

DIVIDENDCAFE | PODCAST TRANSCRIPTION

FRIDAY – OCTOBER 30, 2026

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Well, hello, and welcome to the Friday edition of Dividend Cafe, where today we are going to talk about all the fuss of credit risk in the AI investment space. And I want to make very clear, this is not gonna be a boring topic. If I wanted to do boring, I'd be talking about the midterm elections, which are boring me on a daily basis out of my mind. But they will not be boring, the midterm election results, when they're done. So a week from now, we'll have all that clarity and no longer be boring ourselves with worthless projections and forecasts, and instead be looking at what actually did happen. So next Friday's Dividend Cafe will be about the results of the midterms and what it means for investors and so forth and so on.

But for today, we're gonna talk about AI credit risk. I, first of all, am dressed down for today's Dividend Cafe, not because it is an unimportant topic, but because this is how I am dressed today because I have to go get a whole tuxedo on for a gala event I will be at on Thursday night. I'm recording this Thursday afternoon as opposed to my normal Friday morning recording. And I believe, and I know my content team, certainly Brian and Glen, would remember, I think there were a couple years in the past where I had this gala event I have to attend on a Thursday night each year, where I actually recorded Dividend Cafe in the tuxedo that I will now be wearing this evening. But we're not gonna be doing that anymore. And so this, what you see is what you get today. What you see is not necessarily what you get in terms of the AI credit story.

I wanna be very clear that I am not saying anything right now. I'm not about to say anything that you ought to take as melodrama. First of all, I am not a perma-bear. I always say that, how do you tell if someone's a perma-bear or not? The perma-bear doesn't have any money. But my joke aside, if I'm joking, is that the comment is important in this sense. Things said for shock-and-awe value, things said for clickbait, things said to kinda get people's attention are counterproductive, in my opinion, because I think they desensitize people to things that actually really matter. I, first of all, believe that any comparison ever to things that are 2008-oriented is often gonna be done in bad faith, is often gonna be done as a fear-mongering tactic. And I also think it is done out of ignorance in a lot of cases for the very fundamental reason that 2008's unique proposition was the nature of its impact inside of our banking system. And as concerned as I am about some elements that we're about to talk about regarding AI credit, the interconnectedness therein, the reality is it isn't touching inside of our commercial banking system, and there's certain elements since 2008, both in our capital markets and in our banking system, that are just categorically different.

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And no matter how much people love fear-mongering and tragedy porn, you're not getting that repeat. You can find things that will rhyme, and we will have other very bad events, and there are big risks in markets and in the economy all the time. But trying to get a repeat is, to me, unhelpful. And yet, at the same time, there are certain parts of the jargon involved. We're gonna start talking in a moment about credit default swaps, and that's language that I don't think was very embedded in anybody's vocabulary before 2008 and into the aftermath of '08, when we realized the role that CDS spreads played in some of the systemic risk and the contagion that took place in our financial system.

What I am saying to you as to this urgency of topic today and my passion around the topic is I made a commitment to myself and to my clients at the point of the financial crisis almost twenty years ago that I was never gonna take credit risk lightly again. And when the 2011 Europe moment happened, and when we had some of the 2018 high-yield disruptions, you could look at both 2015 and 2020 in the energy sector, some of the private credit issues that we discussed earlier in the year, even this year. Some of these things are varying degrees of real risk versus perceived risk versus questions. But in each case, I took it seriously because this is a permanent belief of mine that major market events in history almost never start in the stock market, that they almost always start in credit markets and then bleed. So no, this isn't a boring topic because if you're listening to Dividend Cafe, you must have some interest in investing, markets, and economics or economic activity to begin with, and this topic affects all of those things no matter what one's direct exposure may be to AI. So let's walk through this and have a little fun together, shall we?

I wanna start with a chart, and I don't need you to read it. I don't need you to pay attention to it. I don't even really necessarily want you to, but there's a reason I'm putting the chart up. We're gonna throw it up on the screen now, not because of the actual content and message, all of which I think is actually quite interesting and helpful, but it comes from a gentleman named Michael Burry, who became famous because Christian Bale played him in the movie *The Big Short*. And Burry was famous for having a short position on some elements of the mortgage bond and mortgage CLO space going into the financial crisis. And I follow Michael's research. I think he's a very engaging and intellectually interesting read, and I don't always agree with him, but there's an awful lot of people I read and pay, by the way, a very high amount of money to read, even when they're not necessarily people I always agree with or, in some cases, almost never agree with. But I think that there's a certain part of intellectual curiosity that requires me to do that.

And this chart right now is up there for no other reason than to point out what Michael's doing here is looking at the Byzantine nature of the financing structures, the credit and financing risk that takes place in the AI ecosystem. And in here, he's only using one example. One AI company, a big one, a frontier lab that is preparing to go public by the name of Anthropic, that

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has \$537 billion of commitments for compute alone, with another couple hundred billion dollars of commitments for TPU and GPU capacity. And sometimes these commitments are to companies that already have good cash flows, like Google. Other times, these are commitments to companies that don't have cash flows or positive cash flows, like SpaceX. But it is an unprecedented level of spending commitment from a company whose revenue is a tiny, tiny, tiny fraction of the revenues that will be needed to cover these commitments, and you see the way it moves and impacts so many other companies involved in the ecosystem of this.

What I wanna get to is that there are companies that have bought preferred stock in this company making spending commitments to them. There's companies that have bought various notes, convertible notes, and going public in an IPO might very well level and horizontalize a lot of the balance sheet, that it would replace a lot of this debt and preferred structure with common stock. That's one of the great advantages to IPOs, is how it can levelize the balance sheet. But listen, what you have is a very complex picture, and what you have is a situation where many of the people that companies like Anthropic, that a lot of the major AI players, they have made spending commitments to companies that have then issued debt and equity or a combination thereof to them for them to use that money to pay them for the order, and then there are counterparties involved, and that's the essence of it. Take away the complexity of the chart we had up on the screen. That's all you need to know. And I'm gonna come back to why I think this matters in a moment.

Now, we're gonna put another chart up here, which is the cost of insuring a default, insuring against a default in Oracle's debt. Five-year Oracle senior bonds, that cost has skyrocketed in recent months, like more than tripled since the beginning of the year. And so you could say, "Oh, well, there's a growing concern about the credit of Oracle." I mean, after all, they have a heck of a lot of debt, and there are questions about the whole structure. But I wanna point something else out. The volume of credit default swaps in this space, not just Oracle, across the hyperscalers and AI debt issuers, the volume is up about 500% in the last few months, three months alone. Investors are paying more of it, but they're buying more of it. They're paying more for it, but they're buying more of it, too.

And I think that it being protection against companies like Oracle, SpaceX, Google, Amazon, Meta, NVIDIA, Broadcom, all of the cast of characters, that when you look at the volume of credit default swaps insuring against a default, the volume is higher in nine months this year than it was all of last year, and substantially so. But AI-affiliated debt issuance was about \$100 billion last year, and it's already \$466 billion, almost \$500 billion this year. In other words, there's a lot of time on the clock, and this could very well end up being like 6X the amount of debt issuance this year versus last year. I've never heard of anything like it. I've never seen a year-over-year increase in indebtedness in one singular niche sector like this in my life. But it

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does stand to reason that a greater amount of debt rationalizes a greater volume of insurance against that debt. The two sort of go together.

I don't buy the idea that the greater cost of the CDS, the credit default swaps on these companies' bonds, is entirely related to greater fear of credit deterioration or fear of a default risk. Let's put another chart up here that shows how all of these credit default swaps have gone up with companies like Meta, with companies like Google, with companies like Microsoft, but then also with SpaceX and AMD and others, Oracle, that are not in the same exact credit profile. All of them have gone up, but some are still cheaper than others based on their own other cash flows or whatnot. But I guess what I would say is, I don't really believe that people think Microsoft's gonna default on a bond. I'm not saying they won't, but I will say if you put a gun to my head, I would not bet that any of these companies are gonna actually default in a senior debt position. But I think that the credit default swaps cost more, whether that fear of real default or rational fear of default materializes or not, by nature of market dynamics, technical factors, liquidity, the very issuance we're talking about.

When you see this kind of growth of debt issuance, you have to see more hedging against it because the people buying it want to be able to buy more of it, but they have to lay off some of that risk. And that leads to more and more default swaps, which leads to more and more visibility and transparency in the market, which is the point I'm about to get to. So when we talk about this Oracle example, they have \$273 billion of purchase obligations, uncommenced leases that are on their books now. They do not have an earnings base that can cover that. They have \$120 billion of other long-term debt on the balance sheet, and there's just a wide array of accounting things going on.

Okay? So look, if I get into the weeds of all the accounting complexities that exist with Oracle, with some of these other companies we've already mentioned, I will end up being more boring than I want to be, and I'm gonna cause some people to go, "Oh boy, this sounds sinister. This sounds illegal." But see, none of it is. My intention, though, is rather to just ask the question why. Why are some of the companies doing this? Why extend the useful life of assets to spread cost over a longer period of time? It's legal, it's accounting legitimate, I have no doubt about that. But is the motivation for this accounting mechanism concerning? Why are we seeing revenues that are essentially gonna come in 18% to 20% less than the way they're being shown because their customer prepaid orders where the interest expense gets added to the revenue, and that's totally legal, but it misstates what these revenues really ought to be thought about at a headline level.

I could go into more and more of these detailed things. There's so many across so many companies. But I'm not making any accusations of anything untoward. What I'm doing is saying that the best-case scenario is that there's a hornet's nest of accounting complexity. The worst

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case is there's shenanigans going on, and my base case is that a lot of these things are can-kicking measures that provide some cosmetic benefit legally in accounting now and then catch up to you later. And I think all of us should ask why. You can be cynical, you can at least be skeptical, but I'm paid to do this, to be paranoid, to be protective. And I think that stuff may be done within the law and may be done ethically, but it does to me ask why companies are going to the extraordinary level of complexity and risk for something that is creating zero new customers, zero new growth, zero new market share. It's rather just dressing up some of the accounting around things, again, legally. I'm allowed to ask why. You should ask why. And I think that if we're in the golden age of productivity and the biggest boom we've ever seen, you would maybe not see some of the accounting mechanisms we're seeing around some of this.

But back to the issue of the credit default swaps that people are wondering about, what does it indicate? Are we seeing credit deterioration in this space? And I think what you're gonna see in the couple of years ahead is a serious tension about whether or not credit conditions in AI are the news or a sign of the underlying news. In other words, I think back to 2008, again, just to make an example that is imperfect for reasons I stated earlier, that there was a point in which we saw credit default swaps in some of the financial firms blowing out, and you could say, "Oh, wow, they're telling you things have gotten bad at the Wall Street banks." And yet this was right after Lehman had gone down and AIG had gone down and a few months after Bear Stearns had gone down. Now, I'm pretty sure we knew things were bad then, but what happened was, like, when companies like Morgan Stanley or Goldman Sachs were seeing their credit default swaps blow out, it was not merely a sign of the news, it was the news itself, 'cause it led to a run on those banks. It led to a decline in equity. It led to the need for significant new capital.

And so when you look at a story like this, we'll put a chart up right now of the credit default swaps at CoreWeave, and that became a pretty big story over the last week or so. This is genuinely a troubled situation here. I mean, you see, in a reasonably short period of time, the cost of insuring their debt almost triple and triple to a level that is extraordinarily high, that is pricing in a very high possibility of a default. And yet I would suggest that that's in the case of a very troubled, deteriorated risk situation. But then it could lead to more collateral, it leads to tighter liquidity, it leads to higher cost of capital, it leads to more urgency for equity deals. And I think you're gonna see other companies wanting to come transact, particularly counterparties, with a company like this. It's gonna lead to more restrictive contract terms in various AI transactions. It reprises various elements of the sector.

So there's a credit risk embedded in all of this, for sure. But I think the need for finite resources to fund what really seems like an infinite need for expenditures could end up leading to a supply of protection that is inadequate for the demand and, at the same time, enhances the visibility, the transparency, market signals, and creates its own reaction function. And this is, to me, one of the most important elements. I'm gonna read it word for word from Dividend Cafe.

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The stock prices will be impacted, the volatility of the stocks will be impacted. But the cost of credit and cost of protecting that credit will tell us about the AI story, all the while ending up to shape the AI story itself. And this is something I'm very, very confident will play out.

So we have not had to think about the interconnectedness of all this much in the context of the cost of capital. We've talked about returns on invested capital and when they will come and what they will be, the risk around those. I think that the ability to refinance for many is gonna be an issue. There is a lot of things that can impact equity valuations here. But ultimately, the classic negative feedback loop, in my opinion, is where you basically have a rising cost of capital that limits profits on projects, then kills some projects altogether. That reduces capital expenditures, which reduces the revenues and the profits for some of the major suppliers who are financing much of this, which then cuts off or limits more financing, which increases cost of capital more. Rinse and repeat.

That's the negative feedback loop, and the interconnectedness and the circular financing and all these things we've talked about, that's where the rubber meets the road. That's why the CDS spreads and things that people are bringing up around credit deterioration matters, even if you don't believe there's going to be a default in any element of this. So I think that for all the talk in the AI ecosystem about valuations, about presumed growth rates, about return on these investments, I understand we're living in one of the biggest CapEx booms in history, the percentage of GDP it represents, all of this stuff. And we could talk about the positive elements too, where AI will enhance productivity, where AI has already or will in the future drive better margins, where there will be a lasting boost to the American economy. I mean, there is a partially full glass here too, and I don't ever wanna lose sight of that.

But what I'm referring to here is a vulnerability that I can't avoid that's inside, outside, within the AI story. That's the credit risk that I think represents a tremendous concern to the entire sector. You can have a default in a neocloud company. I don't think that's a systemic or contagious event necessarily. But you may have a non-default in a hyperscaler, but that still comes with some sort of a spike in CDS spreads. And in that case, the rising credit fears, the impact on cash flows, we're talking about a whole story that's already on a razor's edge. And I think that the messy Michael Burry chart indicates the interconnectedness that's at play with a lot of these companies, the complexity in some of the structures and counterparties, counterparties to the counterparties. I don't know how these vulnerabilities could be any more obvious. I think a lot of people are programmed to want to ignore it, and I understand that.

And the fact that some people worried about it cannot and will not, I certainly will not, offer certainty around what will happen and certainly couldn't offer timing around it, that causes some to say, "Okay, well, there's nothing to be done here." But I think that the largest need of capital in history all at once is susceptible to more onerous financing conditions, is susceptible

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to a lack of access to needed capital. It's susceptible to a number of things, and this is all at a time when there isn't a great deal of clarity around what returns on all this invested capital's gonna be. I'm gonna close you with the same way I closed the written Dividend Cafe. We intend to look closely at where credit markets indicate particular problems, the neoclouds are an example, but versus general problems repricing across the space.

Those general problems are what we care about, and we think credit markets are gonna be very important in understanding all that. We do not intend to assume they will all stay isolated if financing structures or a more fundamental questioning of the whole cycle come to be questioned. Credit spreads matter, the credit default swap spreads matter, and the feedback loop can be monumental. It may not be 2008 monumental, but monumental nonetheless. So to that end, we work of diligent understanding of credit concerns in AI as a leading indicator to where the overall story goes, both in equity and in the broader economy that has become so incredibly dependent on this story.

Thank you, as always, for listening, watching, and reading The Dividend Cafe. I look forward to a special event we're doing next Thursday with Mark Halperin at 2:00. The link is in dividendcafe.com to talk about the results of the midterm elections. I look forward to being with you in The Dividend Cafe on the same subject next Friday, and of course, I'll be with you in our very first Monday Dividend Cafe of November on Monday as normal. In the meantime, have a wonderful weekend. Clocks are setting back. Thanks so much. Have a good weekend.