

Perspective from Templeton Global Investments

Global Equity Pulse

In focus: AI bubble or sustainable growth?

Artificial intelligence (AI) remains a powerful growth theme particularly for major cloud services providers, as the latest industry evidence continues to show demand running ahead of supply and capacity being rapidly utilized.

With that in mind, we believe the risk of a potential bubble in AI stocks is limited at this point. However, growth is uneven across the value chain, necessitating a bottom-up stock selection process that also considers evolving technologies and supply constraints.

Strong growth and capacity utilization for hyperscalers

The technology sector hit a rough patch in November amid concerns of overstretched valuations, with several AI-related majors selling off despite their stellar fiscal-quarter performance. As a result, the MSCI ACWI Information Technology Index was down 5% in November, snapping its post-“Liberation Day” rally. (See Exhibit 1.)

The market skepticism centers on whether the services providers are generating enough profits to warrant their enormous capital expenditure (capex) on AI capacity buildout, and whether there is sustainable growth across the AI value chain to justify the elevated stock prices. As investors mull these questions, talks of a potential AI bubble and the risk of its bursting have begun to circulate.

Exhibit 1: Technology Stock Performance Softened in November after Months-Long Rally

MSCI ACWI Information Technology Index Six-Month Performance (Last Price)



Source: Bloomberg. As of December 1, 2025. The MSCI ACWI Information Technology Index includes large and mid-cap securities across 23 developed market (DM) countries and 24 emerging market (EM) countries. Indexes are unmanaged and one cannot directly invest in them. They do not include fees, expenses or sales charges. **Past performance is not an indicator or a guarantee of future results.**

We do not agree with that bearish assessment. The numbers and forecasts emerging from the latest quarterly results season indicate that AI is now the primary engine of growth for sector majors, particularly the cloud services providers at the hyperscale level. In broad terms, the top three hyperscalers saw their cloud and AI-related sales grow by 20%-40% year-over-year in the July-September period.¹ A hyperscaler is characterized by industry-leading data infrastructure, able to provide cloud computing services at a massive, global scale.

Entering 2026, these global hyperscalers are all projecting to further increase their AI capex. This was part of the reason why investors pulled back from technology stocks in November. However, we note that the spending is led by surging demand growth, as evidenced by their significant cloud backlogs, which totaled around US\$750 billion as of September 2025.² AI consumption can also be measured through token (small text blocks that form the basic unit for AI input and output) processing volume, with one of the hyperscalers now processing around 1,300 trillion tokens monthly, up 20 times in a year.³

Looking ahead, we see inference driving token consumption, where a trained AI model applies what it has learned on new data to generate predictions or recommendations, as a major near-term return on investment (ROI) driver for hyperscalers. Expanding enterprise workloads through applications such as Copilot, Vertex and Bedrock, as well as pull-through via adjacent cloud services, are also catalysts to keep in mind.

Overall, we do not believe AI capex, while significant, is leading to idle or over-capacity that dilutes shareholder value. Ultimately, token demand relative to cost per token remains a fundamental growth driver that in our analysis shows no sign of slowing down. That should underpin the long-term investment case of hyperscalers and their critical enablers along the AI value chain.

Evolving technological landscape

AI technology advancements are a key part of this equation. For instance, our positive view accounts for the advent of agentic capabilities. In simple terms, an AI agent is a software or application that can perceive, reason and take action with autonomy. It is considered the “next step” beyond prompting basic responses from large language models. This shift will materially increase the volume of tokens processed per task, raising computing intensity and hence the capacity needs for AI training and inference.

Breakthroughs at the semiconductor level are also noteworthy. A significant part of the surging AI capex is spent on AI servers with sophisticated graphics processing units (GPUs) or application-specific integrated circuits (ASICs). These are the “brains” of AI and their architectural enhancements are the key to deliver stronger capabilities at a lower cost.

We are seeing this at play right now with the intensifying competition between NVIDIA’s GPUs and Alphabet’s tensor processing units (TPUs). TPUs are machine-learning ASICs that are said to offer superior processing throughput for AI model training and inference, with faster speed, greater energy efficiency and lower costs. Unverified market reports indicate that the latest TPUs may offer four times the performance-per-dollar over NVIDIA’s flagship H100 GPUs for certain workloads.

The growing popularity of TPUs—which Meta is reportedly considering over NVIDIA’s GPUs—mark an ongoing technological evolution that we believe is accretive to long-term cost efficiency, particularly for companies that can successfully harness them at scale.

However, the cost benefits of AI technology and infrastructure investments may not be immediately apparent on the operating margins, due to depreciation in the accounting process. Under the Generally Accepted Accounting Principles (GAAP), AI infrastructure investments are often considered tangible fixed assets. The requirement to depreciate these assets is putting pressure on operating margins and masking what we believe are real improvements to cash flows and profitability.

Identifying AI beneficiaries and understanding their unit economics thus will require in-depth research that looks deeper than the headline items on balance sheets. It is a nuanced process that also examines the pace of capacity utilization and monetization, cash discipline and a company’s ability to tackle evolving supply-side constraints, among other factors.

Identifying AI beneficiaries

These careful considerations similarly inform our bottom-up stock selection, even as we maintain our high conviction on the AI theme. For instance, we appreciate the risks and opportunities arising from the power bottleneck that is now being recognized as one of the biggest challenges for AI capacity growth. We believe access to power, not just chips, may govern the schedules of capacity growth in 2026 and 2027. Vendors and providers that can resolve power issues the fastest are favorable as they stand to enhance their scale advantage, which is accretive to margins and revenue. Second-order beneficiaries, such as utilities and industrials companies, are also interesting ideas to keep in mind for AI proxy investing.

The same comprehensive approach is applied as we look beyond cloud services providers and semiconductors companies for AI beneficiaries. In the software-as-a-service (SaaS) segment, for instance, we pay attention to concerns of companies losing market share to AI and the impact of vibe-coding, where AI generates software applications quickly and at low costs, potentially making incumbent services obsolete.

Against this backdrop, we focus on SaaS companies that directly benefit from AI agents as a revenue accelerant. However, this is coupled with the realization that these companies may pivot from a subscription model to an outcome-oriented model, with potential impact on long-term earnings growth and stock valuations. At the same time, we believe some software companies, such as select system of record providers, are oversold and hence mispriced relative to their durable models. As we stay invested, we welcome the market volatility, as it may sharpen the management's focus on profitable growth.

Likewise, we believe the recent market scrutiny on technology stocks and the AI value chain is overall a healthy development. Instead of bursting a potential AI bubble, which is not our base-case view, investor concerns about ROI, cost discipline, financing structures and supply-chain limits are helpful for long-term investors, as they keep valuations anchored to fundamentals.

Investment outlook

Third-quarter earnings results in the United States have been robust and we believe corporate America is in good shape, benefitting from probable further Federal Reserve (Fed) rate cuts. The earnings outlook may brighten for small-capitalization stocks, industrials and financials, helping to broaden market performance. Further earnings recovery is also expected in Asia Pacific, but potential dispersions necessitate a selective approach. That means staying nimble with risk/reward adjustments even as we maintain conviction on technology stocks. In Japan, we prefer stocks with structural growth and corporate reform exposures. European equities approach the close of 2025 with a constructive backdrop and still-favorable valuations. Financial services remain a core source of potential upside. In other favorable sectors, capital goods enjoy structural support from electrification and infrastructure stimulus, while luxury may present catch-up potential as organic demand recovers.

North America

US companies have been delivering record margins with healthy results across the market. Third-quarter earnings results were very strong, with roughly two-thirds of companies beating revenue forecasts, and, overall, companies delivering record margins. All 11 sectors had healthy results, indicating a broadening of earnings participation that we had been anticipating. We believe corporate America is in good shape right now, and the environment looks distinctly non-recessionary.

We believe a weaker US dollar will be a factor in 2026. Year-to-date, the trade-weighted value of the US dollar has fallen by about 10%. Various factors suggest to us that its decline is not yet over. Among them, there are probable further Fed rate cuts owing to a softening US labor market. The Fed is expected to continue easing into the first half of 2026, perhaps for longer. Weakening of the US dollar tends to reinforce a broadening of returns across capital markets, by region, sector, and asset class.

Within the US equity market, the earnings outlook has brightened for small-capitalization stocks, industrials and financials. Small-cap stocks and industrials, which are typically more highly leveraged than the rest of the market, will likely see profitability rise as the Fed trims interest rates and debt servicing costs fall. Financials may benefit from a steeper yield curve, improving net interest margin, and from innovations in capital markets.

The implication is that US equity market performance can broaden sustainably away from the still-compelling leadership of large capitalization growth, technology and AI companies. As always, we remain focused on maintaining a disciplined approach, owning what we believe to be high-quality businesses at compelling valuations while balancing cyclical and structural opportunities across the market.

APAC

As of the end of November, about 85% of companies in the Asia ex-Japan region have reported their latest quarterly results. Within this group, 40% delivered positive earnings surprises, which is slightly above historical seasonality.⁴ Overall, signs continue to point to an ongoing earnings recovery in the Asia ex-Japan region, with various forward estimates putting the 2026 earnings expansion at a roughly high-teen percentage level. A low-teen level of earnings growth is also expected for Japan in 2026, similarly a recovery from 2025.

The regional market outlook should find some support from the easing of trade risks. Expected interest-rate cuts by many Asian central banks and a growing focus on corporate governance reforms may also provide the additional tailwinds. Nonetheless, we note the dispersions of performance and opportunities across individual markets. For instance, in the Chinese and Hong Kong market, we note a

high year-on-year base for earnings growth in the first half of 2026—that implies growth may only become tangible in the second half, with lower visibility and higher uncertainties. These nuances are important to keep in mind against the backdrop of elevated valuations, as missed expectations—particularly among frontrunners such as the outperforming Taiwanese and South Korean technology names—are likely to induce market volatility.

Overall, we reiterate the need for a bottom-up selection approach. Technology and AI beneficiaries remain a high-conviction theme in the Asia Pacific region, but being selective means paying attention to valuations and risk/reward. We maintain our core holdings in Taiwanese and South Korean semiconductor companies but will be nimble in adjusting positions and weightings as US majors continue to lead sector performance. Hardware companies are less favorable to us, given their thinner margins and rising cost pressure. In Japan, we also stay selective toward foreign income earners, being conscious of a still-uncertain global growth outlook and a potential reversal of the yen weakness. Our picks in this market are typically marketshare winners or leaders in sectors experiencing structural growth, as well as those going through corporate reforms to the benefit of shareholders.

Europe

European equities approach the close of 2025 with a more constructive backdrop than in recent years. The market delivered solid gains, especially in the first half, supported by US dollar weakness and a policy pivot toward fiscal stimulus, notably measures aimed at defense and infrastructure. That policy impulse helped drive early-year outperformance, yet over the full year Europe did not keep pace with larger gains in parts of Asia where technology-led leadership was particularly strong.

Valuations remain a supportive factor. European equities began the year from a low base after significant fourth-quarter 2024 weakness, and they still generally trade at a meaningful discount to global peers despite recent gains. Macro and corporate fundamentals look healthier, however; inflation has eased, interest rates have come down and many companies, notably in the financial sector, have met or exceeded earnings expectations. Financial services remain a potential core source of upside and include many high-quality businesses that should benefit from greater European integration.

Market leadership has been narrow. Financials and capital goods have outperformed, particularly aerospace and defense, reflecting fiscal tailwinds and cyclical exposure. Capital goods have also enjoyed structural support from electrification, decarbonization and infrastructure stimulus. Luxury and other consumer segments that lagged present catch-up potential as organic demand recovers. Select suppliers in the semiconductor equipment chain could benefit if AI-driven investment broadens beyond current hubs. Value has regained prominence, but we continue to favor stock-level fundamental analysis over simple factor plays.

By region, France and the United Kingdom continue to stand out where leading global businesses remain discounted amid domestic political and fiscal noise. Central and Eastern Europe also host disruptive, export-oriented franchises that can provide diversification, though exposure should be gained selectively given market depth and company-specific risks.

Key short-term risks include political challenges, and Europe's greater cyclical, which could lead to relative weakness in a global downturn. Markets may pause as investors await tangible economic impact from fiscal stimulus, while the narrow leadership and an accelerating AI story concentrated outside the region could keep flows limited. These risks are manageable through selective, active positioning.

Market review: November 2025

Global equities were mixed in November, with the MSCI All Country World Index (ACWI) benchmark declining in US dollar terms as the information technology, consumer discretionary and industrials sectors dragged. In contrast, the health care sector led amid a rotation from higher-beta exposures to defensives. Growth stocks lagged value stocks, while large caps modestly underperformed small caps.

During the month, US stocks were notably pressured by a sharp momentum unwind and fading AI enthusiasm. Sector performance skewed toward defensives despite increasingly dovish Fed rhetoric. European equities outperformed amid constructive macroeconomic signals, although fiscal developments in the United Kingdom drew attention and pushed gilt yields higher. Asian stocks underperformed as Korea and Taiwan tracked global semiconductor swings. Japan, however, remained relatively resilient.

Endnotes

1. Based on company results announcements for the quarter ended September 2025.
2. Ibid.
3. Based on information provided in said company's earnings call, dated October 29, 2025.
4. Source: Goldman Sachs Portfolio Strategy Research, "Asia-Pacific Weekly Kickstart." As of November 29, 2025. There is no assurance that any prediction, projection or forecast on the economy, stock market, bond market or the economic trends of the markets will be realized.

WHAT ARE THE RISKS?

All investments involve risks, including possible loss of principal.

Equity securities are subject to price fluctuation and possible loss of principal. **Small- and mid-cap stocks** involve greater risks and volatility than large-cap stocks. There can be no assurance that **multi-factor stock selection** process will enhance performance. Exposure to such investment factors may detract from performance in some market environments, perhaps for extended periods. The investment style may become out of favor, which may have a negative impact on performance.

Active management does not ensure gains or protect against market declines.

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Investments in fast-growing industries like the **technology sector** (which historically has been volatile) could result in increased price fluctuation, especially over the short term, due to the rapid pace of product change and development and changes in government regulation of companies emphasizing scientific or technological advancement.

Large-capitalization stocks may fall out of favor with investors based on market and economic conditions.

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