AI Model Improvement Leads to AI Buildout Slowdown?

AI advancements are not stopping: Anthropic, OpenAI, META and Microsoft have all launched new models since September. Microsoft and Anthropic were able to make these models better than prior models at a fraction of their prior costs.

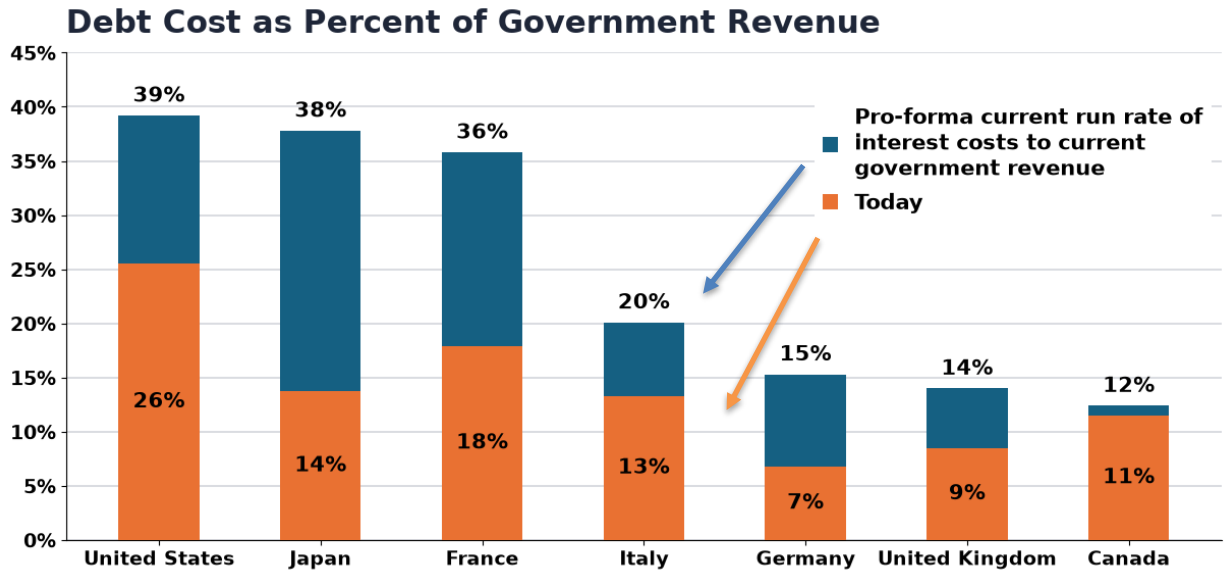
Microsoft for example said that they trained their model at a quarter (4X better) of the compute[1]. Anthropic launched Opus 5.5 which is 40% more efficient[2]. This model improvement was done in only 2 months.

If we keep getting fast improvement in efficiencies, the ultimate demand for additional physical compute should slow down or potentially even decline. As an example, if we have a 10x improvement in efficiency over the next one or two years, it is the equivalent to a 10X expansion of the physical compute in place. In other words, expanding AI Data Centers by 10X with no improvement in efficiency or having a 10X improvement in efficiency without spending a penny more on new AI Data Centers gives you the exact same output. The rapid rise in efficiency adds to the list of reasons why a decline in CAPEX into $NVDA chips, $MU memory hardware, $AMD, $DELL, $CLS, $AVGO, etc. should happen sooner or later. Expect these AI related stocks to do very poorly when that happens. We expect to see share price declines of 50% to 90% on average and some companies won't make it at all. We continue to believe OpenAI won't be able to go public and will ultimately be swallowed by one or more of the other players through a very disruptive restructuring. (Please read our piece on OpenAI - Here)

The Coming Debt Reckoning

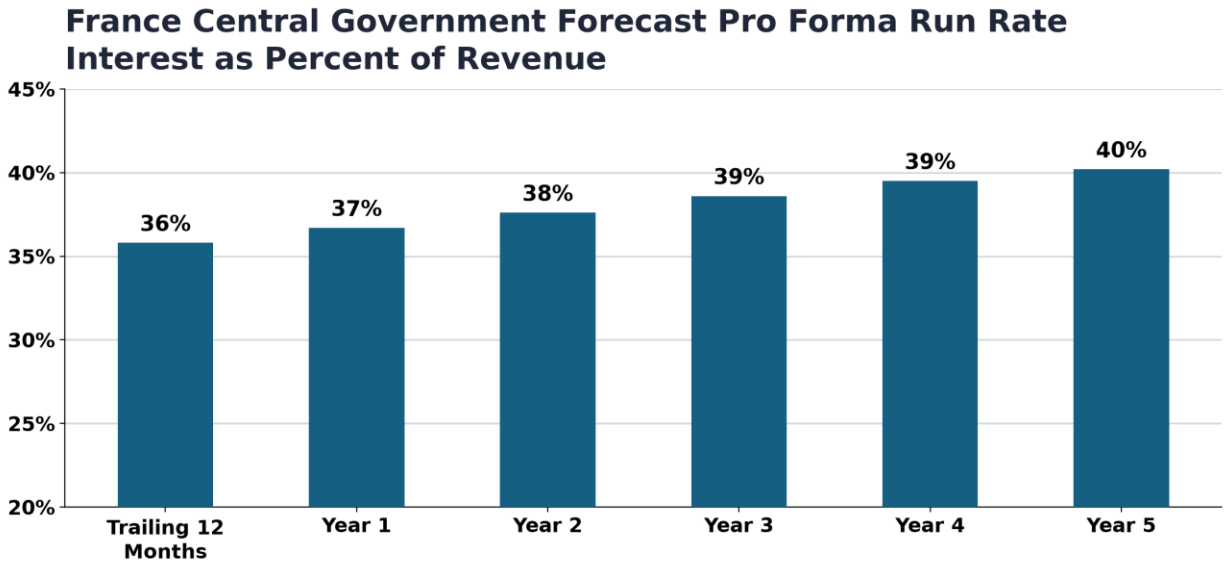
We have been talking about the excess deficits of the United States and much of the western world for years, and now it looks like the market is seeing it too. Government interest rates slowly went higher during the first half of the year, and in late September exploded to the upside.

Countries don't feel the immediate impact of interest rates going higher; they feel it in the future when refinancing their debt. Using the G7, we looked at what the interest service cost as percentage of government revenue would be at current 10-year interest rates, as if all debt were refinanced today. We call it pro-forma current run-rate of interest costs to current government revenue. The results are concerning:



Note: PRO-FORMA RATE being used is LOCAL CURRENCY 10-YEAR BOND RATES as of October 6th 2026 intraday[3]

These numbers should continue to get worse for some countries as deficits (added debt) are high for many countries, with economic growth not keeping pace. France's expected worsening is shown below:



Note: Timelo estimates, assumed 10 year interest rates as of October 6th 2026 intraday, 1.85% GDP growth and consistent central government deficits

There is a crisis coming for government debts. Many investors remain in denial after 40 years of lower rates through 2020. However, we believe that each day there is a new set of investors who reach the same conclusions we have:

- Federal Reserve Chair Kevin Warsh is against printing money except for in a crisis, so the bond market is increasingly at the mercy of supply and demand
- Today, in the 'good times', deficits are too high; in any recession, deficits likely get far far worse
- There appears to be zero political will to resolve the issue of deficits being too high
- U.S. social security trust funds are expected to be insolvent by mid-2032[4] meaning either unpopular benefit cuts or deeper deficits (1.2% of GDP) which adds more pressure

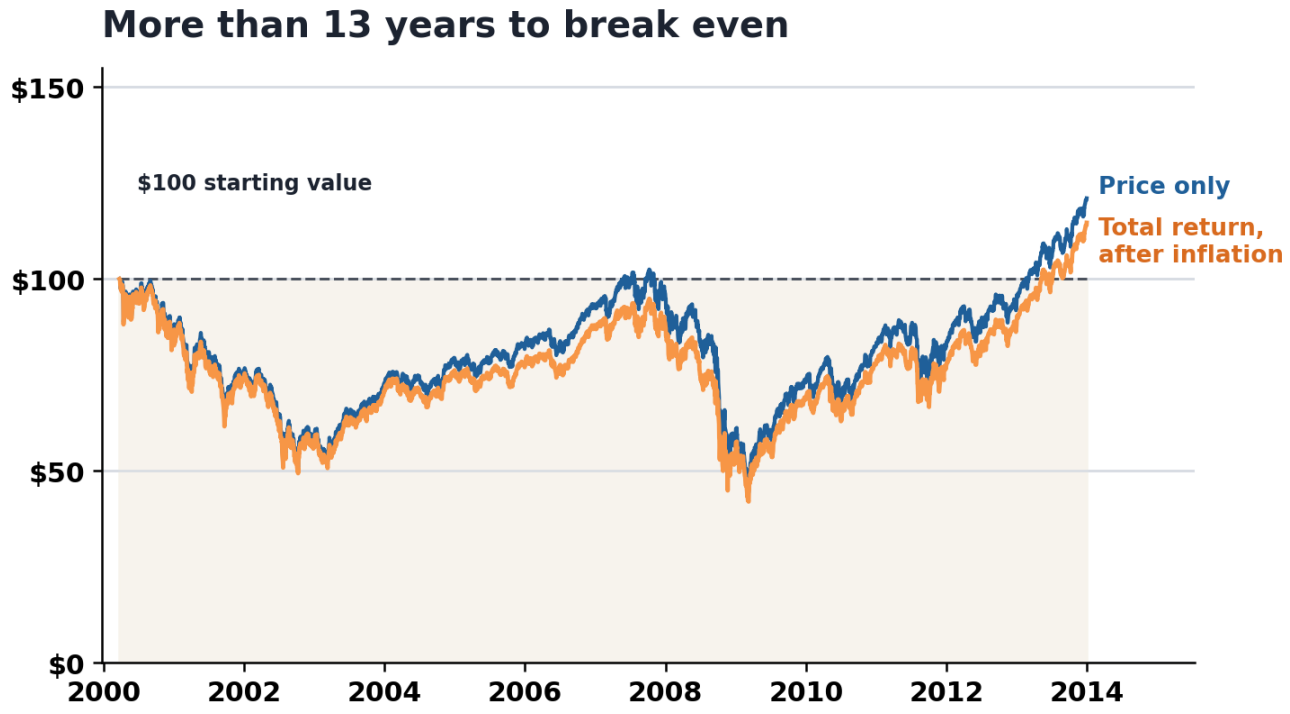
The impact of higher rates will roll through the economy in different ways. Broadly, today, it impacts consumers and businesses with higher cost of borrowing, which slows the economy. Down the road, higher debt servicing by governments requires unpleasant choices. France will be forced to make choices around cutting spending, raising taxes or printing money (France can't print money).

We expect a Sovereign Bond Crisis in France within 1 or 2 years. The country is known for rioting in response to proposals for small cuts to government spending. With France unable to print money to solve its problems, we believe that the European Union will be telling France to cut expenditures in a big way. Remember what happened to Greece in 2011. That crisis got resolved with big government and pension cuts along with 107 billion Euros written down (permanent loss of money). The crisis in France will be a multiple of that since the French GDP is 12X bigger than Greece. When it happens, there likely will be massive riots and destruction in the streets of France. The contagion to other European countries is very likely. We expect large losses on the value of bonds and stocks across the world but particularly in Europe.

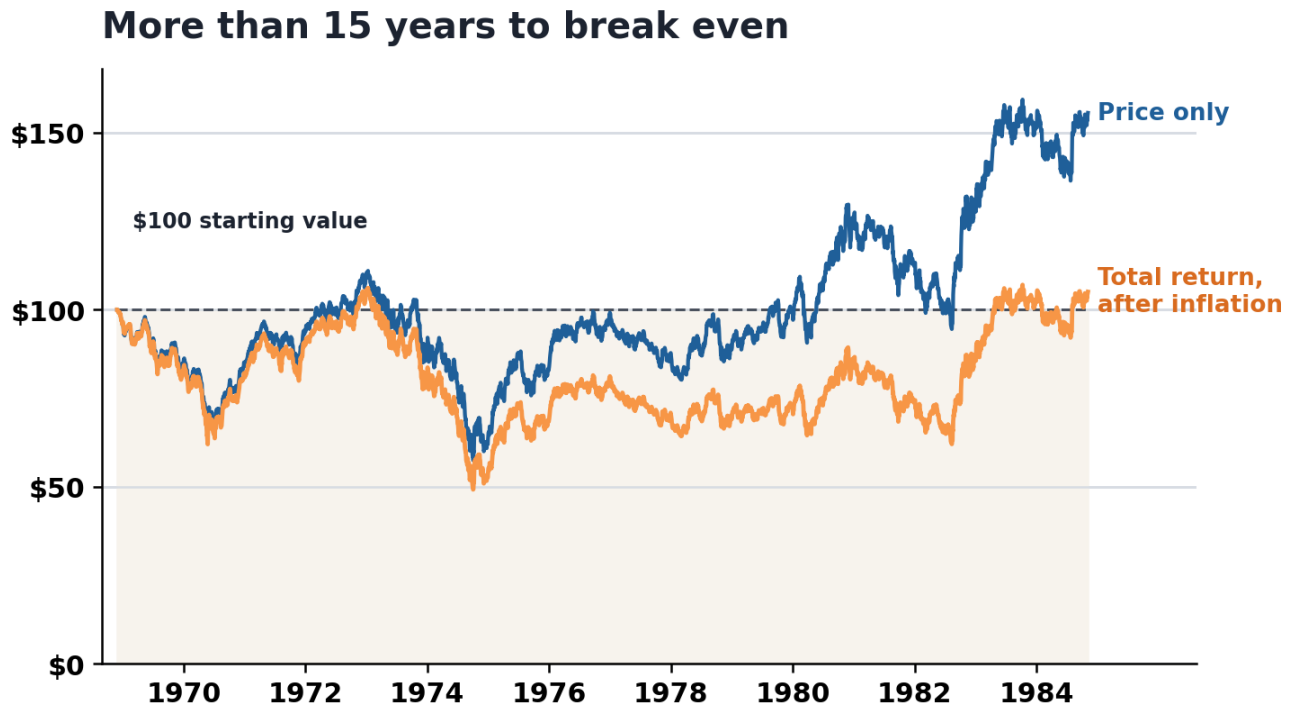
A lot of investors (especially the crowd of under 40 years of age) think buying every little dip is the easiest thing to do. It will work until it doesn't. As we have seen multiple times in history, stocks can decline meaningfully and/or provide no return for a very long time.

Lost Decade for Stocks?

Lost decades for investors are when investors see low returns over 10 years, periods like 2000-2010 or 1968-1978. Lost decades are a painful experience, and we do not think the average index investor is ready for it after 17 successful years of buying the dip. The starting point for many lost decades is high valuations, i.e. tech companies in 2000 and the nifty fifty in the early 1970s.



Source: Bloomberg. Index: S&P 500



Source: Bloomberg. Index: S&P 500

Portfolio Positioning

While the above letter may sound bearish, we see a good amount of opportunity on the long side to buy cheap stocks with good free cash flow and importantly, growth. Names like Dutch Bros, Colliers, Extendicare and Yum! Brands all look like they will be long-term compounders in the portfolio at a very reasonable price.

In regard to the stock markets as a whole (big index ETFs), we are likely to be in for a lost decade with high valuation, government deficits, government debt crisis and a big AI meltdown. This is a very messy set-up over the medium term which is very likely to lead to a long and deep bear market in our opinion. Therefore, we also have plenty of ideas on the short side. There are a lot of bubble stocks, meme stocks and unprofitable companies as natural places for us to find short ideas.

Since 2011 we have been bearish on the Canadian Dollar. First, it was due to commodities peaking when $CAD was above par, then due to degradation of government policies since 2015. We are now making a 180-degree turn. Canada is now open for business and commodity projects will flourish. Therefore, we are now bullish on CAD. The tailwinds of commodities and an improved business environment plus our better fiscal position are a double positive relative to challenging fiscal positions in Europe and the United States. This is a big change from when we went on BNN calling for a 50c CAD in 2024. Link

Jean-Francois Tardif
President & Portfolio Manager

Sources

1 https://finance.yahoo.com/technology/ai/articles/microsoft-ai-chief-says-built-125729863.html

2 https://www.anthropic.com/claude-opus-5-5

3 Bloomberg, europa.eu, mof.go.jp, treasury.gov

4 https://www.crfb.org/blogs/cbo-projects-social-security-nearing-insolvency

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