Thoughts on the *DeepSeek* Disruption to the Tech Sector

The most interesting moments in financial markets occur when a widely held belief that has become embedded in asset prices turns out to be wrong. Monday was such a moment in the stock market. It was the worst single day for the 10 largest stocks in the *S&P 500 Index* since the 1980s, and numerous stocks in the technology, energy, and power sectors experienced declines of 10% to 20%-plus.[1]

The widely held belief that *may* have been invalidated is that the U.S. is winning the race to develop AI due to **Nvidia's** leadership in advanced semiconductors, and due to the financial capacity of our technology giants like **Alphabet, Amazon, Meta** and **Microsoft** to spend the necessary billions it takes to build AI models and access the massive electrical power these models require to operate.

The triggering event was the release of an AI model from a Chinese company named *DeepSeek* on January 20th that appears to deliver comparable performance to America's best AI models with a fraction of the computing horsepower and cost of development. This remarkable feat has shaken the consensus view about how much capital, power, and advanced semiconductors may be required to become competitive in AI.

The validity of *DeepSeek's* claims remains a matter of debate, but we are currently operating under the assumption that the claims are directionally accurate, and therefore it is a material development. We base this on the fact that *DeepSeek's* model is open-sourced, and they have published the technical details behind the model in publicly available white papers. Indeed, we suspect the reason it took a week for financial markets to respond is because computer scientists throughout the world needed time to download *DeepSeek's* model and experiment with it for themselves. By the weekend of January 25-26, the global buzz around the model became loud enough to reach the mainstream, and markets reacted on Monday.

Our investment response to this development spans the past through the present. Risk management is an ongoing priority in our investment process, and we have taken actions over the past several quarters that have proven to be helpful for this moment. For example, we reduced the position size of **Cameco, Constellation Energy** and **GE Vernova** last year, and we trimmed **Cameco** and **Constellation** again yesterday. These stocks have been big winners for the *Managed Equity Growth* strategy, but we booked profits in stages as these stocks advanced to prevent their combined exposure to the "Demand-for-Power" theme from becoming too dominant in the portfolio.

Likewise in the *Managed Equity Dividend* strategy, we trimmed the position size of **Broadcom** and **Eaton** multiple times over the past couple of years as these stocks advanced in an effort to prevent these positions from becoming too large, and to reinvest the proceeds into stocks with higher dividend yields, as per the priority for this strategy. We may take further actions in both strategies as the potential ramifications of the *DeepSeek* development become clearer.

[1] Source: Barclays Capital: "DeepSeeking Missile," Jan. 28, 2025

It should also be noted that significant disruptions often produce winners and losers, and we suspect this case will be no different. One development we have always expected from the advance of AI is a migration of corporate spending toward implementation through technology consultants like **Accenture** (Growth Strategy) and **IBM** (Dividend Strategy), neither of which was impacted by Monday's selloff.

Even for **Nvidia**, whose one-day loss in market value on Monday was the largest in stock market history, the verdict is uncertain regarding the long-term ramifications of the *DeepSeek* bombshell. The initial reaction has clearly been negative, but a valid argument exists that total demand for computing horsepower may go up in the long run if the cost of developing AI drops as much as some believe it might.

As for the broader stock market, we think it matters that approximately 70% of the constituents in the *S&P 500 Index* were up on Monday, even though the 10 largest stocks suffered their worst decline in multiple decades.[2] Moreover, there was clear dispersion within the tech sector, with advances in **Apple, Amazon** and **Meta** helping to offset declines for **Nvidia, Microsoft** and **Alphabet**. This suggests to us that the fallout from the current disruption in AI seems likely to be contained.

[2] Source: Barclays Capital