MetLife Investment Management



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Investment Strategy Insights: Financing the Next Phase of AI

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About this Report

Our team believes that not only do differences of opinion make markets, but they may also foreshadow substantial moves ahead as these differences are resolved. Once a month, investment leaders from our global multi-asset, equities, and fixed income teams meet to share their diverse viewpoints. This report reflects those discussions and debates by providing insights on the topic of the month along with snapshots of our asset class views and convictions across the firm.

The AI narrative has largely been defined by demand. Whether discussing enterprise adoption, infrastructure buildout or returns on investment, investors have spent the past two years debating how large the opportunity could become. Increasingly, however, attention is shifting toward a different question: How will the next stage of growth be financed?

Recent earnings reports suggest the underlying economics remain supportive. While investor attention has focused on large capital raises and share price weakness among some hyperscalers, companies continue to reaffirm plans for significant increases in AI-related spending next year. Cloud and AI businesses continue to generate strong growth and attractive returns, while many of the operational challenges facing these companies are concentrated in slower-growing legacy businesses rather than in AI itself. Incremental AI-related investments also appear to be generating returns above existing corporate averages, supporting management teams' willingness to continue investing despite rising funding requirements.

The more pressing issue today is financing rather than fundamentals. While the economic case for AI investment remains largely intact, the scale of capital required to sustain the buildout is becoming increasingly difficult to ignore. Across credit markets, the common theme is not deteriorating credit quality, but the growing challenge of absorbing an exceptional volume of issuance over a relatively short period of time.

The investment-grade market provides perhaps the clearest example. Hyperscalers now represent a rapidly growing share of the investment-grade universe, and investors are demanding increasingly large concessions to absorb new issuance. Recent debt offerings have generally been well received, but order books have become less oversubscribed and borrowing costs have gradually increased as investors seek additional compensation for growing concentration and supply risk. This appears to be a technical rather than a fundamental issue, reflecting the practical challenge of financing one of the largest capital investment cycles in modern history.

Similar dynamics are beginning to emerge across other financing channels. In asset-backed securities (ABS), investor demand for data center exposure has become increasingly saturated despite generally healthy asset performance. New transactions have frequently required wider spreads, shorter maturities or structural changes to attract capital. Likewise, leveraged finance markets have absorbed substantial volumes of AI-related issuance over the past year, yet investors have become increasingly selective as future funding needs continue to expand. Private credit markets have also adopted a more cautious stance, particularly toward technology-related lending, reflecting a broader reassessment of risk across capital markets.

Importantly, there is little indication that these financing challenges are being driven by weaker end-demand. Hyperscalers continue to pursue ambitious expansion plans, NVIDIA chip pricing remains firm and rising, and activity levels across the broader AI ecosystem remain robust. Evidence from private markets suggests that suppliers supporting utility infrastructure, grid expansion and data center construction continue to experience significant pricing power and elevated profitability, highlighting the strength of demand flowing through the system.

The challenge, therefore, increasingly lies on the supply side of capital rather than the demand side of compute. Higher financing costs, investor concentration limits and a more selective funding environment are likely to increase the cost of future projects. As a result, the pace of AI infrastructure expansion may moderate from the extraordinary levels observed over the past two years. In our view, however, this should be viewed as a new phase of slower and more sustainable growth, rather than a reversal of the investment cycle. The adjustment process of this downshift in rate of investment can be painful for the market, but it sets up a longer cycle and lowers the risk of overbuild.

Ultimately, the discussion reinforced a theme that has emerged repeatedly throughout this year's AI debates. The primary risks facing the sector are becoming less about demand and more about execution, financing

and infrastructure. While the rate of growth is likely to decelerate as capital becomes more expensive and funding markets become more selective, there is little evidence to suggest that the broader AI investment cycle is nearing an end. Rather, the market appears to be transitioning from a period in which demand was the primary focus to one in which financing capacity is becoming an increasingly important consideration. The AI investment cycle remains intact, but its future trajectory is likely to be influenced as much by capital availability as by underlying demand. Such an environment favors the largest and strongest balance sheets, and may become increasingly challenging for smaller, leveraged players. Active credit selection takes center stage.

Conviction Score (CS) and Investment Views

The Conviction Scores shown below reflect the investment team's views on how portfolios should be positioned for the next six-to-nine months. 1=bullish, 5=bearish, and the change from the prior month is indicated in parentheses.

Global Macro

Tani Fukui

Senior Director, Global Economic and Market Strategy

CS 2.5 (unchanged)

The U.S. economy is performing well. While its base remains relatively narrow, stemming from AI and the wealthiest 20% of consumers, there are hints of a broadening. The labor market remains quite strong, with lower-wage workers seeing the most rapid increase in wage growth.

We expect the Federal Open Market Committee (FOMC) to raise rates in December and once more in 2027. Chair Kevin Warsh seems content to move deliberately, if not slowly. Meanwhile, oil prices appear likely to remain elevated well into 2027, versus prior forecasts. This would be growth-positive for the U.S. and other oil exporters, growth-negative for oil importers. Inflation risks, therefore, remain elevated globally, with developed markets continuing their hiking cycle. We expect two more hikes by the Bank of Japan (BoJ), the European Central Bank (ECB) and the Federal Reserve. Markets are pricing in the end of the hiking cycle via the two-year Treasury note.

European growth is expected to be stable or slightly up into 2027, with France an obvious area of concern. Japan is also likely to see a modest improvement in growth. A risk is the potential for more dovish BoJ appointments.

Credit

John Yovanovic, CFA

Managing Director, Co-Head of Leveraged Finance

CS 3.0 (-0.5)

Recent market weakness increasingly resembles a classic October risk-off correction rather than the start of a broader economic downturn. Investors are reassessing AI-related capital spending, higher interest rates, geopolitical risks and policy uncertainty. The result has been wider credit spreads, moderating equity valuations and a flight to quality in rates markets.

Beneath the volatility, the fundamental backdrop remains resilient. Corporate earnings are constructive, consumer credit performance is stable and default rates are low across most sectors. We see the potential for volatility to persist over the coming weeks. But the broader growth trend remains intact, supported by a resilient economy and ongoing AI-driven investment. With the 10-year Treasury still near 5% and the Fed expected to tighten only gradually, all-in yields are attractive across most credit markets for longer-term investors. We are mindful of the limits to that view. Inflation remains elevated, fiscal deficits are large and the capital needs of power, data centers and other infrastructure argue for a structurally higher term premium. We therefore expect any rally to be range-bound rather than the start of a sustained decline in yields.

Currency (USD Perspective)

Alfonso De la Torre

Sovereign Analyst, Emerging Markets Fixed Income

CS 3.5 (unchanged)

We are bullish on the U.S. dollar, reflecting Fed hikes and oil-related risks from Iran re-escalation post-midterms. While the dollar remains rich by both historical standards and recent ranges, near-term catalysts are likely to keep it strong, particularly against the euro. The latter remains under pressure as the end of the ECB hiking cycle comes into view and the risk premium from French credit spreads persists going into next year's election. Low-yielder status also makes the euro a strong funder candidate if and when investors re-engage in carry trades.

The Brazilian election triggered a sharp selloff in the Brazilian real (BRL), yet high carry and potential signals about fiscal execution should keep the currency supported into 2027.

Emerging Markets Fixed Income

Joseph Cuthbertson

Sovereign Analyst, Emerging Markets Fixed Income

USD EM (Sovereign and Corp.)

3.0 (unchanged)

Local Markets (Sovereign)

3.0 (unchanged)

October was a volatile month for EMBI and CEMBI spreads. After a sharp sell-off in late September driven by core rates, spreads recovered early in the month following softer data. By mid-October, however, spreads had once again moved wider on macro factors, with higher oil prices, AI concerns and escalating geopolitical risks in the Middle East all contributing to greater fears of weaker growth and higher inflation. In line with expectations, investment-grade credits outperformed high yield, with BBs outperforming Bs. Consensus overweights in sovereigns such as Argentina and credits with idiosyncratic challenges such as Cameroon and Gabon have performed worse. Countries, including South Africa, that have taken positive macroeconomic measures performed well.

We continue to believe that underlying country fundamentals are robust, but the easy improvements are now behind us. The recent IMF meetings shifted attention toward preserving the improvements in credit metrics made following the 2020/2022 shocks. Improved funding visibility, stronger buffers and more credible policy frameworks have ensured that even lower-rated credits retain access to the market. However, with competition for capital increasing and external funding needs rising, partly due to higher oil prices, the market is looking for countries that are maintaining fiscal discipline and ensuring policy sustainability. Countries that remain on an improving trajectory or are taking credit-positive measures should outperform going forward.

When we look at corporate fundamentals, credit trends remain broadly neutral, rating agency trends are broadly positive and default expectations are declining. On the technical side, primary issuance has slowed down, resulting in positive net financing, but the market continues to absorb supply. Overall, we continue to remain constructive on emerging markets corporates.

In October, local currency assets suffered as domestic bond yields rose and a stronger U.S. dollar provided a headwind. Country performance was diverse. Brazil underperformed following the surprise re-election of President Luiz Inácio Lula da Silva. Frontier names including Uganda and Egypt, which have attracted considerable investor attention recently, underperformed on concerns that higher oil prices will cause their terms of trade to deteriorate. Nigeria has performed better than other popular names due to its refined and crude oil exports.

President Lula's victory marked the first time since Brazil's return to democracy that a candidate who lost the first round of a presidential election went on to win the second round. This surprised hard currency, local currency and foreign exchange markets, where long Brazil positions were a consensus overweight on expectations that a Flávio Bolsonaro victory would be credit-positive. Instead, markets now face concerns that without ambitious fiscal reforms, debt dynamics are likely to remain challenging during President Lula's fourth administration given high interest rates and weaker growth. Our base case is that Lula initially adopts a moderate posture, seeking to reassure investors through his cabinet appointments and a limited fiscal adjustment package. Brazil's strong external position and substantial reserve buffers mean that any sell-off in hard-currency assets should be relatively contained and if valuations widen excessively, we will view this as a buying opportunity.

Multi-Asset

Amien Johaadien,

Portfolio Manager, Global Multi-Asset

CS 3.0 (unchanged)

The balance of factors driving growth is shifting from consumers to investment. Consumer spending is slowing as tax rebates and fiscal support fade, leaving AI investment as the main engine of growth and earnings into 2027. U.S. activity remains firm and a solid base for the next phase.

The next test is whether AI funding and adoption can keep pace with the computing power being built. Hyperscalers have gone from funding their infrastructure with free cash flow to long IG debt, and now they appear to be broadening out to funding with equity. With capex at some hyperscalers already exceeding operating cash flow, spending should continue next year at a slower pace. Token demand is still forecast to grow about 385% in 2026 and 126% in 2027, and a falling cost per token should broaden adoption and lift returns over time. As a result, expect a more selective AI trade, not a bust. Leveraged and richly priced names in semiconductors and neoclouds look most exposed; returns should favor companies that can fund their own buildouts. The focus is shifting from capex levels to the return on invested capital, and early margin gains are appearing. We still see 2027 as the likely inflection point, when AI productivity gains outweigh buildout-related inflation.

Overall, we remain neutral with a positive bias. Risks are building: a Fed hiking cycle, tight energy supplies, political resistance to AI and financing strains. Forward earnings and an S&P 500 Index at 18.7x offset those risks for now. Being neutral lets us position either way as the facts develop, while we keep our conviction in the long-term AI cycle, which stays constructive for risk assets over the medium term.

What to watch ahead: the path of real rates; Microsoft, Alphabet and Amazon capex and funding plans; evidence of AI returns on investment; and the impact of the new Congress and other political changes as a result of the U.S. midterm elections.

Global Equities

Chris Pettine

Research Analyst, Global Equities

CS 3.0 (unchanged)

AI-related spending and infrastructure buildouts have remained strong, with companies citing no weakness in demand and continued improvement in visibility. Investors increasingly are focused on the risk of spending decelerating in 2028, uncertain ROI, financing concerns, political pushback and power constraints. The recent White House AI Summit yielded a commitment to self-regulation.

U.S. consumers remain quite healthy and continue to spend despite higher gasoline prices. Bank loan growth is relatively strong and credit is solid. Potential for AI to reduce deposit switching costs would be disruptive. Industrial stocks have underperformed on macro fears and rates despite solid industrial activity and strong bottom-up fundamentals. Healthcare stocks remain inconsistent, with the most recent outperformance in life science tools, driven by increasing AI adoption in drug discovery.

We remain close to our benchmark in terms of top-down risks such as lifecyle categories, allowing us to look for bottom-up alpha opportunities.

Global Emerging Markets Equity

Taras Shumelda

Portfolio Manager, Global Emerging Markets Equities

CS 2.75 (unchanged)

Our main themes — the conflict in Iran and the risk of a peaking in AI-driven capex — remain unchanged.

In India, demand continues to be strong despite inflationary pressures, the start of a rate-hike cycle and external challenges. Bank credit growth continues. In China, some consumer sectors are showing signs of stabilization, but not enough to make the overall picture more exciting. We are monitoring earnings risk due to a spike in raw material costs and appreciation in the renminbi. In terms of sectors, the team is selective on the AI supply chain and positive on upstream materials and semiconductor equipment. We are looking to diversify into select financials and consumer exposures.

In Latin America, President Lula's unexpected win upended markets and made some investment theses less convincing. We are awaiting an announcement about the administration's economic team, but our mindset concerning Brazil is defensive. In the near term, investing in Brazil is too dependent on the macro picture, which in turn is shaped overwhelmingly by politics and policy.

EMEA has just begun its earnings reporting and investors will continue to digest the results of the U.S. midterm elections and what they will mean for the peace process in Ukraine.

The team sees attractive investment opportunities in the industrial, consumer, technology and financial sectors of emerging markets. We are less upbeat on utilities and real estate. In the light of the recent dislocations in Brazil, we are also reviewing earnings sensitivity and likely earnings forecast changes to many Brazilian stocks.

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