

## CONNECTING THE DOTS

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**M**odern mercantilism and AI continue to drive nearly every big move in markets. Today, the pressure to grab resources as a result of these forces is accelerating, creating acute supply/demand mismatches in goods critical for national survival. At this rate, the world could soon be unrecognizable from the recent past, creating scope for rapid asset repricing.

In our recent CIO letter to clients, we describe how we're processing these ongoing shifts and the implications for investors. Below, we share some condensed highlights.

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## The Accelerating Resource Grabs in AI and Modern Mercantilism

1. **Modern mercantilism is driving the increased weaponization of chokepoints, creating acute commodity shortages and accelerating the global resource grab.**

The US's escalations in Venezuela, Greenland, and Iran are the product of a world governed by realpolitik with less deference to international norms, and in turn are catalyzing **a further breakdown in the US-led system of alliances and an accelerating bid for armaments and commodities.**

How the war in Iran plays out from here remains highly uncertain, but enough disruption has occurred, and the process of resuming shipments will be slow enough, that the commodity shock will persist for some time. But despite the still-wide range of outcomes for the war, the strain the conflict is putting on US alliances is more apparent, and **the value of self-sufficiency in all things has become crystal clear. US allies are moving quickly to establish such independence.**

2. **In the AI ecosystem, the resource grab is broadening out.**

**AI has reached the Barnes & Noble moment.** With the latest release of Claude Code, an upstart competitor has created existential risk for major businesses, much as Amazon posed to Barnes & Noble. Markets have started pricing in the risk to application software companies, and companies will either coevolve with AI or face disruption. Just as the original Barnes & Noble moment led to accelerating investment in the dot-com boom, we expect a broadening capex boom as many businesses increasingly realize the imperative of investing in AI. We suspect we're only in the early stages of market pricing of disruption risk.

**AI's bet on science has paid off, and the profits are fueling a further wave of capex and a looming shortage of compute, which will have to be rationed.** The leading labs bet that with continued exponential scaling-up of compute used in pre- and post-training, the models would keep improving. Agentic AI and tools like Claude Code are now generating significant profits and creating an explosion in inference demand as business adoption rises. There will not be enough supply to meet this demand while continuing to train the next generation of models, and how companies respond to these shortages and where they choose to prioritize compute will shape the next phase of the AI boom.

3. **The challenges of this environment create a need for real assets relative to financial assets.**

**Since 2020, countries have been increasingly confronting crises that demand access to physical assets, whether for defense, energy security, or AI infrastructure.** And public savers in particular are finding the difficulty of exchanging claims on future cash flows (i.e., financial assets) for critical goods (i.e., armaments in a war) at good prices. US tech companies are deploying their vast balance sheets to bid up critical tech inputs needed for the AI build-out. Adjusting to this new reality requires a shift in saving behavior following decades of continually more saving in US financial assets, which worked in an era where the primary crises were financial in nature. **For investors, the cash flows tied to producing, securing, and controlling these critical resources have become more valuable as demand for these resources has risen,** while hard assets like gold and real estate offer diversification against the vulnerabilities of purely financial assets.

4. **As populism, mercantilism, and the fallout from higher energy prices all create pressure for more fiscal spending, cash looks particularly unattractive.**

Policy makers will likely respond to the combination of a secular need to spend and already-strained government balance sheets by reducing the value of money to make debts easier to service rather than by imposing politically painful tax hikes or spending cuts. The limits of this approach are inflation and currency weakness, and those limits are drawing nearer, creating a complicated environment for financial assets relative to cash.

**A period of rapid change calls for diversification and agility.** It's clear that we are in a transformative period, but how any of these axes of change plays out remains highly uncertain. Diversification can bolster portfolio resilience to the wide range of risks, and agility enables investors to reposition as the picture of the world we're heading into becomes clearer.

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