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Letting Some Air Out of AI

Whenever the stock market drops 1-2% of its value in a day, we hear about it—and, of course, the financial press was all over the declines on November 12th and 13th. These minor downturns are primarily driven by emotion and sentiment (does anyone think that the underlying value of stocks fluctuates from day to day?), but of course the press will ask economists and pundits to explain any shift in the indices. The current explanation is that some investors suspect that all those artificial intelligence companies might not be able to recover the billions of dollars they're spending on their models.

Or, put another way, it's possible that not all of them will be relevant a few years from now, and those that ARE relevant will take longer than expected to recover their investments, as the business world continues to digest how, exactly, AI will improve their bottom lines.

Nobody seems to doubt that AI will ultimately transform the world economy. But history has shown how some important new innovations, which did, indeed, go on to transform the world, have experienced collapses early in their life cycle. A classic example is the notorious Panic of 1873, when railroad stocks tanked because, well, their prices had gotten way over their skis, and because the early return on investment was not nearly as great as the hypesters envisioned. The aftermath was not pretty: New York Stock Exchange trading was suspended, and the ensuing depression rippled through the U.S. economy.

And, of course, railroads went right on revolutionizing travel and freight delivery in America's still-developing economy. They were undeniably important; just oversold.

Another example is the Tech Wreck in 2000-2002, a time when it was widely predicted that computer technology and this new thing called software would transform the economy. They did, ultimately, but investors in early innovators like Ashton-Tate (database), AltaVista (search engine), Egghead Software, Prodigy and Pets.com experienced billions of dollars in losses as their solutions were overtaken by competitors.

So many people invested such a high percentage of their portfolios in tech that the collapse triggered a wider market downturn that lasted three years.

There's no reason to expect some kind of major market collapse based on a couple of days of market pullback. But the lesson is not to get caught up in the hype—and it seems to be a lesson that investors must re-learn over and over again.

Two things can be true at the same time: that AI will eventually become a huge contributor to the global economy, and many AI stocks are going to struggle as we journey toward that future. In panics of the past, people who owned a broad spectrum of stocks suffered a downturn and then experienced a recovery, while those who over concentrated on the next transformation in the economy suffered far greater losses. It's possible (who knows?) that we're learning a milder version of this lesson once again.

Sources:

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