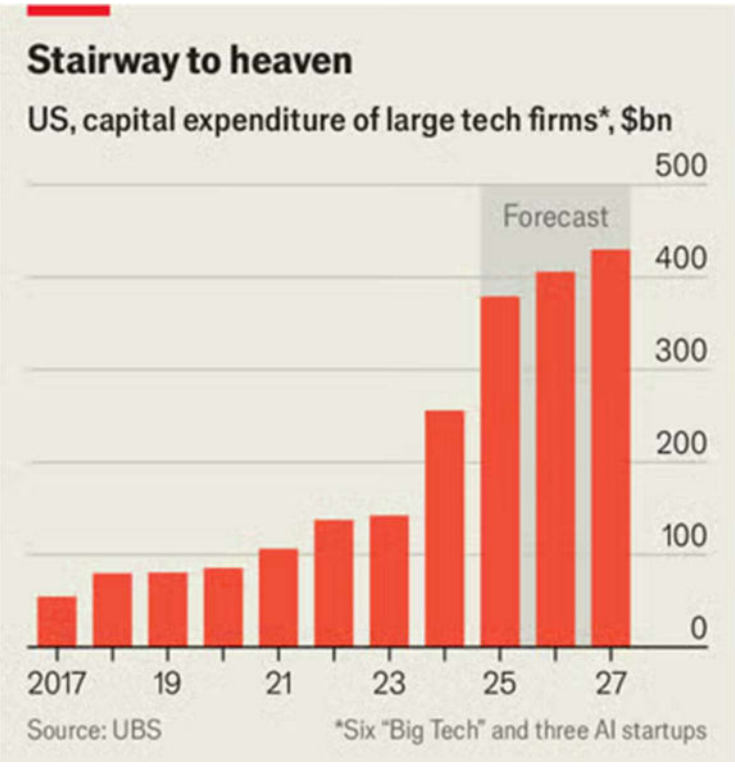
Lebed
Asset Management LLC

Investment Commentary—October 2025

After the market close on September 9th Oracle Corp. (ORCL) released one of the most astonishing earnings reports in recent memory. Investors were elated to learn that contracts for future services had more than tripled. Oracle's share price surged 36% the next day, adding $244 billion to its total market value. The story behind Oracle's blowout quarter and the market reaction reveal a lot about a fascinating but perhaps perilous moment for the U.S. stock market.

Until recently, Oracle was a database company, providing software to run mission-critical databases (information on customers, orders, vendors, employees, etc.) for the world's largest companies. The seeds for a transformation were planted in the early 2000s with the advent of "cloud" based software, accessed remotely over the internet. Serving the largest and most demanding businesses in the world over the internet was an exceedingly complex engineering challenge. Out of necessity Oracle developed cutting-edge expertise in technologies that happily turned out to be critical for running AI. Database software has become a sideshow for Oracle as it now competes with Alphabet, Amazon and Microsoft in hosting and operating AI.

The third quarter surge in contracts for future services resulted from a single deal. OpenAI, the company that sparked the AI revolution with ChatGPT, hired Oracle to build and operate $300 billion worth of AI data centers between 2027 and 2029. No one knows where most of the $300 billion will come from. $100 billion will come in the form of equity from AI chipmaker Nvidia. As for the rest of it, in the frenzied world of AI, the assumption that "if you build it, they will come," seems to have a corollary: "if you commit to building it, financing will come."



As the chart to the left (courtesy of *The Economist*, with data from UBS) illustrates, the Oracle/OpenAI $300 billion data center investment is part of a massive arms race taking place as Alphabet, Amazon, Meta, Microsoft, OpenAI and a few others (the so-called "hyperscalers") rush headlong into building trillions of dollars of AI infrastructure to meet anticipated AI demand. The problem is that AI demand is relatively small right now, and no one knows how fast demand will grow. Hyperscalers are poised to spend well over $1 trillion this year and the next two. (McKinsey and Co. goes even further than UBS, projecting cumulative data center

spending of $5.2 trillion by 2030!). One would hope all this spending is based on a careful assessment of future demand, but that's highly doubtful. The truth is that it's based solely on the universal conviction among hyperscaler CEOs that it's worth paying any price to win (or at least not lose) the AI arms race. As the maxim goes though, two things can be true at the same time: it can be (probably is) true that each of the hyperscalers has no choice but to invest massively in AI, and it can also be true (probably is) that this massive investment bodes poorly for shareholders. None other than the current chairman of OpenAI, Bret Taylor, captured the risk to shareholders well when he said "It is both true that AI will transform the economy, and I think it will, like the internet, create huge amounts of economic value in the future. I think we're also in a bubble, and a lot of people will lose a lot of money."

One way to think about the size of AI infrastructure spending is to ask how much revenue hyperscalers need to generate for every dollar of capital expenditures ("CapEx"). Bain Capital estimates a sustainable ratio pf 4:1, i.e. every CapEx dollar should generate four dollars of revenue. With hyperscaler CapEx about to eclipse $400 billion[1], the 4:1 ratio implies that annual AI revenue of $1.6 trillion should be coming soon.

It's hard to know exactly how much AI revenue the hyperscalers are generating, but based on public information, it's probably not much more than $100 billion per year[2]. Will AI revenue go up nearly 16-fold in the next few years? 100 million people ponying up for premium ChatGPT or the like will be a drop in the bucket. A 16-fold increase would require hundreds of thousands of companies overhauling millions of business processes. It's hard to imagine such a massive re-engineering of the global economy is even possible in such a short time. (And, if a massive economy-wide transformation is underway, why are the share prices of technology consulting firms, which specialize in that sort of thing, not booming?) In the meantime, hundreds of billions of dollars of investment by Alphabet, Microsoft, et al is eating into free cashflow. Investment in long-lived assets is "capitalized," so it doesn't hit earnings right away. But, before too long, as the depreciation of those assets begins to accumulate, earnings will take a big hit[3].

The dramatic rise in Oracle's share price on September 10th illustrates the magical thinking fueling what is widely considered an AI bubble. It's not so much that the value of Oracle's shares went up by $244 billion in one trading session. It's the fact that the value of its competitors' shares didn't decline by a similar amount! The $300 billion in future Oracle revenue from OpenAI is revenue that won't be available to Microsoft or Alphabet or Amazon. Isn't Oracle's gain their loss? Not in today's stock market!

None of this is to say that AI won't unleash an unprecedented economic transformation. But, as the late 1990s rush to build out the infrastructure of the internet taught us, when there is an arms race to develop the infrastructure for a technology revolution, the companies that build the infrastructure (anyone remember WorldCom and Global Crossing?) may not reap the rewards.

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[1] Hyperscalers are pursuing creative ways to offload CapEx to investors. We don't believe this alters the fundamental picture, and, in any case, we don't take comfort in the hope that financial engineering will save the day.

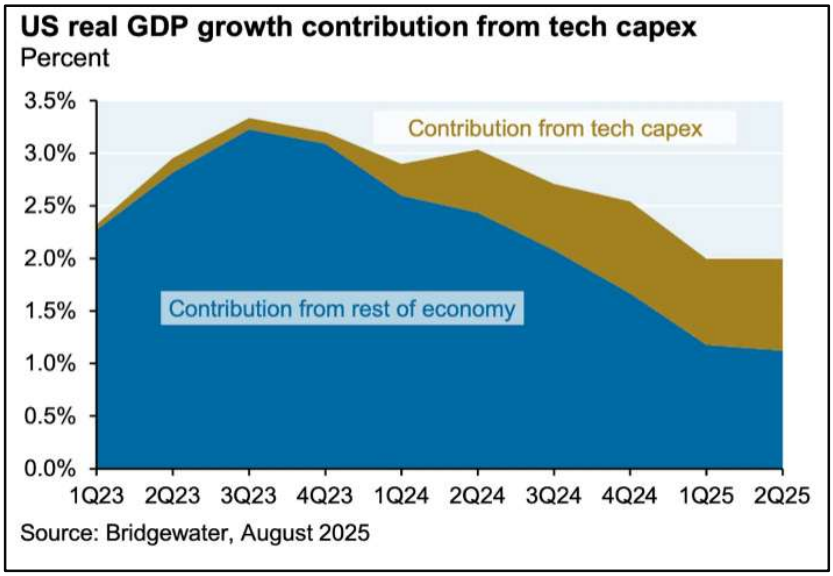
[2] Microsoft reported $13 billion of AI-related revenue in the fourth quarter of last year (Microsoft's second fiscal quarter) but hasn't updated that figure recently. Revenues at OpenAI and Anthropic, the most prominent AI startups, are reported to be running at a bit over $20 billion annually combined.

[3] Hyperscalers have recently been playing games with depreciation schedules; this may postpone the pain that will come when depreciation from the AI CapEx binge hits, but it will also make the pain worse when it finally comes.

In the meantime, the AI bubble has driven technology share prices to new heights. Four companies—Nvidia, Microsoft, Apple and Alphabet—now represent around ten percent of the total value of all publicly traded stocks in the world. Outside of the last few years, nothing even approaching that level of concentration has occurred since at least 1900.

Although we have been increasingly dubious over the last two or three years about future returns for the giant technology companies, that wasn't always the case. Seven years ago, referring to a now out of date acronym, we noted that "client holdings in the five FAAMG stocks (Facebook, Apple, Amazon, Microsoft and Alphabet/Google) will tend to complement each other as the companies compete over the next decade for the future of artificial intelligence, big data, and cloud infrastructure, as well as augmented and virtual reality." That has certainly proven true. AI is the next big thing—maybe even the biggest big thing ever! —and the changes it will bring will be dramatic. But now more than ever it's important to remember that investing in the companies that marshal vast sums to build the infrastructure for a technological revolution may be unwise. That was true with railroads in the late 19th century, telecommunications companies in the late 20th century, and seems likely to be true for the companies pouring trillions of dollars into AI data centers.

One bit of good news is that the massive amount of data center construction taking place is helping to prop up the U.S. economy. As the chart below illustrates, we might be dangerously close to slipping into a recession if it weren't for massive investment in AI infrastructure. As hyperscalers look increasingly outside the U.S. to build data centers, that benefit may fade. It is also rapidly pushing up electricity costs for U.S. consumers and businesses, which creates its own risks. But for now, the economic benefit is substantial.



The other bit of good news is that the AI bubble is primarily being funded by hyperscaler shareholders and not by debt. The housing bubble that led to the financial crisis of 2008/9 was funded by massive borrowing. When that bubble burst hundreds of billions of dollars of loans went bad, and the wider economic pain was vast. When the AI bubble bursts it will have some impact on the wider economy, but the bulk of the fallout will likely be absorbed by shareholders of hyperscalers and other AI companies. And those shareholders may suffer greatly. Sitting on the sidelines when a stock market sector is booming can be hard and it can be frustrating. Eventually, however, the AI bubble will burst, and when that happens investors who invested more cautiously may be very glad they did.

Boston, MA
October 9, 2025

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We will invest for the long-term while always striving to maximize returns and minimize risk.

We will seek to minimize your investment expenses.

We will not accept any payments or anything of value from third parties that might influence our choice of investments for your portfolio.

We will invest our personal assets in parallel with yours.