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AI'S HIGHER BAR: FROM DEMAND TO RETURNS



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DEMAND IS NOT THE ISSUE

Third-quarter earnings season is underway. Several technology companies reported this past week. One message was consistent: AI-related ***demand*** remains strong. Microsoft and Alphabet pointed to AI as a major cloud growth driver. Amazon said newly installed AI capacity is being absorbed quickly. Supply remains tight across compute, data centers, power, and networking.

However, the market's reaction has been more mixed.

THE COST OF MEETING AI DEMAND

We may be nearing a shift in the AI debate. For the past several years, investors focused on whether AI demand would materialize. The focus is now shifting toward what it costs to meet that demand and how quickly record capital spending can translate into earnings, free cash flow, and attractive returns.

The scale of the buildout explains the higher hurdle. Based on guidance, Amazon, Alphabet, Microsoft, and Meta are on pace to spend roughly $730 billion in combined 2026 capital expenditures—nearly 80% above 2025 levels.

For perspective, $730 billion is comparable to the projected annual economic output of Belgium or Ireland.

At that scale, utilization, monetization, financing costs, and payback periods simply matter more. A higher cost of capital raises the hurdle further.

GOOD IS NO LONGER GOOD ENOUGH

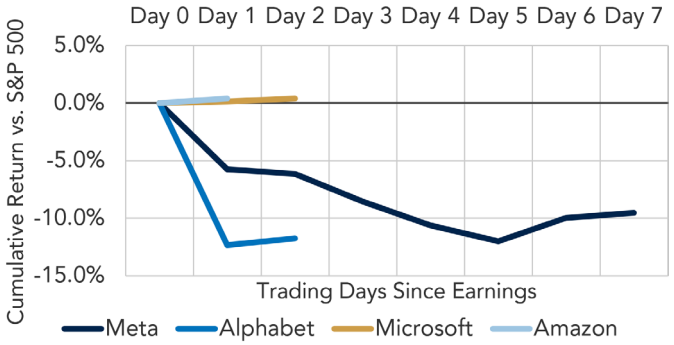
Recent earnings offer different examples of the same issue. Meta's core business remains strong, yet investors focused on the scale and likely duration of its AI buildout. Alphabet reported exceptional cloud growth, but investors also weighed softer-than-expected search monetization, negative free cash flow, and another large increase in capital spending ahead. AI can be both a new growth engine and a potential disruptor to the profit pool funding the buildout.

Microsoft presented a cleaner operating picture. Azure growth accelerated, margins held up, and cash generation remained healthy. Amazon also showed strong AWS growth and profitability, while quarterly capital spending came in far above expectations.

The stock reactions illustrate the higher bar. Strong operating results did not translate into uniformly strong stock performance. Investors appear more willing to look through a strong quarter if spending is rising faster than expected or the path to cash returns remains unclear.

STRONG AI DEMAND, A HIGHER MARKET HURDLE

Cumulative post-earnings performance relative to the S&P 500 | Day 0 = pre-report close.



WHO PAYS FOR THIS?

These businesses are not capital-constrained in the traditional sense. As the scale of AI investment grows, though, how that investment is funded is becoming part of the return equation. Microsoft priced a $25 billion debt offering, its first U.S. investment-grade offering since 2017, while Meta outlined nearly $100 billion of potential equity financing.

None of this signals balance-sheet stress. It does illustrate how the size of the buildout is broadening the funding toolkit. For investors, the question is not simply whether these companies can fund the investment, but whether the returns ultimately justify both the capital being committed and the cost of funding it.

The opportunity remains significant. Demand is strong and supply is constrained. What is changing is the market's standard of proof. Strong growth alone may no longer be enough. Investors increasingly want evidence that AI demand can be monetized efficiently, converted into cash flow, and generate attractive returns on the capital being committed.

Chart source: Stock Analysis and S&P 500 historical prices. Returns through October 30, 2026. Relative return equals company cumulative price return minus S&P 500 cumulative price return. Lines end at the latest completed post-earnings trading day available for each company.

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