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Well, hello and welcome to the Dividend Cafe. I am your host, David Bahnsen. I have been inspired to write a piece on AI and the disruption that it represents to the software industry and to investors and to various other elements of the economy for some time, and various issues over the last month have come up where I have had to push it off—the stuff with the Fed and then, of course, all the things with the Iran war.

And yet today we're going to do it. And naturally, after I completed the Dividend Cafe early this morning, as I'm sitting here recording in the middle of the market day on Friday right before the market opened, the president did announce the Strait of Hormuz is open, and the blockade is working, and Iran's coming around and this and that, and markets are rallying and oil has dropped. And so those things, as I've been talking about for some time, were part of the conversation in very recent past Dividend Cafes, and I'm very happy to see the way certain things are playing out.

But I want to comment more on that, and I'm going to do that Monday in the Dividend Cafe. By then we'll have had a weekend of more analysis there. I do want to go forward with today's topic about the AI disruption thesis. I think you could argue, if it were not for the Iran war, this would be the biggest story in markets so far this year.

In fact, in early February, which was close to a month before the military operation around Iran began, you had a pretty substantial sell-off in the software space and a big question about not the AI thesis as in AI as an investment, but rather AI impact into software verticals. And so a tangential story became a really big one about the artificial intelligence disruption into various elements of the marketplace.

I want to suggest to you the very easy trifurcation, three-part separation, of categories of AI companies. I believe I've done this before, but we'll recap. There are the hyperscalers, the customers of AI computing power—the Googles, Microsofts, and Metas. Then there are the pick-and-shovel companies that provide the needed parts for this computing power, with chipmakers like Nvidia and Broadcom being obvious examples.

And then there are the makers of the language models—the LLMs, the so-called AI labs—programming, training, and distributing generative AI applications. About a year ago, the narrative was that everyone in this chain was a winner. The people paying for AI, the people receiving the payments, the companies building the tools, the companies producing the outputs, even the competitors and the users—all were considered winners.

It never seemed to occur to people that some of these assumptions might undercut others. Investors began to realize that some of these categories are adverse to one another, even within categories. AI labs compete with hyperscalers while relying on them. Hyperscalers compete with each other. And products created from AI may displace existing enterprise applications.

That is what drove the sell-off in February, as people began to question whether vertically integrated software companies would be threatened. Since then, sentiment has fluctuated, but I think there is a renewed optimism about the development of AI itself.

I want to reiterate that there is nothing contradictory about believing that AI represents a powerful technological transformation and at the same time recognizing that the commercial implications are not obvious or binary. AI products are incredible, but that does not mean every competing company is obsolete. Nor does skepticism of commercial outcomes require dismissing the technology.

This is a false dilemma, and we've seen it before. The internet did not destroy media; it reshaped and strengthened it. Social media did not destroy advertising; it expanded it. E-commerce did not eliminate retail; it changed it while high-end retail flourished.

The premises were often correct, but the conclusions misunderstood the dynamism of markets. Markets adapt, incorporate, and evolve. Disruption creates change, not necessarily destruction.

We are now in the phase of so-called agentic AI, where systems not only perform tasks but begin to act autonomously. Capabilities are advancing rapidly. There is growing confidence in AI's reasoning ability. I will continue to maintain that there are limitations, including philosophical ones, but that is not today's focus.

From a commercial standpoint, the key issue is disruption. It is undeniable that AI is making coding faster and cheaper. That poses a real threat to companies whose value proposition is tied solely to code. But those companies are fewer than many assume.

What is unique in this cycle is the reduction in switching costs. Historically, even better technologies struggled to displace incumbents because switching was costly. AI is reducing those costs, amplifying the threat.

At the same time, data shows that AI's measurable impact on productivity is still limited, though rising. Mentions of AI impact in earnings calls and surveys have increased, but we are still early.

Another way to think about this is that AI companies themselves are behaving as though disruption is real—massive capital expenditures to meet demand suggest that demand exceeds supply. That is true, particularly for the pick-and-shovel segment.

But the question is not whether disruption exists. It is how far it goes and where its limits are.

AI is fundamentally a pattern-recognition tool built on past data. New situations requiring judgment, taste, and wisdom remain challenging. Human intuition often involves risk awareness and "skin in the game," something AI cannot replicate.

There is still a need for human validation in many cases. Not all, but many. This is where I push back on the totalistic disruption thesis.

There is also an economic constraint. As Citadel's research pointed out, the computing power and energy required for full-scale AI deployment act as natural limits. Adoption and integration do not move as fast as capability. The speed of technological advancement exceeds the speed of economic diffusion.

Furthermore, many companies being written off have competitive advantages and time to adapt. The assumption that disruption is zero-sum is flawed. In reality, the total market often expands.

This leads to the investment question. We must avoid both extremes—assuming everything is broken or everything is attractive. The dispersion within technology is enormous. Valuations, growth, profitability, and exposure to AI vary widely.

We must look at companies individually.

Some companies benefit from network effects, deep integration with customers, proprietary data, and strong brands. But more importantly, the most compelling opportunity lies in companies that turn AI into a complement rather than a threat—companies that provide solutions, not just software.

Many investors talk about SaaS but focus only on the software, not the service. The service component—the human element, the consultative relationship, the integration—matters greatly.

This is where anti-fragility comes in. Some companies will not merely survive disruption; they will benefit from it by incorporating AI into their strengths.

So as we wrap up, there is real disruption. There is also real limitation. There is enormous opportunity and significant uncertainty.

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There will be winners and losers. But the idea that this represents existential doom for the entire software sector is misguided. Disruption is not sufficient as an investment thesis. It must be contextualized.

Finally, I want to briefly reference the chart of the week, which ties this discussion into credit markets. Technology exposure has increased across investment-grade bonds, high-yield bonds, and bank loans—not just private credit.

If one believes impairments are coming, it must be a broader credit story, not just a private credit story. These loans are senior secured, meaning equity would have to be wiped out first. So ultimately, the question comes back to equity outcomes.

I'll leave it there. Please reach out with any questions. Thank you for bearing with me this week in the Dividend Cafe. I look forward to being with you Monday to discuss markets, Iran, and where we go from here.

Thanks for listening. Thanks for watching. And thank you for reading the Dividend Cafe.