



Wealth Management
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Cooper Wealth Management of
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Thoughts on the market

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The New Industrial Revolution



“The promise of artificial intelligence and computer science generally, vastly outweighs the impact it could have on some jobs in the same way that, while the invention of the airplane affected the railroad industry, it opened a much wider door to human progress.”

- Paul Allen – Co Founder of Microsoft

The artificial intelligence industrial revolution is upon us. Computer processing power is growing at an exponential rate never seen before and the full impacts on the global economy and society have yet to be determined. While we don't have a crystal ball to predict the future, we can draw on history to inform us how events might progress. This month, we will compare the development of the US rail system to the current AI buildout to try to shed some light on the potential effects on jobs, inflation and corporate earnings.

The market's greatest fear regarding AI at the moment is the level of spending. The major developers have spent \$2.6 trillion year to date, and while companies have begun to take on debt, balance sheets and cash flows remain healthy. This level of spending pales in comparison to the cost of developing the US rail system.

By 1870, the US railroads had total debts of \$1.5 billion. To put that in perspective, the total US money supply at that time was \$1.2 billion. The railroads actually owed more money than was in circulation. In today's dollars, \$38.3 billion. How did they manage it? The US government granted the railroads 180 million acres, or almost 10% of the continental US, at \$1.25 per acre. They did use 62.3 million acres for rails and sold the balance of the land between \$2.50 and \$10 per acre, depending on usage and distance to the rail line. Investor money was also an important factor but massive borrowing was still required.

The funding of the development of AI has some important differences. There are no government handouts. The US government did invest \$8.9 billion in Intel and received 9.9% of the company in exchange. If they had done that during the building of the railroad up to 1870, they would have likely owned most of the US rail system. Railways don't make money until they are completed, but AI companies are already generating billions in revenue. Also, the major AI companies already generated billions in revenue from their existing businesses. For example, Alphabet, the parent company of Google, made \$62 billion in the first quarter of 2026 but still borrowed \$31 billion for AI expansion. Seeing that level of borrowing on its own would be worrisome but in context, it's manageable. We have been concerned about borrowing in past letters, but at this time, debt levels of the AI developers remain acceptable. The bond market met Alphabet's \$25 billion US bond offering with enthusiasm and there was total demand of \$115 billion. They even managed to sell some 100 year bonds at 6.125% and still maintain an investment grade credit rating. We are nowhere near the debt levels of the railroad era and the cash flows continue to grow.

One of the biggest differences between the two eras is inflation. In 1870, the US economy was in a deflationary period and the general level of prices fell by 3.68% with the freer movement of goods. The railroads were paying principal and interest with dollars that had more purchasing power than when they borrowed. By contrast, the US inflation rate currently stands at 3.7%. By the time Alphabet has to repay that 100 year bonds, assuming the historical average inflation rate of 2.1%, the dollar will only be able to buy about 15 cents worth of goods. The key to today's inflation is energy prices, particularly diesel. According to US market data, approximately 14.9 million barrels per day are moving through the Strait of Hormuz, down from 17.3 million, largely accounted for by the absence of Iranian oil due to the US military blockade. Crude oil flowing is a good thing but we won't see prices at the pump decline until the oil is refined into gas and diesel. Refinery capacity has been reduced due to damage both in the Middle East and Russia. The market's ongoing concern is what Iran will do next. Economically, Iran is being crippled. The local currency, the rial, started the year at 1.5 million rial to one US dollar and now stands at 2.5 million to 1 versus 33,000 to 1 in 2018. Their inflation rate is 89.8% as of September. A desperate country may try extraordinary measures in the search for relief. Given the approaching US midterm elections, there is concern Iran may try to damage additional oil infrastructure in the Gulf. Whatever the case, we view it as unlikely Iran would give in prior to the elections.

Another interesting parallel between 1870 and today is interest rates. Interest rates peaked in 1873 at 6% and did not rise above that level until the Baby Boom inflation period of 1973 to 1999. Since then, we have not seen the 10 year US interest rate above 6%. However, the 10 US rate has risen to 5.23%, given the US government's estimated \$2.1 trillion budget deficit and the smaller \$130 billion from US AI developers. The main difference is that in 1870, the US government ran a surplus of \$101.3 million, or \$2.59 billion in today's dollars. The next US Federal Reserve meeting is October 27-28 and we expect no movement on rates so close to the election. A rise in the US 10 year Treasury yield to over 6% is very concerning and could push the US into a recession unless productivity gains from AI can offset the effect on higher interest rates on the US consumer. The US economy has managed to grow so far despite rising interest rates but the growing disparity between rich and poor can still have an impact at the ballot box.

On the jobs front, unemployment in 1870 was at 3.52%, with 10% of the non farm work force all employed by railways. With building complete, unemployment began to rise as fewer workers were needed. By 1878, unemployment reached a high of 8.25% as America suffered through a six year recession. The current US unemployment rate is 4.1%, helped out by an aging population and reduced immigration. The US Congressional Budget Office estimates that by 2030, annual deaths will exceed annual births and population growth will rely entirely on immigration. Experts on the economy have worried that the rise of AI will lead to massive job losses but this hasn't proven to be the case yet.

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US corporate earnings remain robust as a whole. The main AI companies are making record profits and benefits are being seen across a wide range of companies. Even in a recession, people won't stop using their phones and computers. At some time in the development of AI, there will be a tipping point and we will see corporate failures and consolidations, just as there was in the railroad industry when competition reduced profit margins and weak companies failed. We are not near that point quite yet but if private debt and equity money begin to dry up, this will accelerate. The strong will survive and grow. For now, the overall corporate earnings outlook remains very positive.

US consumer spending also continues to grow, up 0.9% in August, while US consumer confidence fell to its lowest level since 2014. Spending is being propped up by top earning households and steady wage earners and again highlights the growing income disparity in the US as the Confidence Survey reflects the broader population. A large driver of consumer spending has been the rise in the US stock market. While the market continues to grow, so will spending. We have the greenlight from the US consumer for now, but if US interest rates continue to rise, the yellow caution light will be flashing for us.

In Canada, oil stocks have stayed firm, but we have seen a mild correction in bank shares as September saw some profit taking by institutions prior to the end of the September quarter. With Canadian interest rates also edging higher, we have seen the prices of bonds, preferred shares and higher dividend payers such as the pipeline stocks also sell off, but their income and lower volatility make them a continued hold for our income oriented portfolios.

The blinding speed and high cost of the current development of AI are worrying for a number of reasons, but they are not unprecedented. There will be surprises, both good and bad, but for now, the new industrial revolution continues. Until next time, stay well.

As always, questions, concerns, comments and feedback are welcome.

Yours truly,

Walter, Charles, Trevor and the Cooper Wealth Management Team



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