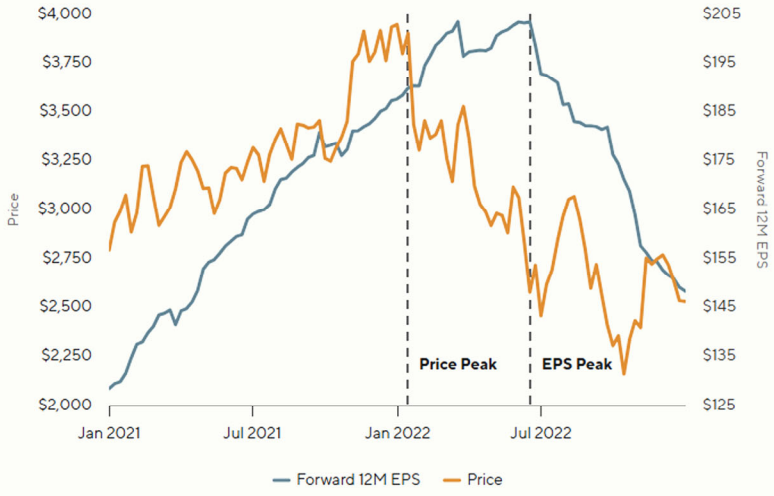


Source: GQG Partners LLC (charts), Alliance Bernstein (data), World Semiconductor Trade Statistics (data). Data as of and through 30 September 2025.

In our view, the market will not wait to right-size valuations once investors remember that the semiconductor industry is among the most cyclical businesses in existence today. If history is any guide, even some of the best executives at the center of it all will not exactly give a heads up before the next decline, either. Investors who relied on their comments during the prior market peak in late 2021 were effectively blindsided as the industry's inherent unpredictability ran prices off a cliff.[9,10,11] Similarly, the sell-side has not historically been helpful in identifying inflection points either. For example, in the prior cycle, semiconductor stock prices peaked about six months before earnings expectations did. By the time consensus estimates began to recede, market prices for the industry had already collapsed by more than a third. To be clear, this is not a criticism of these high-performing executives or analysts—rather, it underscores the fact that this is an inherently cyclical, volatile business, and even those with unparalleled insights into its workings would find it difficult to time precisely, in our opinion.

Markets anticipate earnings declines well before consensus estimates reflect the impact

Philadelphia Semiconductor (SOX) Index



Source: GQG Partners LLC (chart). Bloomberg (data). As of 8 December 2025. You cannot invest directly in an index. PAST PERFORMANCE MAY NOT BE INDICATIVE OF FUTURE RESULTS.

> *"I would expect that **we will see a supply constrained environment for the vast majority of next year** is my guess at the moment. But a lot of that has to do with the time of our **demand is just too great**."*
>
> ***Jensen Huang, Nvidia, August 2021***

> *"Hyper cloud and service provider **demand continued to be strong**...On the supply side, our lead times remain extended and stable. **Inventory in our channels and at our customers remains very lean**... What we continue to see with the recovery, and I made a point of saying that–and there's now–**we're now in the midst of a very strong spending recovery** in enterprise, particularly, so **we're continuing to see strong demand bookings in the semiconductor side**...growth in networking, broadband, server storage lately of some 20% to 30% year-on-year are **real, true end demand**... **going into '22, firing on all cylinders**. And by that, I mean more than just forecasting. We've actually seen the backlog. **We have the backlog and they keep building up**."*
>
> ***Hock Tan, Broadcom, December 2021***

> *"Our third quarter business was driven by **strong demand across all 4 growth platforms**... We are **entering a period of higher structural growth**. The multiyear megatrend of 5G and HPC-related applications are expected to fuel a massive requirement for computation power and propel greater need for energy-efficient computing, which demands the use of leading-edge technologies...**we expect TSMC's capacity remain very tight in 2021 and throughout 2022....is there any possibility of oversupply? Not for TSMC**, okay?"*
>
> ***Che-Chia Wei, TSMC, October 2021***

In addition to the structural cyclicality inherent in the semiconductor industry, another factor inflating perceived profitability during the AI infrastructure build-out is the exclusion of key costs under Generally Accepted Accounting Principles (GAAP), notably stock-based compensation/restricted stock units (SBC/RSUs). It is our view that these metrics further reinforce this over-earnings dynamic; the totals are hardly immaterial, standing at nearly $250B for the most recent fiscal year. While RSUs masquerade as non-cash charges, they effectively represent a portion of total employee compensation expenditure, thus requiring businesses to spend cash on share buybacks to mitigate their dilutive effects.

HYPER SCALER SPENDING POWER (EARNINGS) ARE THEMSELVES AT RISK

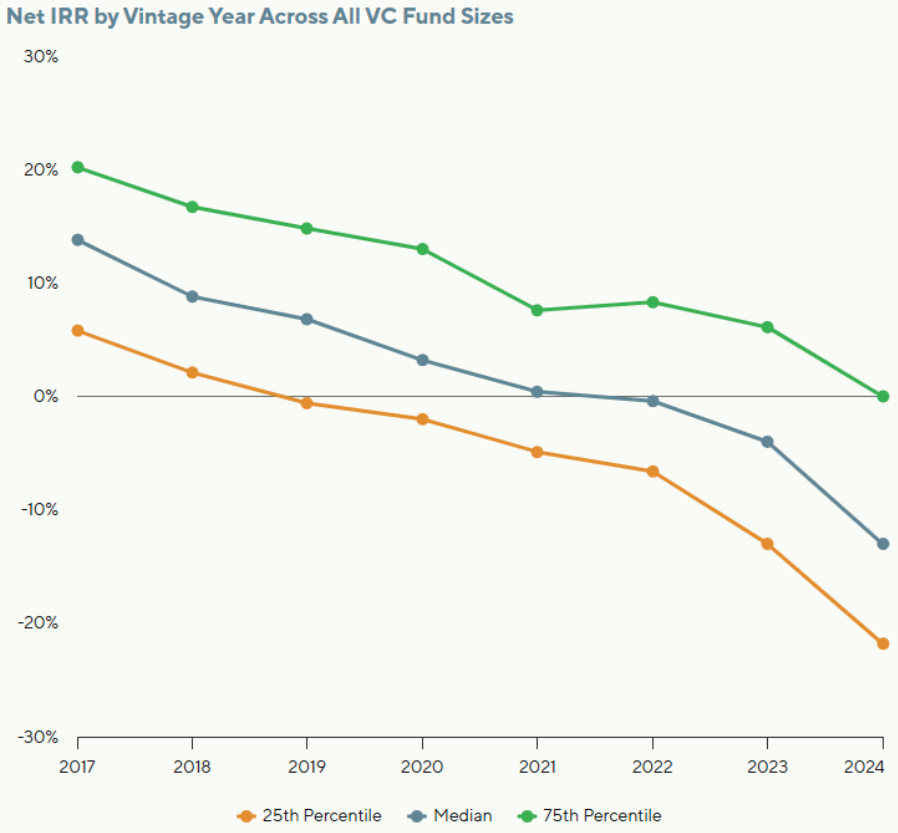
While the over-earnings dynamic affects other companies in the S&P 500, it is important to recognize that hyperscalers themselves—accounting for roughly a fifth of the S&P 500's weight—appear to be also over-earning, albeit through a different set of mechanisms. As we see it, a portion of their cloud revenues are from the AI start-up ecosystem, which is raising record amounts of capital at unprecedented valuations despite lacking clear long-term moats or enduring revenue potential. In some cases, ex-OpenAI employees are launching their own foundational AI model businesses and hitting valuations of $50B or more before a single dollar of revenue is generated.[12] In other cases, application startups are generating revenue but expending what appears to be an unsustainable percentage of it on costly GPU compute. According to Andreesen Horowitz, many AI startups have already spent 80%+ of capital raised on compute resources.[13] Including the usage from Large Language Models, almost half of the incremental revenue growth in the hyperscalers' AI business has been driven by venture capital (VC) funding.

Further to this point, selling to an unprofitable customer base introduces significant risks, as this revenue source is vulnerable to external shocks and funding cycles. Anthropic and OpenAI together account for ~$30B in run-rate revenues and are likely spending an even larger amount on compute, making them dependent on raising additional funds.[14,15] One example is OpenAI's recent commitment to purchase an additional $250B of compute from Microsoft over the next few years.[16] OpenAI, which is now 27% owned by Microsoft, remains heavily reliant on external financing. In 2025 alone, OpenAI has raised over $40B, up from ~$7B in 2024, in addition to receiving revolving credit lines and striking infrastructure partnerships with other players to sustain its operations.

This dependency on external financing raises broader questions about the sustainability of the hyperscaler-driven data center build-out, which extends to smaller, privately funded operators. Often, we hear the argument that hyperscalers have deep pockets and can afford to continue the data center build-out. However, **more than 60% of data centers operating today do not belong to hyperscalers**, according to data from 451 Research. Rather, they typically belong to smaller companies, many of which are funded by private capital. In our view, this scenario is far worse than the dotcom era, where 80% to 90% of the infrastructure build-out came from the large telecom companies and only a small percentage was from start-ups. This probably explains why Deutsche Bank is currently looking at hedging its data center exposures.[17]

Adding to these concerns is the fact that VC funding, which has fueled much of the hyperscalers' AI-driven revenue growth, is showing signs of strain. Over $100B of capital flowed into AI startups in 2024; that figure has risen to over $160B as of the end of Q3 2025, representing nearly 70% of total VC deal value this year. If Andreesen Horowitz's observation is correct, and close to 80% of this funding has been funneled into hyperscaler spend, the sustainability of these revenues becomes increasingly uncertain.

Median VC fund returns over several prior vintages are poor



Source: GQG Partners LLC (chart), Carta (data). Data as of 30 June 2025. For illustrative purposes only. Content does not constitute investment advice and no investment decision should be made based on it. PAST PERFORMANCE MAY NOT BE INDICATIVE OF FUTURE RESULTS.

Investor sentiment among limited partners (LPs) remains deeply negative according to Pitchbook research, with net cash flows to LPs running a cumulative deficit of $169B since 2022. Compounding this, VC funds with vintages dating as far back as 2018 have delivered effectively no meaningful distributions to capital paid in. The resulting hesitation among LPs to commit additional capital has also led to a meaningful increase in the time it takes to close new funds. By the end of Q3 2025, venture firms had secured just $45B in new commitments for the year, the lowest since 2017. **If such VC funding weakness were to further slow and spillover more to the AI startup side, this could indirectly impact hyperscalers' revenue growth trajectory and further exacerbate risks tied to the broader data center build-out.**[18,19,20]

THE REALITIES OF GPUS GOING FROM SCARCITY TO GLUT

Channel checks conducted by our non-traditional analysts across more than a dozen resellers reveal that Nvidia's H200 GPUs are now widely available in bulk at a deep discount, with some priced more than 50% lower than they were a year ago. Notably, several of these resellers have recently secured direct partner status with Nvidia and claim access to the latest generation of Blackwell chips. While discounts for Blackwells are smaller than those for H200s, the mere fact that these units are available through secondary marketplace channels marks a stark reversal from this year's narrative of extreme scarcity. The claim that access is limited to buyers with the deepest pockets and strongest strategic relationships no longer appears to hold true.

At the same time, industry sentiment has shifted decisively toward renting over buying GPUs, but rental rates also appear to be weakening—a clear signal in our view of emerging oversupply.

In our view, the broader implication is a fundamental misallocation of capital: trillions of dollars in planned investment over the coming years are at risk of generating subpar economic returns. This is a zero-sum game that diverts capital from other productive sectors. As we have written recently, we view this as the "Dotcom Bubble on Steroids," where the market's distortion lies not in the P/E ratios themselves (which are undoubtedly elevated by any historical standard), but in the inflated earnings in the denominator itself.

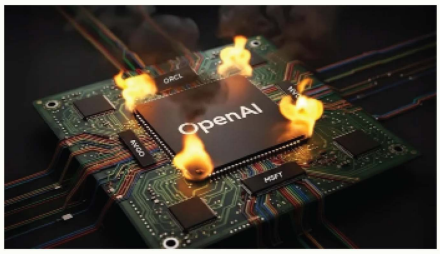
Supply glut? Rental prices for Nvidia's chips have been under persistent decline

Silicon Data A100, H100, and B200 Rental Price Indices ($ hourly rate)

Source: GQG Partners LLC (chart), Bloomberg (data), Silicon Data (data). Data as of 30 November 2025. You cannot invest directly in an index. PAST PERFORMANCE MAY NOT BE INDICATIVE OF FUTURE RESULTS.

Ultimately, we believe the market is pricing a perpetual boom in an environment that is already flashing clear signs of saturation. As hardware scarcity turns to glut and the circular flow of hyperscaler deals and VC slows, the earnings multiplier that has propped up the S&P 500 faces a potential violent unwind. The current valuation framework appears to assume that hyperscaler CapEx will continue to flow indefinitely, enriching all those that are part of the supply chain—but our data suggests the faucet is already tightening. We believe Investors who are ignoring these second-derivative risks are not merely betting on AI, they are betting against the fundamental laws of supply and demand. In our view, when the CapEx merry-go-round stops, the over-earnings will vanish, leaving behind a market that is not only overvalued, but fundamentally mispriced.

Related Insights



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END NOTES

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[2]Forgash, Emily and Ghosh, Agnee. "OpenAI, Nvidia Fuel $1 Trillion AI Market With Web of Circular Deals". Bloomberg. 7 October 2025.

[3]Becker, Sam. "Meta's AI spending spree has even the most bullish stock analysts wondering: How much capex is too much?" Fast Company. 18 November 2025.

[4]"Is Software the New Shale?" GQG Partners LLC. 27 December 2022.

[5]Data fetched from the Bloomberg Terminal expects calendar year 2025 operating margins for Nvidia, Broadcom, and Arista Networks to come in at 61%, 43% and 43%, respectively as of 5 December 2025.

[6]Leswing, Kif. "The question everyone in AI is asking: How long before a GPU depreciates?". CNBC. 14 November 2025.

[7]GQG Research. Management groups we have spoken with—who have good visibility and experience with the technology—believe the lion's share of the chips' economic useful life will end up being closer to 18 months.

[8]United States: OECD Economic Outlook, Volume 2025 Issue 2 | OECD

[9]Jensen Huang, Nvidia Q2 2022 earnings call. August 2021.

[10]Hock Tan. Broadcom Q4 2021 earnings call. December 2021.

[11]Che-Chia Wei. TSMC Q3 2021 earnings call. October 2021.

[12]"Mira Murati's Thinking Machines seeks $50 billion valuation in funding talks, Bloomberg News reports". Reuters. 13 November 2025

[13]Appenzeller, Guido, et al. "Navigating the High Cost of AI Compute". Andreessen Horowitz. 27 April 2023.

[14]Bort, Julie. "Sam Altman says OpenAI has $20B ARR and about $1.4 trillion in data center commitments." Tech Crunch. 06 Novembre 2025.

[15]Hu, Krystal and Seetharaman, Deepa. "Exclusive: Anthropic aims to nearly triple annualized revenue in 2026, sources say." Reuters. 15 October 2025.

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[17]James, Liam. "Deutsche Bank Explores Hedging Data Center Risks Amid AI Boom". Markets.com. 7 November 2025.

[18]Tarhuni, Nizar, et al. "Venture Monitor: The definitive review of the US venture capital ecosystem". Pitchbook Monitor, NVCA. 30 September 2025.

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DEFINITIONS

Blackwell chips are NVIDIA's next-generation GPUs designed for large-scale AI, data centers, and high-performance computing.

CapEx (capital expenditure) refers to the funds a company uses to acquire, upgrade, or maintain long-term physical or intangible assets. Unlike operating expenses, which cover daily business costs, CapEx is an investment in assets expected to generate economic benefits for more than one year.

Earnings Per Share (EPS) is a measure of a company's profitability, calculated by dividing quarterly or annual income (minus dividends) by the number of outstanding stock shares.

Limited partners are investors in a limited partnership who provide capital but have no say in the business's management and liability that is limited to the amount of their investment. They are often referred to as "silent partners" and are common in venture capital funds and private equity, where the partnership structure is used to raise capital from passive investors.

Net IRR (Internal Rate of Return) is the actual, after-fee rate of return an investor receives on an investment, accounting for all costs, management fees, and carried interest.

Operating margin is a company's profit for every dollar of sales after deducting production costs like wages and raw materials but before accounting for interest and taxes. A higher ratio in an operating margin is generally better, as it indicates the company is efficient in its operations and is good at turning sales into profits.

The **Price-to-Earnings (P/E) ratio** is a stock valuation metric that divides a company's share price by its earnings per share (EPS), indicating what investors are willing to pay for each dollar of a company's earnings. A higher P/E suggests investors expect higher future earnings, while a lower P/E may indicate a stock is undervalued or has lower growth potential.

SBC stands for Stock-Based Compensation, and **RSUs** are Restricted Stock Units, a common type of SBC. These are forms of non-cash payment that companies use to reward and retain employees by granting them an ownership stake in the company.

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The **Philadelphia Semiconductor (SOX)** is a capitalization-weighted index comprising the 30 largest U.S.-traded companies primarily involved in the design, distribution, manufacture, and sale of semiconductors.

The **Silicon Data A100, H100, and B200** Rental Price Indices are a daily financial benchmark that tracks the average hourly cost of renting an NVIDIA A100, H100, and B200 graphics processing unit (GPU) across various providers and regions.

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