M1 CAPITAL
INVESTMENT MANAGEMENT

Is AI in a Bubble and Other Risks – Market Commentary

May saw a continuation of trends both internationally and in South Africa.

Internationally Tech, and AI-related shares in particular, continued to lead. This is evidenced by the +10.6% return for the Nasdaq, outperforming the +5.2% for the S&P 500, itself outperforming the MSCI World Index at +4.6%. As one might expect Growth outperformed Value +7.0% to +2.3%.

Emerging Markets also performed strongly at +9.7%. Emerging Markets are disparate of course and the strong aggregate return was also AI-driven via Korea and Taiwan.

Closer to home, the Gold price continued to derate and this drove our market lower in ZAR terms, but with a low, positive return in USD. SA is underperforming Emerging Markets substantially, though more correctly one should probably rather say that AI and Korea and Taiwan are outperforming strongly.

The various market returns are summarised in Table 1 below.

Table 1. South African and global equity returns (USD) for May 2026*

	May-26	YTD 2026
FTSE/JSE ALSI (ZAR)	-0.3%	0.8%
FTSE/JSE ALSI (USD)	2.8%	3.1%
MSCI World	4.6%	10.5%
MSCI World ex-US	2.8%	9.4%
MSCI EM	9.7%	25.6%
MSCI Value	2.3%	10.9%
MSCI Growth	7.0%	10.0%
S&P 500	5.2%	11.1%
Nasdaq 100	10.6%	20.5%

*Total return indices, Source: Factset

"Andy Cheng is 26, unemployed and, with the help of a little borrowed money, the proud owner of $60 000 worth of Taiwanese Tech stocks … he doles out the following advice: "Buy any stock and you will make money".

AI mania has gripped any number of stock markets across the globe in recent months …"

The above is sourced from a Bloomberg article this week and summarises both the state of play and what we think might be a precarious time. Our first thought on reading was that we have read similar descriptions of the stock market environment prior to the 1929 market crash.

The arguments for the rise in prices are well-known, and the belief that this could be a once-off response to a step change in demand, even though the spending is often debt-funded.

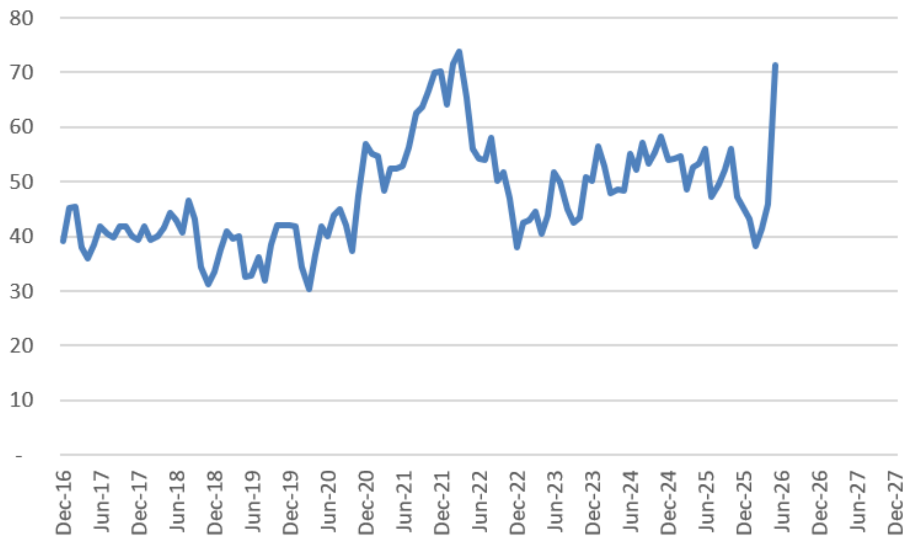
At the same time global stock markets are displaying the characteristics of a bubble.

How expensive is AI?

We first consider if AI-related stocks might present risks from a valuation perspective, prospective earnings growth notwithstanding.

Exhibit 1, or Chart 1 below, is the forward PE i.e. taking into account profits to be earned in the current year, of Palo Alto Networks, a well-known cybersecurity company, considered to be a major beneficiary of AI.

Chart 1. Forward PE of Palo Alto Networks



Palo Alto is expecting +136% growth in earnings in 2026, yet, per Chart 1 above, even taking this into account, its PE multiple is over 70x. Tellingly, perhaps, the current valuation is in line with what it was in early 2022. Later in that year the stock experienced a -35% decline.

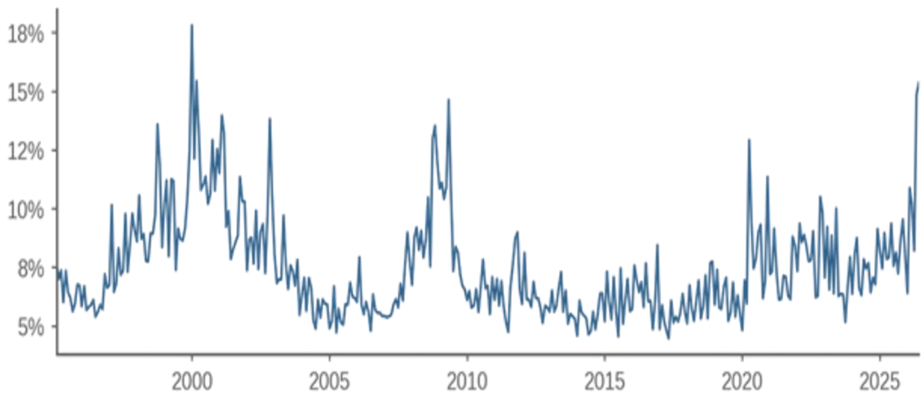
This is of course one example, but we see many others.

Other indications

Last month we commented on the narrow breadth of the April market movement as being a sign of a late cycle rally.

We present in Chart 2 below the dispersion of returns in the MSCI All Country World Index (ACWI).

Chart 2. Monthly return dispersion – MSCI ACWI

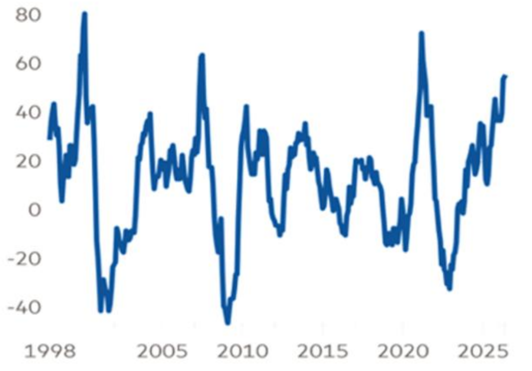


Source: Acadian based on data from MSCI. For illustrative purposes only.

Per Chart 2 above, the prior peaks in dispersion occurred most prominently in 2000, also in 2008, and most recently early in 2020.

Finally, we drew attention to Asia at the beginning of this article and have in fact asked ourselves privately if any sustained market declines might not initiate from East Asia. But leverage in trading has been rising in the US too, illustrated in Chart 3 below.

Chart 3. Growth in margin debt in US securities accounts



Source: Finra

While the data in Chart 3 above merely represents growth and not necessarily excessive levels of leverage, the parallels with previous market turning points in 2000, 2008 and 2020, are once again unmistakable.

Alan Greenspan famously commented that bubbles are not possible to identify in advance. We agree. After all if this were not the case bubbles would hardly arise in the first place. At the same time the conventional signs – a new technology, exuberance, leverage, and of course steeply rising prices, are all present. We suggest caution.

Other things to worry about

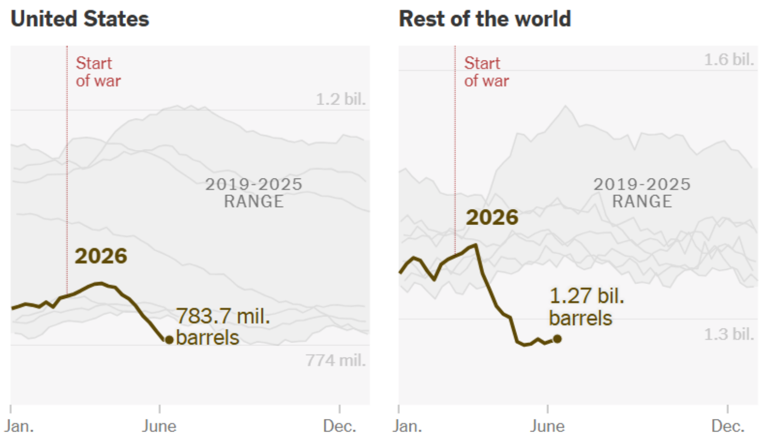
While the Oil price has declined sharply in recent days, we continue to think there is significant risk embedded in the Oil market. We celebrate the end of active hostilities but our prior commentary stands – we continue to wonder how the US and Iran might achieve agreement given publicly stated positions.

We believe Iran is in a dominant position – the end of hostilities itself suggests so, while the public recriminations between Israel and the United States confirm it. So Iran's demands will likely have to be accommodated.

The pressure on the US of course arises from the level of Oil inventories, illustrated in Chart 4 below. These are effectively exhausted and President Trump himself said last week "We run out of reserves at about four weeks. You know, there are reserves all over the world, and we would really run out, and there'll be a time when you wouldn't be able to get it. It would be bedlam."

We think a reinitiation of hostilities is unlikely – specialist independent commentary says US military assets in the region are already being withdrawn. Which leaves the negotiations, and if these drag on, or fail, a crisis could yet materialise. Just yesterday at the time of writing a ship was attacked in the Strait. Insight into the actual state of affairs remains difficult as always. But we are happy to defer to the collective wisdom of the Oil market for now.

Chart 4. Oil inventories – weekly levels



Source: New York Times