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The Roaring Twenties

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There is likely something distinctive about the "twenties": they repeatedly appear as inflection points where technologies move out of the laboratory and into the real economy, reshaping productivity, markets, and ways of life within just a few years.

In the 1820s, steam power and the railway began transforming largely local economies into integrated industrial systems. In the 1920s, electricity enabled the first modern industries (automotive, chemicals) and propelled societies into the era of mass consumption and large-scale industrial productivity. Today, the deployment of Artificial Intelligence across all layers of the economy is redefining the rules of the game.

In financial markets, these periods have typically been associated with strong equity performance. More specifically, the suppliers to the groups driving technological revolutions—the "picks and shovels" of modern gold rushes—have consistently emerged as the key winners of such transformations.

Population ageing, monetary liquidity, and of course Artificial Intelligence are the major economic forces of our time. They interact and naturally shape our investment decisions.

1- Intelligence has become a raw material like any other

Every technological revolution gives birth to a new essential raw material: coal in 1820, electricity in 1920, intelligence in 2020.

When we speak of "intelligence," we refer to the response capacity of AI language models. This is measured in "tokens," roughly equivalent to a word or character when interacting with ChatGPT, Mistral, or Claude. For instance, if I ask these models to translate this very letter into French, I will consume around 3,000 tokens.

This task can be performed using free versions of these models. However, for companies using them for more complex applications, usage must be paid for based on the number of tokens consumed. Intelligence now has a price—the token—and a cost: the chips and electrical energy required to generate it.

While AI may appear highly complex at first glance, its economic model resembles a standard business: revenue must be generated (by selling tokens) to meet financial obligations. Producing more efficiently and increasing sales is the constant objective of all companies. AI is no exception.

Reflecting the rapid evolution of usage, intelligence is now being budgeted within corporations, and some are already reporting that they have exhausted

their annual token quotas. They are seeking cheaper alternatives to US models based on closed architectures. Chinese models are taking a different approach: they are currently less advanced in terms of quality but have the significant advantage of being open source and far less expensive.

Competition is therefore taking shape, and the intelligence market increasingly resembles a commodity market in which products are so standardized that they become indistinguishable: all barrels of oil are the same, all gold bars are identical. We appear to be moving toward a commoditization of the token—meaning that the same question asked to different models increasingly yields similar answers, making the choice of model less relevant. In finance, this is known as "commoditization." The commoditization of the token—and therefore of intelligence—appears increasingly likely for 90% of use cases.

2- Population ageing and rising monetary liquidity

Demographic ageing is arguably the most structural factor influencing financial markets over the long term. Public debt was already substantial before COVID; the current decade has pushed it to a new level.
States must now simultaneously finance rising healthcare, pension, and defense expenditures, as well as increasingly heavy interest costs, while an ageing population contributes less to pension funds, historically the main buyers of sovereign debt.
This constraint is pushing governments toward increasingly short-term financing. In the United States, T-bills (sub-one-year government debt), highly sought after by banks, money market funds, and hedge funds for their unique combination of yield, liquidity, and low volatility, have become the cornerstone of public financing.

This evolution has several major consequences:

— With a large share of debt refinanced at very short maturities, the US budget becomes extremely sensitive to Federal Reserve policy rates.

— Trillions of dollars of debt must be rolled over each year, requiring persistently high levels of liquidity in the financial system.

— As public debt continues to grow faster than the economy, central banks are effectively forced to maintain sufficiently accommodative monetary conditions to ensure continuous refinancing.

This abundance of liquidity mechanically supports financial asset valuations, particularly scarce assets such as equities and gold. Market performance becomes less driven by fundamentals and more by liquidity availability. However, this also makes markets more fragile: any contraction—even temporary—in liquidity can trigger sharp corrections and fuel the formation and bursting of speculative bubbles.
Among the forces that can redirect liquidity from financial markets toward the real economy are massive investments in AI-related infrastructure, rising energy, industrial, or technological commodity costs (for instance, following the closure of the Strait of Hormuz), and the increase in equity supply via IPOs.

In this environment, relatively scarce financial assets—equities, gold, certain commodities—remain structurally supported as long as liquidity stays within financial markets. Conversely, when liquidity flows more heavily into the real economy, the environment becomes significantly less favorable for equity valuations.

Liquidity flowing into data centers

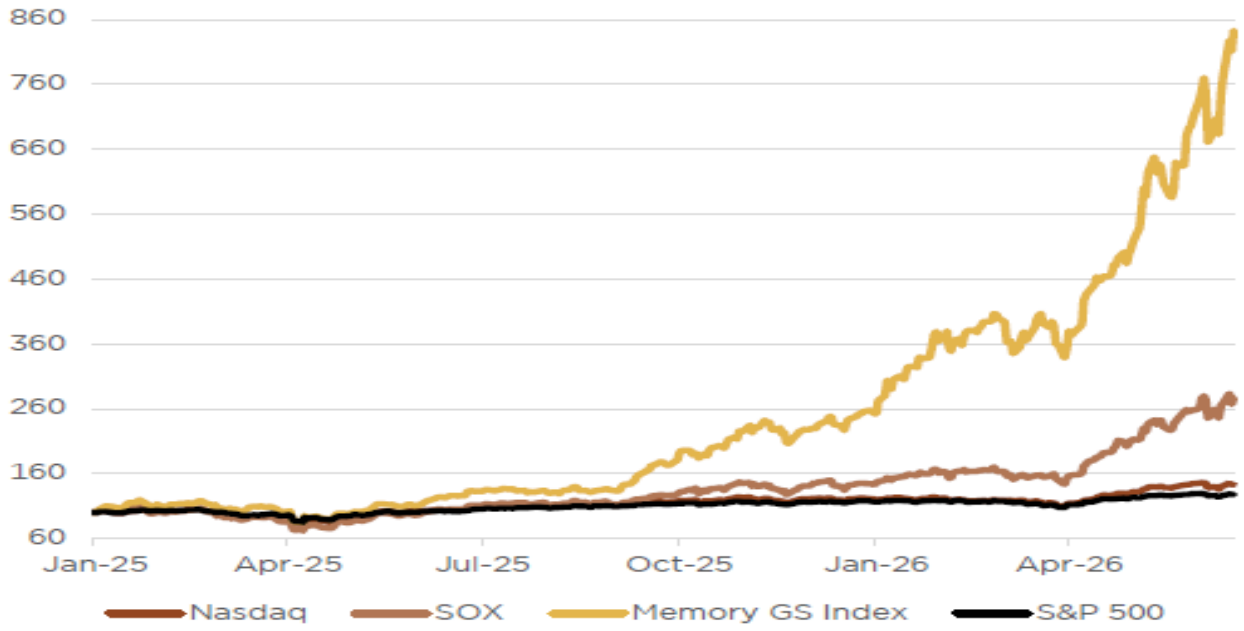
This is precisely what we are experiencing today, with investment spending on data centers reaching unprecedented levels. Around $1 trillion (3% of US GDP) will be spent annually for 4–5 years to make artificial intelligence a tangible reality.

This represents a massive transfer of liquidity from the balance sheets of data center builders to those of their suppliers. Such a project is large enough to be broadly negative for financial market liquidity, but positive for the real economy.

As in every industrial revolution, this liquidity does not circulate evenly: it concentrates on the beneficiaries surrounding the builders—the modern "picks and shovels."

Memory chip manufacturers such as SK Hynix or Samsung are among these winners: their revenues have tripled in just six months. Such performance has enabled employees to receive exceptional bonuses of around €300,000, while shareholders have benefited from a tripling of share prices.

In markets, our preferred strategy is to focus on suppliers to companies investing heavily in data center construction—namely semiconductor manufacturers and electrical equipment producers. These are the "picks and shovels" of our era. This positioning has been particularly favorable in the first half of the year.



Base 100 performance as of January 2025 of the Nasdaq, SOX, memory chips, and S&P 500 indices. The performance of semiconductor manufacturers (particularly Memory chips) is in a league of its own, far outpacing the rest of the market. Source: Bloomberg, Edmond de Rothschild.

Can markets continue to rise while liquidity shifts into the real economy?

A semiconductor bubble?

Based on the previous chart, the answer appears to be yes. Optimists argue that if an index doubles because earnings estimates also double, valuation multiples remain unchanged and no bubble exists.
That is true—but caution suggests that when an index triples in less than two years, signs of irrational exuberance flash bright red.
Bubbles are often characterized by the arrival of private companies whose founders seek to monetize and realize the value of their shares. The upcoming mega-IPOs of SpaceX, Anthropic, and OpenAI are valued at hundreds of billions despite companies still generating tens of billions in losses.
We typically only know we were in a bubble after it has burst. But if we assume we are in one today (given the sharp rise in indices), the optimal strategy is not to sell. As in 1999 during the dot-com bubble, markets continued to rise for another 12 months before turning downward.
Our strategy is therefore to capture this momentum while ensuring that AI exposure does not become excessive in portfolios, which requires regular rebalancing and gradual reduction of exposure.
The true exit signal would be a sharp rise in borrowing costs for these companies (widening credit spreads). This is not what we observe, as we are still in the early phase of the AI investment cycle. However, early signs of future stress are emerging: data center investments require financing, and while large tech firms initially funded them with excess cash, debt issuance is now beginning to appear.
When private debt becomes unsustainable—when cash flows generated by investments can no longer cover interest payments—the bubble bursts.
The banking crises of the 1830s and the 1929 crash remind us how technological revolutions (steam and electricity) can initially delight investors, before triggering violent reversals once excessive leverage builds up.
We are not there yet, but the trajectory is forming. In the meantime, profits and share prices of data center suppliers continue to rise rapidly, and we expect this to persist at least until year-end.

Investment strategy

Liquidity expansion is the number one driver of asset prices over the long term. In the short term, a shift of liquidity from financial markets to the real economy driven by technological revolution typically results in:

— Lower overall asset valuations

— Concentration of liquidity in companies supplying infrastructure builders

— A significant rise in one or more commodities tied to the investment cycle

The deployment of artificial intelligence strongly resembles the steam cycle of two centuries ago and the electrification wave of a century ago. In the current

cycle, financial markets struggle to generate strong returns outside semiconductor companies. Chipmakers have seen both profits and share prices surge in the first half of the year, driving the broader market.
Finally, intelligence is becoming a commodity—another raw material: the token. It now has both a price and a cost. The price of the token has risen by 65% since the beginning of the year. While AI will likely be deflationary in the long run, inflation dominates in the early stages.
This inflation sits at the core of our investment strategy. It leads us to maintain short duration in bonds and to favor equities—particularly major semiconductor manufacturers benefiting from this inflationary cycle.

"*Capitalism, by its very nature, is a process of economic transformation: it is not only never stationary, it cannot be*." — Joseph Schumpeter