The Mega AI bubble

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The world of AI with its fuzzy borders never fails to surprise. At a time when geopolitical tensions, wars, and a clogged global energy pipeline have hugely increased economic uncertainty, the US stock market is set to break another set of records, this time for the mobilisation of capital through initial public offerings (IPOs) by unlisted firms. The firms in question SpaceX, Anthropic, and OpenAI—that have announced mega IPO plans have one thing in common. They have either been created as, or have metamorphosed into, firms in the AI space.

The numbers are staggering. SpaceX hopes to raise as much as $75 billion through its share sale, which would value the company at around $1.75 trillion. Anthropic, which recently raised $65 billion in a funding round that valued the company at about $965 billion, has filed papers for an IPO that would possibly take its valuation well above $1 trillion. OpenAI, valued at $852 billion in March this year, is looking to land a similar bonanza. With these firms set to make their equity market debut, the sums mobilised will surpass the $156 billion raised in the record-breaking year of 2021. Meanwhile, Google's parent conglomerate, Alphabet, has also announced plans to mobilise $80 billion in equity to part-finance its AI expansion, with $10 billion of that to come from a deal with Berkshire Hathaway.

But these absolute figures only reveal a part of the story. Central to this story are the ambitions of a few firms dominating the AI landscape with huge investments, driven more by the competition to be the leader than by clear evidence of future earnings and profits. Backed by cash-rich firms and risk-hungry promoters and creditors, the AI industry began on a shaky footing, bleeding money in search of the holy grail of building machines more intelligent than humans. But soon, as the results of those investments began to yield unexpectedly encouraging results even if still distant from the elusive final destination—finance capital wanted a share of the potential pie.

Fears that they might miss the boat pushed financial investors to bet heavily and disproportionately on AI. The valuation of the principal AI firms, which were recording losses or minimal profits, soared. It helped that the proportion of their shares that were "free float" (or available for trading) was extremely small. Thus, after the IPO and the subsequent listing, less than 5 per cent of SpaceX's shares will be available for trading by entities other than its promoter, Elon Musk.

The frenzied search for a stake in AI soon spread to even firms with narrow links to AI. One estimate puts the share of 41 broadly defined AI-related firms included in the S&P 500 at close to 50 per cent of the market capitalisation of all covered firms. That speculative frenzy has now taken new forms. Large sums of money are flowing into mutual and exchange-traded funds that either hold privately acquired stakes in the AI majors going to market, promise to acquire such stakes in the near future, or link the returns they offer investors to the performance of AI stocks. As the AI majors take market indices to even higher levels, investors want to extract at least some of the gains for themselves, through whatever means available, reasonable or otherwise.

In this mêlée, the valuations of the core AI firms have reached levels where the sums that they plan to mobilise from the market amount to a small share of their market capitalisation. But mobilising those sums would help augment resources to finance their AI rollout, as well as drive valuations to levels that would enrich their promoters hugely and provide them the base to leverage for future capital mobilisation.

These mind-boggling valuations are facilitated by two factors: massive liquidity in the market and the hype around AI. SpaceX's prospectus, for example, is reportedly peppered with pictures of rockets and satellites promising a new frontier in space, integrating telecommunications, data centres with lower set-up and operating costs (because of extensive real estate, lower temperatures, and energy from the sun), and near-unlimited AI deployment.

A bubble waiting to burst

However, there is cause for scepticism. If SpaceX does realise its targeted $1.75 trillion valuation, it will be priced at more than 90 times its annual revenue (as against 20 times in the case of an actually profitable Nvidia). There is also evidence to question the revenue and profit expectations implicit in other AI firms. But the terms of the SpaceX IPO give Musk unchallengeable control over company policy.

Yet the threat this poses to future capital access has been partly subverted by the system. Wanting to benefit from the boom in the prices of SpaceX and Anthropic stocks, those setting the rules for inclusion of new firms in indices like the S&P 500 and Nasdaq are changing those rules. As opposed to the requirement that newly listed companies must wait a year and meet certain profit targets before being considered for inclusion, the Securities and Exchange Commission is planning to reduce the waiting period and waive the profitability requirement for "megacap" stocks. This would force "passive investors" such as index funds and institutions like pension funds to allocate some of their funds to these stocks. That may seem attractive to investors in these funds, given the expectations that the prices of these AI stocks will spike on listing. But in the medium term, prices are likely to fall, eroding the value of investor capital and the savings and incomes of pensioners.

Seen in this light, whatever else AI may deliver, its subordination by finance capital threatens to impose a cost on those, wittingly or otherwise, looking for a return from the industry. A cost for generating the small number of the world's trillionaires.

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