



The Cost of Intelligence

In fishing, a big splash can attract bass. It's not the splash that attracts them but rather the perception that another fish is feeding nearby. Competition is a strong motivational force to trigger a bass to strike a lure and be caught. People and businesses (run by people) exhibit similar reflexive behavior when they believe others are "feeding" and they are potentially missing out on a meal or opportunity. The recent AI spending frenzy bears resemblance to this behavior and summarizing the timeline of events may provide valuable perspective.

A large splash occurred on January 3rd, 2025, when Microsoft announced \$80 billion in capital expenditures (CapEx) to build out AI enabled datacenters for 2025. Meta Platforms then announced a 2025 CapEx increase of \$60-\$65 billion. One month after that, Alphabet raised their 2025 CapEx forecast to \$75 billion. Two days later, Amazon announced plans to boost CapEx spending to \$100 billion for 2025. The announced spending increases ranged from 42% to 80% when compared to the prior year. The same behavior occurred in the fall of 2025, when Alphabet raised its CapEx forecast again to a range of \$91-\$93 billion. Amazon then revised its CapEx estimate upward to \$125 billion, followed by Meta's upward revision of \$70-\$72 billion. See the tables below which highlight capital expenditure growth vs revenue growth. CapEx is growing around 3 to 4 times faster than revenue and the growth rate is accelerating.

*Take note, the AI related spend began in 2023 but 2025 was the first year these companies directly referenced AI spending when communicating CapEx numbers. Figures in the table below are in billions.

CapEx						Revenue				
	Alphabet	Amazon	Microsoft	Meta			Alphabet	Amazon	Microsoft	Meta
9/30/2024	\$ 13.1	\$ 22.6	\$ 20.0	\$ 8.3		9/30/2024	\$ 88.3	\$ 158.9	\$ 65.6	\$ 40.6
12/31/2024	\$ 14.3	\$ 27.8	\$ 22.6	\$ 14.4		12/31/2024	\$ 96.5	\$ 187.8	\$ 69.6	\$ 48.4
3/31/2025	\$ 17.2	\$ 25.0	\$ 21.4	\$ 12.9		3/31/2025	\$ 90.2	\$ 155.7	\$ 70.1	\$ 42.3
6/30/2025	\$ 22.4	\$ 32.2	\$ 24.2	\$ 16.5		6/30/2025	\$ 96.4	\$ 167.7	\$ 76.4	\$ 47.5
9/30/2025	\$ 24.0	\$ 35.1	\$ 34.9	\$ 18.8		9/30/2025	\$ 102.3	\$ 180.2	\$ 77.7	\$ 51.2
12/31/2025	\$ 27.9	\$ 39.5	\$ 37.5	\$ 21.4		12/31/2025	\$ 113.8	\$ 213.4	\$ 81.3	\$ 59.9
3/31/2026	\$ 35.7	\$ 44.2	\$ 30.9	\$ 19.0		3/31/2026	\$ 109.9	\$ 181.5	\$ 82.9	\$ 56.3
Avg. % change	19%	13%	9%	18%		Avg. % change	4%	3%	4%	6%

Is this spending frenzy a result of targeting new abundant and rich waters? Are they reacting to one another's behavior and the perception that others are feeding nearby? There is nothing alarming about a company allocating large sums of capital toward attractive investment opportunities. Apprehension arises when future return characteristics of an investment are uncertain and perpetually changing. If an investment has a short shelf life, then you need to earn a positive return more quickly. If an investment has a long shelf life, then you have a longer more flexible timeline to earn a positive return. AI investment return profiles at this time appear to be trending more towards the former.

Hyperscalers like Alphabet, Amazon, Microsoft, and Meta began extending the useful life of datacenter server equipment in 2021 from 2 to 4 years. In 2023 they extended the useful life again from 4 to 6 years. These changes produced an immediate (catch up) benefit by reducing depreciation on existing assets. This raised GAAP operating income, net income, earnings per share, and lowered run rate depreciation on both existing and new assets. Due to the size of the companies, these changes yielded temporary earnings boosts in the billions of dollars per quarter.

Large hyperscalers earnings benefited from extending the useful life of datacenter equipment from 2021 to 2024. This helped give birth to the Mag 7, who accounted for over 30% of the S&P 500 market capitalization at that time. I highlighted some risks this type of market distortion can produce in a letter from February 2025 titled [“Fat tails, Expectations, and Fragility.”](#) Effective January 1, 2025, Amazon reversed course and announced a shortening of the useful life of datacenter server equipment. Specifically citing AI as the cause in the following 10-K Annual filing released in February 2025:

*“We completed our most recent servers and networking equipment useful life study in Q4 2024, and are changing the useful lives of a subset of our servers and networking equipment, effective January 1, 2025, from **six years to five years**... changes above are **due to an increased pace of technology development, particularly in the area of artificial intelligence and machine learning**.*

Hyperscalers continue to allocate immense sums of capital to assets that have a shorter shelf life than expected (according to Amazon’s filing above). How has the return picture taken shape in the 4 years since ChatGPT-3.5 was released and the CapEx feeding frenzy began?

Microsoft	continues to acknowledge short term margin pressure with no specific monetization window.
Amazon	claims monetization will occur in 2027 to 2028 with “customer commitments for a substantial portion of it.”
Alphabet	CEO Sundar Pichai described their \$185 billion CapEx projection for 2026 as, “an eye toward the future” with no details on when the investment is expected to be profitable.
Meta	recent communications indicate that meta has more compute than it can use, AI agent development is progressing slower than expected, and a clearer ROI picture for Meta AI should emerge in the next 12-24 months.

In short, the general narrative in 2026 continues to be: “compute demand is strong/rising” and “monetization will occur in the next 12-24 months.”

Where will the demand, revenue, and margin come from to make these massive investments profitable? The answer on the demand side largely comes from two private companies, OpenAI and Anthropic. They make large commitments for datacenter compute (demand) to train and run large language models. The revenue side is slightly more complicated. OpenAI

and Anthropic don't exclusively pay cash to the hyperscalers for the datacenter compute consumed. They largely trade equity ownership in their company for compute credits from the hyperscalers. This is a part of the "circular financing" deals reported by financial news outlets. Deals that the [FTC is keeping a watchful eye on](#). OpenAI and Anthropic are valued on the basis of something called implied market value. It represents the hypothetical value an owner *could* sell their shares of the company at today, based on the price investors paid in the latest funding round. When you hear OpenAI is worth \$852 billion and Anthropic is worth \$965 billion, those numbers are based on implied market value. As long as this implied value continues to rise, the spending will likely continue.

Q: Why does this matter for investors who primarily operate in public equity markets?

A: Ownership stakes, incentives, and exit liquidity.

For reference, here is where the ownership stakes currently stand:

- Microsoft has a 27% ownership stake in OpenAI and 2% stake in Anthropic.
- Amazon has an estimated 6% ownership stake in OpenAI and 15% stake in Anthropic.
- Alphabet has a 14% ownership stake in Anthropic.

To gain perspective on the incentives at work, let's review Microsoft's relationship with OpenAI. In 2019, Microsoft invested around \$10 billion in OpenAI (largely structured as the aforementioned compute credits) for an undisclosed ownership stake. When OpenAI completed its for-profit recapitalization in October 2025, Microsoft's ownership stake was revealed to be 27% and was re-valued to \$135 billion (implied market value). A 13x return in 6 years seems like an incredible return on investment until you look at what was happening prior to the for-profit recapitalization. Microsoft was reporting OpenAI investment performance under the equity method by recording its proportionate share of OpenAI's losses on its income statement under *Other income*. Quarterly losses grew from \$683 million on September 30, 2024, to \$4.9 billion on September 30, 2025.

Other, net under NOTE 3 – OTHER INCOME (EXPENSE), NET

September 30, 2024 –	(\$683)
December 31, 2024 –	(\$1,165)
March 31, 2025 –	(\$1,013)
June 31, 2025 –	(\$1,864)
September 30, 2025 –	(\$4,923)

The October 2025 recapitalization allowed Microsoft to recognize a \$6 billion dilution gain, reset the OpenAI carrying value basis to \$135 billion, and avoid suspending OpenAI losses the following quarter - when OpenAI's carrying value was expected to hit zero. This change allowed Microsoft to account for its OpenAI ownership stake the same way Amazon and Alphabet account for ownership stakes in Anthropic and OpenAI.

The broader significance of this change is revealed if we skip forward to Amazon and Alphabet's 1st quarter earnings results of 2026. To the relief of the market and sell side analysts everywhere, both companies reported strong earnings beats while further raising revenue and CapEx forecasts. Here is something that was not highlighted or discussed for obvious reasons:

- **60% of Alphabet's net income came from *other income*.**
 - \$37.7B of \$62.5B Net income, up from \$11.1B of \$34.5B Net income prior year
- **52% of Amazon's net income came from *other income*.**
 - \$15.6B of \$30.2B Net income, up from \$2.7B of \$17.1B Net income prior year

The change in *implied market value* of Alphabet and Amazon's Anthropic/OpenAI investments accounted for 60% and 52% of their net income. This is essentially the same type of unrealized mark-to-market item Warren Buffet has preached to ignore entirely when evaluating Berkshire or any business. If you net out the other income gain, both Alphabet and Amazon missed earnings expectations. This provides ample incentive to inflate Anthropic/OpenAI's strength and demand because each new funding round raises their implied market value, resulting in a boost to earnings which helps justify the CapEx spend. As the hyperscalers march toward \$1 trillion in annual CapEx, investor perception seems to be – the higher the number the lower the risk.

When dealing with private company implied valuations in the trillions of dollars, adequate exit liquidity becomes a concern for investors. Pools of capital large enough to support valuations of this size become increasingly scarce. In other words, the higher the number the higher the risk. The future of Anthropic/OpenAI hinges on the success of their IPO's and the willingness/ability of public markets to provide adequate exit liquidity. If Sam Altman and Dario Amodei can convince public markets to buy in, vast sums of your capital will flow into these companies as they go public and are [mechanically added to all major index funds](#). This will provide obvious immediate benefits outlined earlier to both the AI companies and the large hyperscalers.

A favorite Charlie Munger quote of mine is, "show me the incentive and I will show you the outcome." Abundant incentives exist for hyperscalers and AI companies to inflate demand forecasts. As the technology/fiber optic bubble of 2000 showed us, even with tremendous future demand, overestimating demand and overbuilding capacity can have severe consequences. When internet traffic was found to be *only* doubling every year rather than every 3-6 months, orders were pulled and S&P 500 earnings fell 40%. Demand is a necessary component for a business to be successful. But demand without margin is a lousy business. Think of the classic Munger/Bufet example of airlines. The current margin outlook for the hyperscalers spending spree is uncertain at best. This uncertainty is being inversely framed as opportunity rather than risk. Companies are behaving as if this is a win at all cost, winner take all scenario as they willfully shift from capital light to capital intense businesses. If it turns out to be a winner take all scenario, what is the cost to wait and see? The following Steven Wright joke I find to be both funny and relevant.

"The early bird gets the worm, but the second mouse gets the cheese"

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