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Global Markets Research

Research Alert

Will AI boom evolve into the next dot com bubble?

AI flagged as a potential market shock in 2026-27 in Fed's Financial Stability Report

AI boom differs from dotcom bubble; backed by fundamentals & growth prospects

Risk of a shock is minimal; but could shave 0.4ppts from global GDP growth this year

Brief recap of risks in the Fed's Financial Stability Report

According to the latest Fed's bi-annual Financial Stability Report, policy uncertainties, which includes global trade, central bank independence and geopolitical risks topped the list of financial stability concerns amongst corporates. Concerns over trade had abated somewhat, while worry about artificial intelligence (AI) was on the rise.

Key highlights from the report include:

- Trade concerns had abated somewhat, dropping from top singular concern among other policy risks
- Central bank independence mentioned as risk for first time
- Hedge fund leverage was at highest levels since 2013
- **AI was cited as potential market shock in next 12-18 months by 30% of the Fed's market contacts**

Worries over AI is on the rise

Zooming in to the last point on the Fed's concern on a potential market shock, the concern was nonetheless primarily focused on how sentiment towards AI, instead of fundamental demand, had driven recent stock gains, and how a shift in that sentiment could lead to "large losses" in markets and potentially implications on the broader economic and monetary policies, as in the dot com bubble.

Taking the bull by its horn, **we opine that the scenario has minimal risk for now**, mainly because:

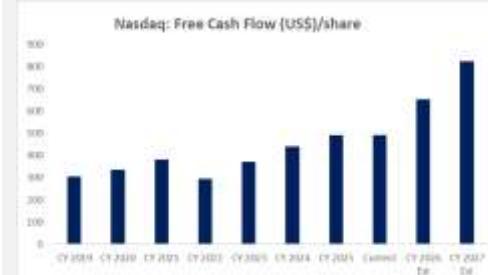
- Valuation wise, the price/earnings (PE) ratio of the mega cap tech stocks are indeed elevated at 30-40x (save Tesla), but remains below the 60x benchmark in a bubble-type valuation (Refer to Figure 1). On a broader picture, the P/E ratio for Nasdaq at around 40x currently is also sharply lower than triple digits at the peak of the dot com bubble. Moreover, we opine that this is justified given their growth prospects and on a fundamental basis, cash generated from existing businesses are also more than adequate to cover their current investment in AI (Refer to Figure 2).
- Nasdaq has been rallying since 4Q of 2022, backed by the AI upcycle and strong corporate earnings. A 3-4 years rally remains short as compared to the 6-year PC cycle boom (late1970s-1980s). Due to limited data, we have used the IBM shares as a reference point for the

Figure 1: Elevated P/E ratio, but below the "bubble-like" levels



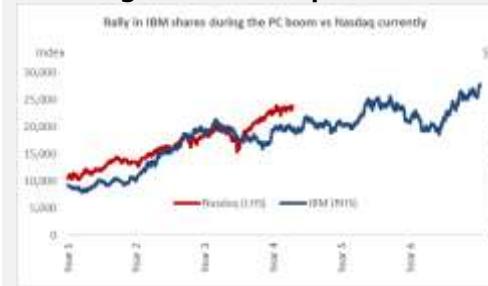
Source: Bloomberg, HLBB Global Markets Research

Figure 2: Cash flow from operations more than sufficient to cover investment needs



Source: Bloomberg

Figure 3: Rally from previous PC boom suggests still room for further gain in Nasdaq

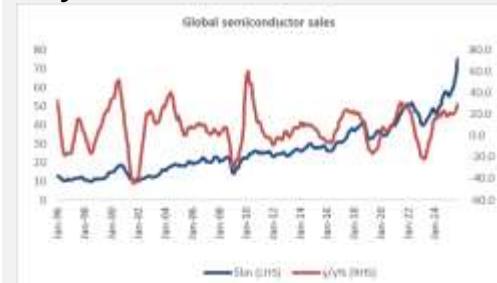


Source: Bloomberg

PC cycle boom. (Refer to Figures 3). Nasdaq has also rallied 130% since 4Q22 to-date vs the around 200% gain in the 6-year rally for IBM.

- Corporate earnings are expected to be backed by robust demand. The latest data from the Semiconductor Industry Association (SIA) showed that semiconductor sales remained robust and jumped 29.8% y/y and 3.5% m/m in November to its highest ever monthly total at \$75.3bn. (Refer to Figure 4). Sales were broad-based and annual sales is expected at \$772.2bn in 2025 (22.5% y/y)
- Sales is expected to be equally strong in 2026, with the WSTS recently upwardly revising its global semiconductor sales projection to \$975.5bn (26.3% y/y). Growth will be driven by broader AI use-cases in end segments, faster adoption and "tech premiumisation." Memory and logic are again projected to lead growth, both increasing by over 30% y/y while other product categories are expected to continue their gradual recovery, growing at a more moderate pace. All major markets are also expected to expand, led by the Americas and Asia Pacific region. Europe and Japan are forecast to see low double-digit growth.
- In fact, Sassine Ghazi, CEO of Synopsys has recently said that price rises and memory "crunch" will continue through 2026 and 2027 with the AI infrastructure boom lasting longer than expected.
- Just a recap, we have highlighted that in our Research Alert "Positive on electronics and electrical sector" dated 27 March 2024 that the product replacement cycle typically averaged around 3.5-4.0 years, suggesting that the tech boom could peak in 2026, hence posing a downside risk to WTST's projection.
- In short, we opine that the current AI boom is different from the speculative dotcom bubble of the late 1990s, risks of AI being a potential market shock remains minimal, a view shared by Fed Chair Jerome Powell who commented, ***"This is different in the sense that these companies, the companies that are so highly valued, actually have earnings and stuff like that."***

Figure 4: Robust global semiconductor sales to continue drive corporate earnings and tech rally



Source: Bloomberg

Similarities between the dotcom bubble vs AI boom

- Market concentrated on a few large companies
- Significant investor exuberance/media hype, with warnings of a potential "bubble"
- Potential for massive long-term productivity gains across the economy.

Dotcom Bubble	2025 AI Boom
<ul style="list-style-type: none"> New tech companies that were unprofitable/had little profits Extremely high PE/ratios 	<ul style="list-style-type: none"> Most (not all) leading AI companies (Microsoft, Google, Nvidia) are highly profitable giants with strong balance sheets Valuations are high but not at alarming levels (Nasdaq: 30-40x currently) backed by strong earnings growth

<ul style="list-style-type: none"> ▪ Many companies had business models that lacked proven demand or clear revenue plans ▪ Capital was deployed rapidly into numerous speculative IPOs from small startups 	<ul style="list-style-type: none"> ▪ Has immediate, widespread and tangible applications in industries like transportation and healthcare ▪ Capital investments are strategic extensions of existing platforms by large, established tech firms, focusing on massive infrastructure like data centres
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Narrow base for economic drivers and risks to monetary policies

Notwithstanding, the narrow base for economic drivers currently does pose significant challenges and risk to the global economy in 2026, and will have implications to monetary policies. Should the AI-driven productivity gains turn out to be overly optimistic, this could lead to a sharp drop in investment in the high-tech sector and a correction in the equity markets.

The spillover will be widespread, with trade flows likely disrupted for export-oriented economies that specialise in technology products like Singapore and Malaysia, job losses (a jeopardy to Fed's dual mandate to promote maximum employment), negative wealth effects that will weigh on private consumption, as well as the tightening of global financial conditions as in the dot com bubble. ***A study by the IMF suggests that a moderate correction in AI stock valuations as part of a general tightening of financial conditions will shave global growth by 0.4ppts in 2026 relative to baseline (3.3%).***

On the flipside, rapid adoption and investment of AI by businesses could also significantly improve productivity and boost medium-term growth prospects sooner rather than later, potentially lifting global growth by as much as 0.3ppts in 2026, hence an overall muted impact.

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