

TECH AND INVESTMENT ENVIRONMENT

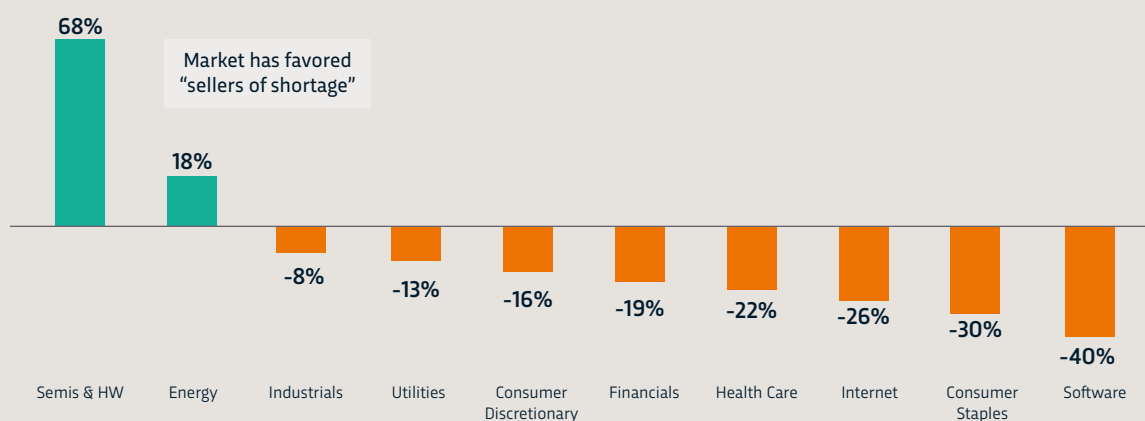
In preparation for writing this, it has been hard to find a good point to stop as the world seems to continue changing at every increasing speed. If we had to summarize events, we would probably defer to ecologist Garrett Hardin when he noted regarding the psychology of predictions: "Predictions of doom are always more popular than predictions of progress." When markets and industries evolve as fast as AI is currently, predictions of infinite abundance or impending doom seem to multiply. We still remember the 1999 best seller, "Dow 36,000: The New Strategy for Profiting from the Coming Rise in the Stock Market". The Dow was at 11,000 at the time and was expected to reach 36,000 a few years later. Those "few" years turned out to be 20 years. While we could always be wrong, we can point to three supposed impending catastrophes that we believe may also not happen: (1) the bursting of the AI bubble (as equivalent of the "dot.com" bubble), (2) the AI-driven mass unemployment, and (3) the total eradication of certain industries ("SaaSocalypse" as exhibit 1).

The year-to-date performance of the S&P 500 has gone from -7% at the end of March to +11%, currently. The Nasdaq added 15.6% in April, the best month for the index since October 2002. The S&P 500 is on pace to grow its quarterly earnings by 27% year-over-year, which would be the strongest growth rate since Q4 2021. An unrelenting increase in corporate earnings with expectations of more gains to come. For the full year 2026 earnings are now expected to grow 22%, a significant uptick from expectations only a month ago (+18%). Net profit margins are on pace to surge to another record high at 14.7% (the previous record high was 13.2% in Q4 2025).

However, the leadership producing these returns has been narrow and dispersion has been extreme. In the last month just 25% of US stocks outperformed the index (MSCI data), which is in the first percentile of all observations since 2004. Despite the S&P 500 being 7.7% above its 50-day moving average, only 52% of its components are above their own. For only the third time ever, the S&P 500 index hit a new all-time high while at the same time having more constituent companies set new lows than highs.

This has been a market in which the semiconductor industry has gone parabolic while the rest of the tape doesn't feel so hot. The PHLX Semiconductor Sector Index (SOX) delivered a spectacular 38% gain in April, marking the 2nd best month on record, only surpassed by February 2000 and as we noted in the opening section of our letter is now up over 60% during Q2.

S&P 500 median relative performance by sector (trailing 1 year)



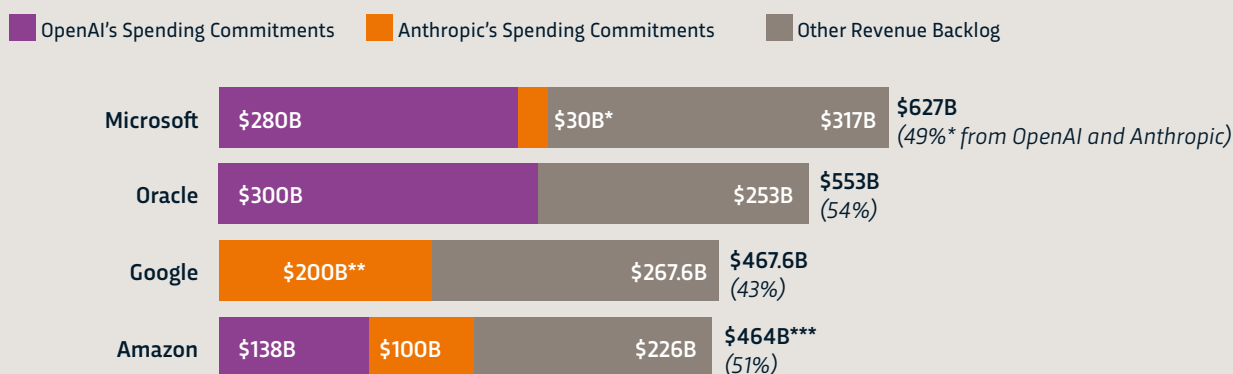
Source: Bloomberg and Coatue analysis as of May 5, 2026. Sector classifications are subjective, determined in Coatue's sole discretion and subject to change.

The dispersion has been caused by the insatiable demand for AI-driven compute capacity. The word bubble is often associated with what is going on but, having lived through the dot.com bubble, while the stock price action does feel excessive in some cases, this is not driven by "dark fiber" deployments and/or debt-financed loss-making enterprises. The demand for compute is quite real. Alphabet (Google) increased revenues by 22% in the quarter (with cloud growing a stunning 63%). Amazon increased revenues by 17%. Microsoft by 18%. Meta by an incredible 33%. Even Apple, often viewed as the growth-laggard of big tech, increased revenues by 17%. Growth has been phenomenal. The combined LTM revenues of Amazon, Apple, Alphabet and Microsoft alone hit a record \$1.94 trillion, larger than the GDP of all but thirteen countries.

However, a portion of this growth (and more so of the cloud business backlog) has its foundation in the compute capacity commitments of Anthropic and Open AI. Both companies have a combined ARR of over \$55b as of April (a number that could double by year end) making them unprecedented even in the tech industry for their ability to grow revenue at an accelerated rate even at scale. As incredible as these businesses are, the ultimate economic model is still unclear.

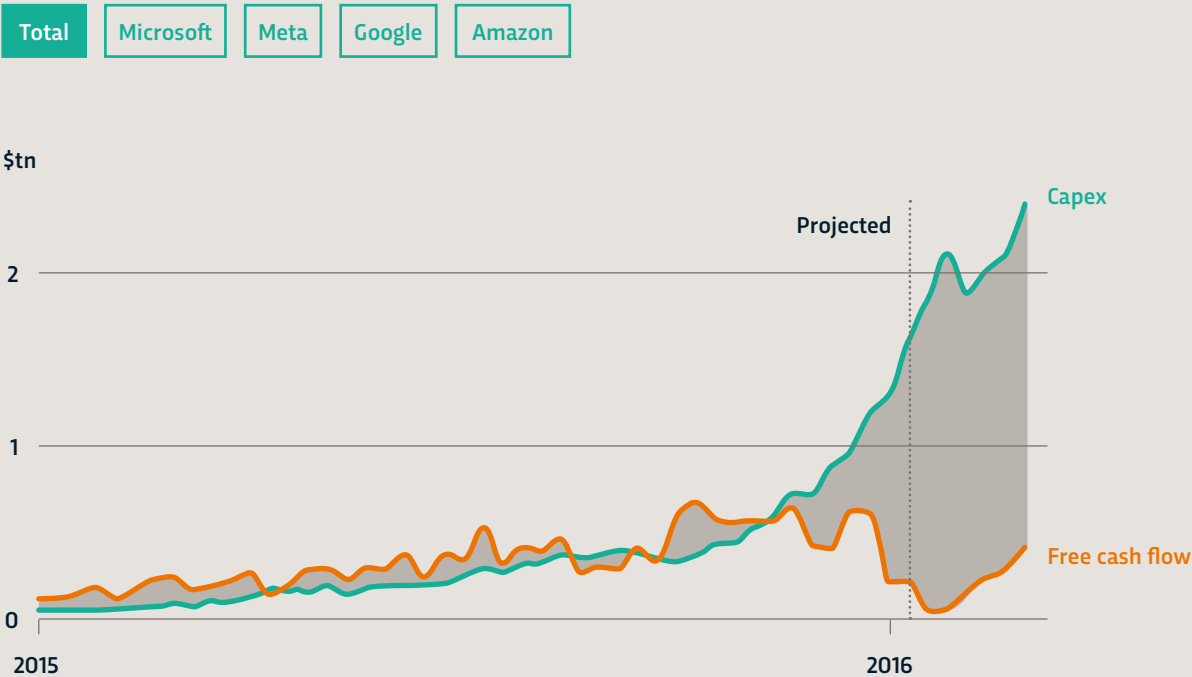
AI Whales

OpenAI and Anthropic's spending commitments to the four biggest U.S. cloud providers, as a percentage of those providers' revenue backlog.



* At least. ** Approximately. *** Including Amazon's April Anthropic agreement. Other figures as of March 31. Source: Company filings. The Information reporting

The significant capital expenditures by the tech giants, while producing fabulous growth and profits, has also taken a significant toll (at least for now) in FCF generation.



Source: S&P Visible Alpha • Projections based on consensus analyst forecasts

As a result, despite the fabulous results, these companies, as buyers of hardware, have seen their valuations contract while the rewards have been going to the sellers of hardware. Hence the dispersion that has favored the semi-related subsectors.

Market is rewarding the sellers of the storage

	Players	Fundamentals	YTD Return
Sellers of products in shortage	BROADCOM COHERENT MARVELL GE VERNOVA LUMENTUM SAMSUNG Micron NVIDIA tsmc SK hynix Western Digital SEAGATE SanDisk	• One-time product sale • Fixed cost base • High pricing power • Big EPS revisions	~107%
Buyers of products in shortage	amazon Google Meta ORACLE Microsoft	• High upfront capex / opex • Returns over several years • Modest EPS revisions	~4%

Source: Bloomberg, Coatue analysis, as of May 5, 2026. "YTD return" reflects the average YTD price return of the names shown

The jaw-dropping growth and evolution of AI has also given rise to another narrative, further instigated by AI industry leaders, that this technology will bring about an extinction-level event for many (mostly white-collar) job categories, that could push unemployment well into double digits. The AI “Jobpocalypse”.

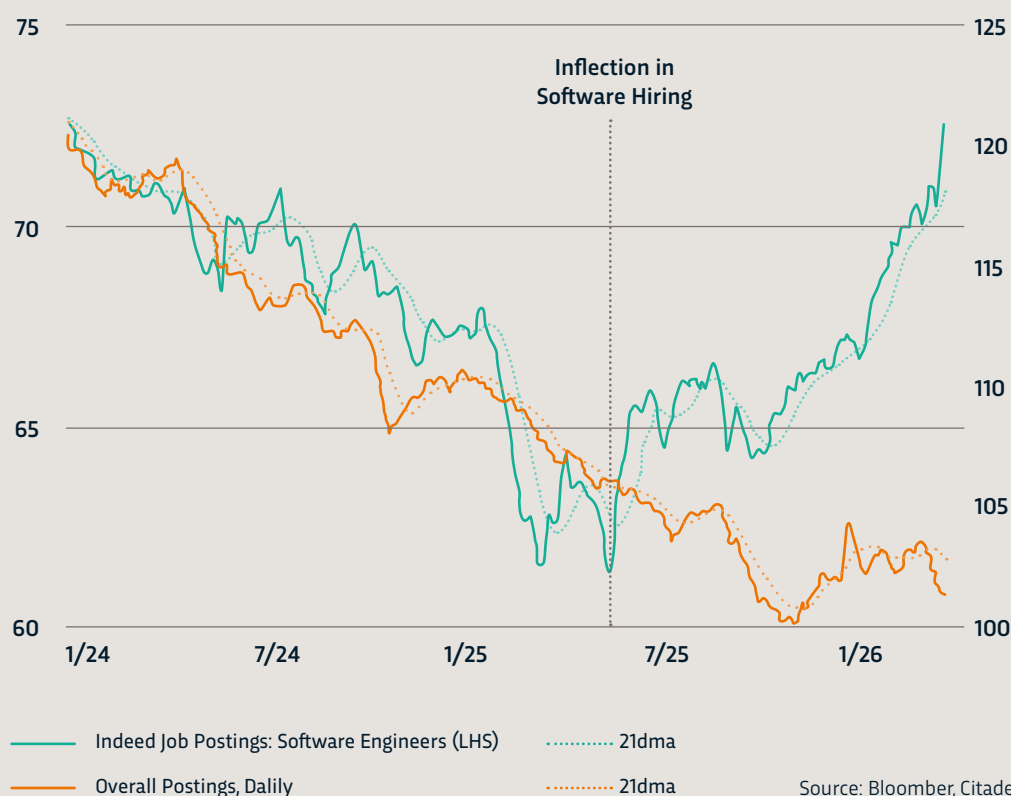
A16z framed the “doomer” argument quite nicely, “If AI can do our thinking for us, then humanity’s ‘moat’ evaporates and our terminal value goes to zero.” They point out that the fallacy of this narrative is that it implies a fixed amount of work and hence a zero-sum competition between existing workers, and anyone or anything that may do the same job - in this case, AI.

History suggests that when the cost of a powerful input declines, the economy does not simply stand still. Lower costs typically lead to better quality, faster delivery, new products becoming viable, and demand expanding outward — a dynamic often described by Jevons Paradox, where greater efficiency in the use of a resource can actually increase total consumption of that resource. If history is any guide, technological transformation tends to expand the overall size of the economic pie. Each “dominant economic sector” has eventually given way to an even larger successor, whether through electrification, the mechanization of agriculture, or the rise of the internet. In the process, new technologies have not only displaced some activities but also created entirely new categories of work that previously did not exist.

We will most likely see a lot more AI augmentation rather than AI substitution of roles. In fact, we see this right now in Software engineering, which was supposed to be patient zero in the AI Jobpocalypse. The substitution might come one day but it is certainly not here now.

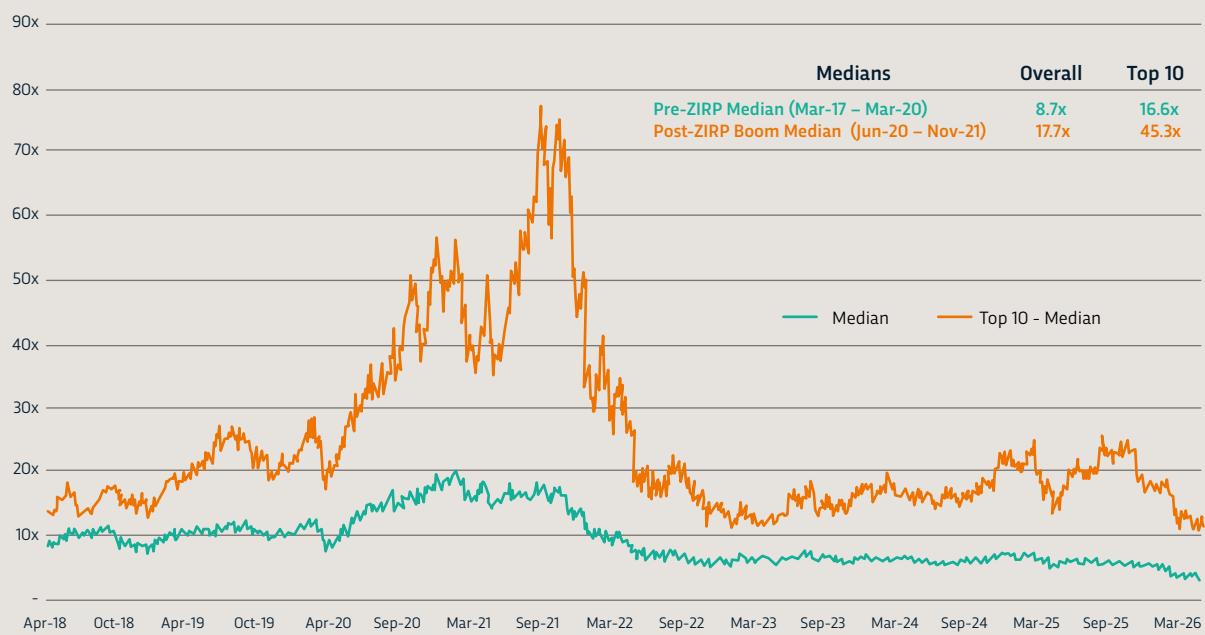
Demand for Software Engineers Is Rising

Indeed Job Postings Software Engineers + Overall Postings, Dalily and 21dma



Another alleged impending catastrophe and big contributor to the stock market dispersion has been the now well disseminated “SaaSocalypse” narrative. The notion that with the rapid rise in coding capabilities (i.e. Claude Code, Codex), the days of software companies are numbered as end customers bring the development in-house or de-platform their existing software solutions in favor of new AI-native entrants. This has caused a massive derating of almost every software company.

Implied ARR Multiples



Source: Company filings and CapitalIQ as of May 29, 2026 (Meritech Software Pulse). Implied ARR is defined as quarterly total revenue × 4.

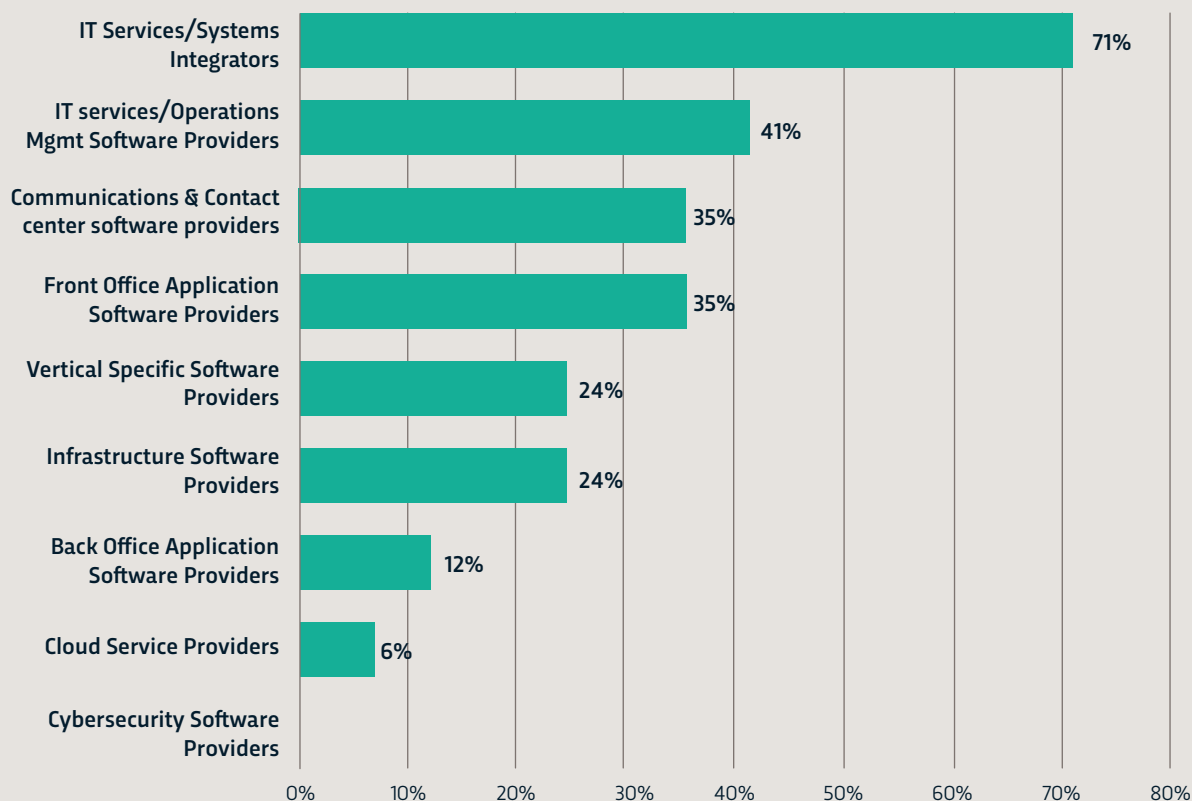
AI has been blamed for the ARR deceleration in enterprise software. However, this deceleration started in early 2022, prior to the launch of ChatGPT in November of 2022. After a pull-forward in “digital transformation” during Covid, customers went through a long digestion period. In addition, company budgets (including IT budgets) were further pressured by inflation and allocation of share toward cybersecurity which have crowded out growth in more traditional SaaS budget areas. There was undoubtedly some additional pressure on budgets as AI-related investments increased further stressing dollar spend in other areas of IT. However, the deceleration had already begun.

Taking a contrary view, there may even be reasons to think that AI could be an accelerant to certain incumbent software businesses (indeed, before the big SaaS selloff, this was the narrative). The risk and friction (with regards to compliance, support, cybersecurity, training, etc.) resulting from a wholesale change of certain enterprise software platforms are enormous. Hence, we still find it likely that many of these businesses will use AI to augment their offering (vs letting AI replace them), causing revenues to re-accelerate at some point. The most likely outcome for “AI v. SaaS” is, of course, a lot more nuanced. Some companies are intrinsically more vulnerable, and a lot will simply depend on execution.

We already see evidence of this nuanced approach by a recent CIO survey in which 71% of respondents identified Systems Integrators as the area expected to bear the cost of AI spending reallocation. In contrast, front-office (i.e., CRMs), vertical SaaS, and infra were somewhere in the middle, while back-office, cloud, and cyber appeared to be relatively safe.

Jefferies CIO Survey: 71% Expect to Cut Systems Integrators to Fund AI. Cybersecurity> 0%.

Which area(s) of your IT budget do you expect to experience the greatest reduction in budget growth or absolute spending due to reallocation toward AI? Select up to three.



Source: Jefferies CIO Survey (Mar 26)

It would be a wild understatement to say these are exciting times and change is inescapable result. While ultimate bear or bull outcomes usually take longer than people think to truly reveal themselves, the near-term dispersion certainly brings challenges while presenting interesting opportunities at the same time.



José Medeiros

Partner e Portfolio Manager
San Francisco

