ARTIFICIAL ANXIETY

Anything but Artificial

Given the price volatility in certain sectors, it's apparent that artificial intelligence ("AI") anxiety has made the market skittish to any new model update or perceived industry-displacing application. Market participants are growing wary of the immense spending by mega cap technology companies, as well as the rise of agentic AI that may upend the traditional software platforms that enterprises are built on. Beyond just investors, many Americans have started to question the impact that these technological advances may bring. As RMC has previously written about, the AI impact on the market and economy is anything but artificial, and if its rising unpopularity continues, it could slow the AI boom and potential productivity gains. Some of the largest AI-related companies in the S&P 500 are what drive broader market returns and earnings growth, and their spending has become a key component to U.S. GDP. As more Americans become familiar with this technological revolution, they are seeking to understand how datacenters will impact energy usage, how AI applications will impact their job, and how societal "norms" could be upset. This anxiety started to consume the market in the first quarter, and this was before the Iran war effectively doubled the price of oil.

- *Construction & Deployment:* Investor sentiment towards the "Magnificent 7" stocks has shifted, with each underperforming the S&P 500 in the first quarter. This has led to a broadening of the market with outperformance from nearly all sectors besides Technology. Microsoft has been under the most pressure, moving lower by ~24% for its worst quarter since 2008. The hyperscalers are fronting the bill for construction and deployment, and investors are questioning their return on investment. Most recently, Amazon disclosed it plans to spend ~$200 billion in AI infrastructure in 2026, bringing total hyperscaler AI spend to an estimated $700 billion for the year. Their poor stock performance was a key contributor for the recent correction in the Nasdaq and Dow Jones Industrial Average, or a retracement of more than 10%, and the S&P 500 moving lower by ~9.0%. The valuation of the top ten largest S&P 500 companies, as measured by a forward price-to-earnings multiple, is now the lowest in three years at 23.0x[i].

- *Applications & Agents:* Software-as-a-service (SaaS) companies have been a market envy for decades, with their highly profitable, seat-based, subscription model. The software industry is now in its worst ever drawdown relative to the S&P 500. With the IGV iShares Software ETF down ~25% in the first quarter, this drawdown is worse than the dotcom bust, financial crisis, and 2022 rate hike shock[ii]. New releases from Claude, an advanced large language model by AI company Anthropic, are designed for enterprise integration and autonomous AI agents. This has threatened the "per-seat" model, assuming AI leads to lower head count, and has threatened the existence of some SaaS companies altogether, assuming AI coding can replace their function with in-house solutions. These are the concerns that have spread to the private credit industry, of which several of the private fund giants have large loan portfolios with software providers. Fed Chair Powell, amongst others, has stated the $1.8 trillion private credit industry does not pose a systemic risk, however, the potential AI impact on software has led to significant redemption requests from investors in private funds. Some have imposed redemption limits while others have not, but this has led to a tough start to the year for Blackstone, KKR, Apollo, and their peers. Major SaaS companies argue there is a disparity between what the market believes, which drove prices quickly lower, and what is happening fundamentally. Most remain very profitable, high cash flow companies that continue to grow, deploying AI tools to customers and utilizing AI internally in their favor.

- *Jobs & Society:* The societal anxiety from AI relates to job displacement, wealth concentration, privacy risks, and the fear of a dystopian society reserved for a sci-fi movie. While past technological revolutions, most recently the advent of the internet, made certain jobs obsolete,

they also created entirely new industries that were previously inconceivable. Given the autonomy of AI applications, however, some fear the unemployment in “knowledge” work could rise, challenging the structure of the U.S. economy altogether. This anxiety manifests itself in the pushback on datacenter construction at the state and local level, which this technology relies upon, given insufficient energy resources, rising utility costs, and employment concerns. Large AI companies have recognized these concerns, most recently OpenAI, which proposed solutions like a 4-day work week or an AI-invested public wealth fund. The fact that AI companies are deemed powerful enough to propose such policies has just fueled anxiety further.

Stuck Between Iran and a Hard Place

Although AI remains a prevailing market theme, the Iran war and rising oil prices are now front and center. WTI Crude was ~$55/bbl in December and just ended the quarter at ~$101/bbl, a price not seen since 2022. As summed up by famed economist and investment strategist, Dr. Ed Yardeni, “The US economy and stock market are stuck between Iran and a hard place currently. So is the Fed…If the oil shock persists, the Fed’s dual mandate would be stuck between the increasing risk of higher inflation and rising unemployment.”[iii] The longer the war continues, the longer oil prices are likely to remain elevated, resulting in potential commodity price shocks and stickier inflation. In that situation, the Fed may consider raising interest rates, rather than cutting, as the market consensus expects. An extended closure of the Strait of Hormuz for several months would likely spur a global recession, although the U.S. is now more insulated from these shocks than Asia and Europe. Further speculation on the secondary effects of the Iran war is futile for now, as many of the events over the past several weeks have been unpredictable. What is predictable, however, is the upcoming corporate earnings calendar which could potentially provide clarity for investors. On a positive note, 2026 earnings expectations have been revised higher since the start of the year, despite the market noise and the S&P 500 moving lower. This suggests strength in corporate fundamentals and implies valuation compression in a richly valued market. Conversely, AI anxiety may continue to distract investors from the fundamental story, or the Iran war may provide justification for companies to lower expectations for the year.

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[i] JPMorgan Asset Management
[ii] Goldman Sachs Research
[iii] Yardeni QuickTakes

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