FORT SHERIDAN ADVISORS

Show Me the Money

Artificial intelligence was again the defining theme of the past two weeks of earnings. While demand for AI remains strong, the largest technology companies are increasing their spending far faster than their profits and cash flows are growing, and investors appear less willing to keep funding the difference. With concerns growing over the sustainability of this investment and its payoff, the Nasdaq fell 2% last week – approaching the 10% correction territory.[1] We think investors' message to the industry is clear: show me the money.

Strong Demand, Soaring Costs

Let's start with the good news, though. Alphabet's cloud revenue grew 103% from a year ago, Amazon Web Services grew 39%, its fastest pace in nearly five years, and Microsoft's Azure cloud service grew 48%. The contracted backlogs reported by Google Cloud and Amazon Web Services, together with Microsoft's commercial backlog, now total more than $1.8 trillion. The leading AI developers are growing at even faster rates: Anthropic and OpenAI's combined annualized revenue has quadrupled this year to $120 billion and is projected to reach $180 billion by year-end.[2]

The problem is the cost of meeting that demand. Alphabet, Amazon, Microsoft and Meta together spent more than $200 billion on capital expenditures in the third quarter alone. Their guidance implies $720 billion to $740 billion for the full year. Alphabet and Amazon expect to spend significantly more in 2027, and Meta expects to keep investing aggressively. Meanwhile, Alphabet's free cash flow was negative $9.1 billion in the quarter, Meta's turned negative for the first time since 2012, and Amazon's was negative $42.4 billion over the past twelve months. Only Microsoft is showing strict spending discipline, with free cash flow still positive.[3]

Apple, which reports results later today, has taken the opposite approach. Rather than building its own fleet of AI data centers or investing hundreds of billions in its own AI models, it has largely sat out the spending race and worked with partners such as Google to offer AI services. In this environment, investors seem to value its cash generation and spending discipline, with its shares hovering near record highs.

With so much cash going out the door, investors had little patience for any shortfall in results. Alphabet's operating income came in 6.5% below expectations, sending its shares down 12.6% on Thursday. Amazon posted record operating income, but its stock fell after its earnings missed expectations by 4% and advertising revenue missed by 6%. Meta's results topped forecasts, yet its stock fell more than 7% the next day after a securities filing showed the company could sell as much as $700 billion of new stock over several years to fund AI investments. Not even Microsoft could catch a bid in this risk environment, despite its stellar earnings.[4]

Capital Is the New Bottleneck

For the past few years, investors have focused on AI's physical bottlenecks, from chips to power to memory – benefitting the stocks of those firms. As we discussed in our last video update, the key bottleneck may now be access to capital. The spending plans of the largest AI companies have grown to a staggering $5.8 trillion, much of it not yet reflected on their balance sheets. To fund this spending, these companies must raise additional debt and equity. Unfortunately, they are competing for that capital with the federal government and other businesses in a U.S. market that has already absorbed $5.2 trillion in new debt and equity this year through October. And more supply is coming, with Anthropic signaling plans to go public imminently and OpenAI widely expected to follow.[5]

With the increased demand for capital, creditors and investors are becoming more discerning. Riskier borrowers, including the smaller data center operators that rent out AI computing capacity, now face much higher interest rates, with some of their bonds yielding near 15%. Conditions are tougher even for the largest firms. OpenAI last week had to cut its latest fundraising target by a third. And as mentioned previously, investors are even balking at new stock sales from public companies like Meta.

600 Central Ave, Suite 325
Highland Park, IL 60035
(847) 559-9700
www.fortllc.com
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The Google Search Question

Given our holdings in Alphabet, we thought a closer review of its results was worthwhile. Since the rollout of ChatGPT four years ago, investors have worried about how AI could affect Google's core search business. This quarter's slowdown in search therefore landed on an already nervous market. Search revenue grew 12%, short of the 15% analysts expected, and marked the second consecutive quarter of slower growth. With search generating nearly half of Alphabet's revenue, its results carry outsized weight for the stock.[7]

The underlying issue concerning investors is how Google will make money as search shifts to AI-generated answers. Management attributed this quarter's shortfall to a lag in monetization. AI Mode, Google's new AI-native search experience, is drawing more queries, but for now those queries generate less advertising revenue than traditional searches. Management believes it can close that gap over the coming quarters as it builds out advertising in the new format.[8] But the market is unlikely to give Google the benefit of the doubt until it sees results.

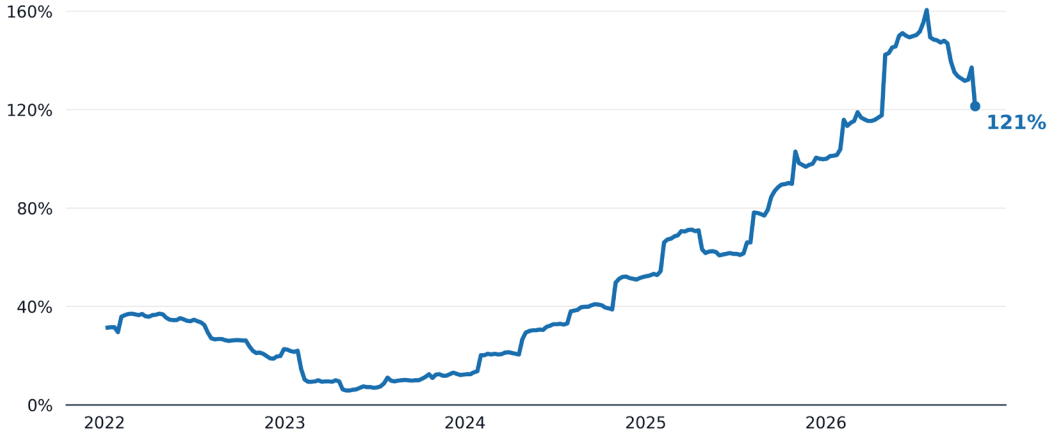
Much is going right at Alphabet, but search remains its core operating engine. While we remain constructive on Alphabet over the long term given its strategic position in the AI ecosystem and integrated control of the full AI stack (chips, computing capacity and models), we think the stock will likely struggle to regain its momentum until there is more clarity on the outlook for search. As such, we expect quarterly updates to take on increased importance.

Pressure Moves Downstream

With AI spending growth outrunning earnings growth for many of the hyperscalers, investors are beginning to recalibrate those spending growth expectations. Consensus expectations for growth in capital spending over the next three years for Amazon, Alphabet, Meta, Microsoft and Oracle – while still sizable – have fallen from more than 160% in late July to just over 120% today. Consequently, concerns over AI capital expenditure deceleration are now rippling out to the companies that supply the buildout.

Hyperscaler Capex Estimates Still Rising, but Growing More Slowly

Year-over-year change in consensus estimates of combined capital spending over the next three years for Amazon, Alphabet, Meta, Microsoft and Oracle



FORT SHERIDAN ADVISORS *Source: Bloomberg (10.30.26).*

The question now is whether capital spending expectations have topped out. If they have, that is a tough environment for the companies downstream of it. Peak growth usually means peak valuation multiples, and investors have begun to price in a deceleration. The key industry in question is semiconductors.

Since its high in June, the Philadelphia Semiconductor Index has fallen 27%, including a 7.2% drop on Friday. Chipmakers are investing heavily in new capacity to meet what has seemed like insatiable demand, with Chinese producers also adding to the competition, particularly in memory chips. Semiconductor history is full of cycles in which supply catches up with demand and eventually overshoots it, leading to falling prices and collapsing margins. The heightened investment by chipmakers just as hyperscaler spending growth is moderating has made investors nervous that history could repeat.[9]

Strength Beyond AI

Because AI-related stocks account for more than 40% of the S&P 500's value, any weakness in the AI complex has an outsized weight on the headline indices. Beneath the surface, however, many companies outside AI are reporting strong results.[10] In energy, Exxon Mobil's profit more than doubled from a year ago and Chevron's nearly tripled. Record refining results drove the gains, as the conflicts in Ukraine and the Middle East keep oil and fuel prices elevated. Exxon generated $19.1 billion of free cash flow in the quarter and Chevron $12.0 billion, far stronger near-term cash generation than most of the hyperscalers.

Health care has been the other standout. Large drugmakers have carried the sector to record highs, led by Eli Lilly, whose revenue grew 39% on demand for its obesity and diabetes treatments. Johnson & Johnson, Merck and AbbVie also beat expectations and raised their full-year guidance. While the pace of advancement in biology rivals that in technology, it draws far less attention. At the same time, investors and companies are growing more optimistic about AI's potential to speed drug discovery and lower costs. In a way, we think that gives health care exposure to AI's upside without the burden of funding the buildout.

Financials and consumer companies are also performing well. Visa grew revenue 13% and rebutted fears of weakness among lower-spending consumers. Mastercard and American Express also both solidly beat expectations. Similarly, among consumer staples, Coca-Cola, Altria and Colgate-Palmolive all beat estimates and raised their outlooks. Despite persistently high prices, the U.S. consumer seems to be holding in.

As investors reassess the path of the AI trade, we think they may seek out sectors with more modest valuations. For instance, energy and financial stocks trade at 13 to 14 times expected earnings, well below the S&P 500's 19 times.[11] The AI boom has drawn attention away from these companies, many of which are growing earnings and generating cash without the funding demands facing the AI leaders.

Concluding Thoughts

To be clear, we remain constructive on AI's potential to drive economy-wide growth, and to benefit the major technology platforms we hold. However, as the spending numbers get larger, investors will need proof that these firms are earning a commensurate return and that their core businesses are not at risk from the technology they are building. And if we are heading into a more capital-constrained environment, companies that can fund their expansion with internally generated cash flow are likely to outperform those dependent on external capital.

The major technology companies remain key holdings for us, and we expect they will be dominant businesses for years to come. But we also think companies outside the AI complex, including energy, health care, financials, consumer firms and businesses tied to the physical economy are positioned to perform well – oftentimes with less demanding valuations and a more stable balance sheet outlook in the near-term. Their earnings do not depend on the AI buildout, and many of them remain overlooked.

Sincerely,

The Team at Fort Sheridan Advisors

600 Central Ave, Suite 325
Highland Park, IL 60035
(847) 559-9700
www.fortllc.com
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Citations and Disclosures

[1] Bloomberg and Financial Times (10.30.26).
[2] Company earnings materials; Fort Sheridan Advisors, The AI Capital Bottleneck (10.22.26).
[3] Company earnings materials, October 2026.
[4] Company earnings materials and securities filings; CNBC (10.29.26); Bloomberg (10.22.26).
[5] Fort Sheridan Advisors, The AI Capital Bottleneck (10.22.26); Wall Street Journal (10.30.26).
[6] Wall Street Journal (10.30.26); Reuters (10.15.26); Financial Times (10.30.26); Bloomberg, (10.22.26).
[7] Alphabet earnings materials; Reuters, (10.28.26).
[8] Alphabet earnings call.
[9] Bloomberg (10.30.26).
[10] Bloomberg Intelligence (10.28.26).
[11] Company earnings materials; Reuters (10.28.26); FactSet (10.30.26); J.P. Morgan Asset Management.

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