

TSCM Flash Thought

DeepSeek - AI Dilemma or Investment Opportunity

What happened?

- DeepSeek made waves this week after the Chinese AI lab released their reasoning model 'R1' which was reported to be similar to OPENAI's newer o1 model and ANTHROPIC's newer Claude 3.5 Sonnet model with significantly less investment.
- Reports suggest that DeepSeek R1 reasoning model was trained for ~\$6m, which is the most surprising revelation as it calls into question the necessity of the billions already spent by U.S. hyperscalers.

Why did the market sell off on this news?

- Heightened concern that spending on semiconductors and related capital equipment will slow or decline if AI or LLMs (Large Language Models) can be done more efficiently.
- From a stock market perspective, the AI theme boosted the semiconductor space since 2023 making AI-related stocks heavily crowded on the long side coming into 2025.
- As the market seemingly rushed for the exits on these AI stocks, high passive ownership by index funds and leveraged ETFs contributed to the dramatic sell-off.

Is the party really over for AI semiconductor infrastructure?

- With DeepSeek suddenly demonstrating a more efficient way to develop LLMs, the fear now is that deceleration and decline will come much sooner than expected.
- We believe these fears are overblown in the near term with uncertainty driving the market to overreact to the downside.
- In their earnings reports a few days after the DeepSeek announcement, Meta announced plans to invest "hundreds of billions of dollars" in AI infrastructure over the coming years and Microsoft targeted \$88 billion of capital expenditures this fiscal year.

TSCM's Perspective on the Technology Hardware Landscape

- Total AI spending expectations are unlikely to change materially over the next few years - the arms race is too powerful of a driver for the industry to suddenly change course.
- If DeepSeek or other new entrants make AI or LLMs more available to a broader user population, that should further increase overall demand on the tech infrastructure.
- These types of changes or disruptions are a feature, not a bug, and one that experienced technology investors have seen before.

As quality growth investors with a strict focus on fundamentals, we will continue track the short-term dislocations in the market. While much of the attention has been on technology's megacaps, we are closely monitoring the small and mid cap companies in that ecosystem.

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