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Well, hello, and welcome to the weekly Friday edition, Dividend Cafe. I'm your host, David Bahnsen. I am back in New York City after a week in Miami, Florida, where I very much enjoyed the annual Hightower Advisors Summit, and we had some wonderful meetings and wonderful discussions there, but got back into New York City last night and this morning, Friday itself, got to write a Dividend Cafe about today's subject.

The subject was, is somewhat new here in Dividend Cafe. I mean, certainly adjacent to the subject I've written about many times. But the subject itself, which is data centers and what in the world all the fuss is about as it pertains to a sort of national conversation around data center that's taken over many categories of news from markets and financial media, but all the way into a lot of political, local news, all sorts of ramifications, technology itself, obviously, the way it all is a vital integrated part of the AI story.

This is not something that is new to many of you as a topic, and it's certainly, as I mentioned, not new in the news cycle but the way Dividend Cafe is gonna cover it today, I think you'll find to be somewhat novel. As is often the case, there is nothing new under the sun. We talk about topics sometimes as if they're brand new when they're not.

And in this case, in fairness, there is some definite newness to discussion of data center, but we need to go back a little bit in time

because data centers were not invented with ChatGPT three or four years ago. think it became a pretty national and prominent part of commercial real estate life in the United States over thirty years ago in the 1990s.

Data centers certainly are a major part, I mean, the physical facilities that house servers and that really made the internet possible even in the early stages of just simply processing email communications. Broadly speaking, a factory that rather than having widgets or parts has digital services is not new.

The data that has been stored and processed to make the internet possible was really a part of data centers going back into the 1990s. Now, a lot of it was smaller businesses in particular, were in a closet. Uh, IT centers that had a stack and a rack and servers right there. And I wanna make one point now that I'll kind of elaborate on in a moment.

These warehouses were filled with what's called CPU, essential processing units, and that's gonna be a distinction from where we- Are now for a reason I'll get to. But then I think the second phase, which became a very big deal, and now these physical facilities started to get a lot larger and people started to see 'em a lot more in various parts of suburbia or out in more rural areas or whatever the case may be.

But it's the kinda 2010s data centers are different than the '90s and definitely different than the AI story we're getting to in a moment. But what I'm really referring to is that which made the cloud possible, and now there is a need for a lot more storage. First of all, smartphones

took off, but the cloud computing elements really got hyperscalers involved.

And you did have massive facilities that at this point were housing tens of thousands of servers, managing the data, the traffic of cloud, of social media, and of streaming. And then, of course, this kinda third iteration data center is the one we're gonna talk about right now. And first and foremost, I should point out that they're largely housing something a bit different than CPUs, and that is GPUs, which is graphic processing units.

And I'm gonna explain why that matters here in a second. But the AI infrastructure, the need for this source of power for AI generative models, your ChatGPTs your Quads your Geminis they bring in first of all, significantly more processing of computation which requires a lot more space and a lot more infrastructure.

But I don't wanna get into the tech side of it, 'cause first of all, it bores me to tears, and I gotta think it's gonna bore a lot of you to tears. But I think that why I bring this up in terms of just the massive increase, exponentially so, in computations being done, so therefore the requirement for a lot higher quantity of these centers, which themselves, each one has a higher requirement of physical space.

But that most importantly, being basically a home for GPUs that take about 10 times more power than CPUs do, and it's oftentimes more than 10 times. And so then now you have a much higher energy demand in much larger facilities that require a lot more cooling. So there's a water and energy and power component as well.

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So they're not glorified server closets like the 1990s , but they're also not just mere warehouses like the 2010s. These are digital libraries, and they are of an industrial and technological sophistication, size, scale that is very unique. Well, why is an economist finance, investment, property like Dividend Cafe talking about this granularity of technology that is data center?

And the reason is this has become just a massive economic story. Without boring you with too much data The reality is that you could make an argument that data center construction and some of the adjacent components to it represent 100% of net economic growth last year. I think it's closer to 80%.

There's some cases that for it to be smaller, 'cause, ' the reason why it's, uh, gray is because it depends on how you're measuring certain things. Harvard economist Jason Furman, who was in the Obama administration, in which there's an awful lot of things that I disagree with him about.

He is a neo-Keynesian to the core, and I am, shall we say, not, and yet I know him to be a very straight shooter and honest broker, even when I disagree with him. calculated investment in technology to be about 92% of GDP growth last year, but that's including more than just AI infrastructure spend. It's including equipment and software, and so there's some murkiness there.

Renaissance Macro Research estimated the data center build-outs were higher dollar contribution to GDP than all consumer spending was.

Now, these things are weighted differently percentage-wise, but the dollar contribution, that's unbelievable. Okay? So what we know is it's a big, big deal, regardless of how you're exactly measuring it.

Total construction spending last year was down 1.4%, and data center construction was up 30%. So think of how much construction would've been down without data center, and by the way, that's construction, meaning there's shovel in the ground. There's money for approved projects. The amount that is committed or being pursued or targeted because it is not yet entitled, zoned, approved, et cetera, is exponentially more.

We're talking about actual dollars spent. The data center subcategory of construction was four times higher last year than So we're seeing something that's significant. Industrial production for IT equipment is up 80% since the beginning of the decade. The rest of industrial production, dead flat.

So I'm in the camp, S&P Global did a great study that suggests data center construction and adjacent is about 80% of last year's GDP growth and I think that they make their argument cogently. So this is a big deal for the entire state of economic growth The question, though, is more than just what it represents now in economic growth, because these hyperscalers are not spending this kind of money, there is not this sort of investment going into data center if there isn't some belief that it contributes to a lot more economic growth later.

At some point, you have to get some productivity on the other end of it. What the data centers are building and facilitating, I've talked about

this before with the overall AI dominoes, the language models have to then w- be essentially transferred into some sort of product that is used by businesses at an enterprise level or consumers to drive productivity and drive quality of life and all these things.

And there's lots of arguments that's gonna happen in spades. How it's all economically measured, we don't exactly know. But what's on the line here for data center investment is not just merely what the investment is in the here and now, but what it's supposed to be creating for the future as well.

This is a grow- this is a conversation about present economic growth and future economic growth. And it, kind of helps to mask something, a sort of quiet part of this that needs to be said, which is, if this is such a huge percentage of economic growth right now, what is not taking place in the economy?

Well, very muted multifamily development. office construction has gone negative. Overall commercial real estate, even factory construction that's non-data center oriented - has gone completely flat. Across the whole industrial cycle, there is just this really significant contribution from data center and then either negative or flattening across everything else.

And so the economy has kinda gone all in on a, particular play. The analogy I've become fond of using, first of all, I'll give a hat tip to my friends at Strategas Research because this was a sort of articulated comparison that I first got from them, is in comparing it to the fracking, the shale revolution, if you will, of 2010, '11, '12, whereby significant

capital expenditures were going into hydraulic fracturing and horizontal drilling, but almost nothing else post-financial crisis was happening there.

So you had a disproportionate contribution from a single sector, single investment, and that's a very good thing, but it was masking that there was a lot of muted economic activity in other sectors of the economy, and it's really quite similar. But where Strategas Research was making the analogy is in the other part that I want to point out now, is that this was a very disproportionately positive part of economic growth with fracking 15 years ago and with AI data center now But it was very politically unpopular.

It was very culturally problematic. You had a lot of people against it, even though it was, like, the big thing going on in the economy. Then it was much more partisan. It was divided up among a red state, blue state thing, and there was definitely an administration at the time.

I think the Obama administration did not get enough credit for being reasonably supportive of what was going on. But a lot of the reason they didn't is they didn't wanna talk about it because their own base didn't really like it a lot. And that's not quite the case here, where there is a significant concern and cultural stigma around this major catalyst of economic activity with AI, but I don't think it's as partisan.

I think it's either bipartisan or nonpartisan, depending on how you look at it. And so there's a great analogy there in the data center moment now to fracking then of some questions about public sentiment and popularity in a both political and cultural context around this thing that

is very economically catalytic to current growth, and in fact, we're dependent upon it, in the very short term.

My own position is, like so many things these days, requires nuance, and it gets lost in a black hole of nuance where I would s-say to you I'm overwhelmingly for data center, and I'm overwhelmingly against the federal government telling cities, counties, ordinan- local places that they have to bypass their own ordinances to get these things done.

I think that there should be the right separation of powers. There should be Tenth Amendment, federal localism, federalist localist approach, and if a particular municipality doesn't want a data center in their backyard, they don't have to have one. And then there's trade-offs to that, and they will live with the trade-offs.

But I do not support Washington, D.C. running roughshod. So on one hand, I think a lot of municipalities are, wise to say we're concerned about the energy consumption. We're concerned about water needs. I mentioned the cooling factors earlier with GPUs versus CPUs. And I think that there are some that are just rank NIMBYs that are saying, "I like not looking at things I don't like looking at, so I don't want a data center twenty-two miles from my house that I might have to drive by. "

Tho-those things are a bit different, but the point being there are zoning laws and entitlement ordinances at play that I don't think should be bypassed. If they're not being bypassed for a local pub or a church or a Costco, then I'm sorry, I don't think Silicon Valley billionaires should get them bypassed by Washington, D.C.,

no less. So all at once, I can be pro-data center and pro-growth investment for the future for risk-takers. I think the cost of the risk-taking should be borne by the risk-taker. And I think it mostly is, by the way, but I do not support crony deals and I do not support violation of the Tenth Amendment.

However, I do support data center and growth and investment so forth. So if somehow some people can wrap their arms around the fact that both those things can be true at hand, maybe you can follow the consistency of what I'm trying to suggest. But what's going on now Townships starting to pass ordinances blocking all data centers, even where about 25% of hyperscaler computing comes from power comes from, this data center corridor in Northern Virginia.

Loudoun County is starting to push back. Certain states have flirted with bills. Maine actually passed one at the legislator, and then the governor vetoed it. So this thing is not done. I mean, the political toxicity around this at either a st- a city, county, or state level is significant. And I would suggest that's okay even though if I were in some of the localities, I might ha- be supportive of the blockers in one and not supportive of the blockers in another, depending on those local circumstances, okay?

But where do we go from here? Well, what's ironic is you absolutely have to have these data centers built to have this whole thing come together and for the computing power that is required and the electricity generation needed to fund these GPUs. If this whole story is gonna happen, you need more. But I'll tell you, the CEOs of these

companies don't act like they wanna win the PR war very much, and they're going to have to.

But in the meantime, I'm perfectly fine to say that the trade-offs that exist in some people wanting data centers and others not, it's okay, and everyone can live with those trade-offs. Let me read It to you the way I put it in Dividend Cafe here. I don't think making the case out of fear and panic is going to work.

I don't think scaring people that China's gonna beat us is going to work. But I also don't think that not making the case is going to work. We really need data centers, and they're gonna benefit your lives so much, but we don't care if we have your approval or not, 'cause we're just gonna ask the White House to override your city council.

I don't think that's the right play to win friends and influence people. The need of the hour is a massive public relations effort that would be economic, political, and cultural, but done in the spirit of the social contract of our economy. And it has gotta be rooted to, and I'm gonna give you five things here.

A, the economic reality, the data center AI CapEx is vital in the present economic moment. That's an pretty easy case to make. So make the case. Number two, the economic reality that if AI is gonna deliver the future promised productivity growth that people have promised, it's vital for a future economic moment.

Go make that case. Number three, the local sensitivity. We have zoning laws, we have community processes for a reason, for good or for bad.

So honor those processes the way other businesses do, and do not seek to bypass them just for billionaire Silicon Valley folks. Number four, a disdain for cronyism has got to be front and center.

Where water, power, other costs are socialized, but the profits are privatized, that has got to be rejected. Number five, the realization that the energy needed to power the construction and investment requires more natural gas and more pipelines to get the natural gas there If you can't make that case, and if you don't understand that, you don't understand the whole data center story.

I don't think there's enough totality in this entire narrative. I'm not against building more data centers. In fact, I'd argue right now it's the biggest thing we have going for the economy. The data's rather clear. But I assure you that not all of these data centers are created equal, not all the data center sponsors are created equal, not all the projects are.

Much like the pipeline analogies of 15 years ago when I talked about fracking shale revolution, there's different counterparties, there's different funding models, there's different contracts. There will be winners and there will be losers. And that was so, so true in the shale revolution, and it is so, so true in data center.

When it comes to direct data center investment, be discriminating. Sponsor quality is paramount, and I'm telling you right now you're gonna see how right I am about this. And there's people that do not take this seriously are gonna be wrong, and they're gonna learn it the hard way. I don't think there's any basis for rejecting societal norms and constitutional structures to accommodate commercial actors.

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I think you can let localism play out and let different communities experience those trade-offs the way they want to, and that will lead to some that are very pro data center, some that are not, and some that have different particulars, and I think that's fine. The adjacence to this story for investment opportunity is where I would focus, not necessarily the story itself.

Power generation, utility output, water, natural gas, natural gas pipelines. There's a lot more to this from an investment standpoint than just the mere data centers. But in the end, like AI, data center is not an end, it is a means to an end, and the data centers have to create computing power, so the computing power can fuel AI tools, so the AI tools can drive productivity.

And those dominoes have a lot of risks and rewards within them. Stuff that can go wrong, stuff that can go right. That is the investment story here. That is the broader point I'd make around the data center particulars as we fight through this as if it were just a NIMBY story. There's a lot going on. I hope this is helpful for your thoughts when you think about this from an investor standpoint, and I welcome your questions anytime.

I love the topic. A lot more to say in the weeks, months, years ahead. In the meantime, thank you for listening Thank you for reading. Thank you for watching The Dividend Cafe. Monday is Memorial Day, so we'll have no Dividend Cafe on Monday, but I'll be with you next week. I'm in different cities in Texas each day next week, speaking and meeting with clients.

And then I'm at the Reagan Library next Friday, uh, part of the Reagan Foundation's Annual Economic Forum, where I'll be speaking with Secretary Besant and Jamie Dimon, amongst other luminaries. Looking forward to that, and I believe I'll be recording The Dividend Cafe from the Reagan Library next Friday.

In the meantime, happy Memorial Day weekend. Take care