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Research Insights

Artificial Intelligence:
After the First Wave

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Farislowsky Fraser

Introduction

Artificial Intelligence: After the First Wave

As artificial intelligence continues to reshape the global technology landscape, the forces driving economic value within the ecosystem have shifted meaningfully since our last Research Insights on the topic. To understand what now matters most for long term investors, we sat down once again with Jeremy Schaal, Managing Director and Portfolio Manager, US Equities. In this follow up discussion, Jeremy revisits the AI stack, from chips to infrastructure to applications, explaining how power constraints, evolving competitive dynamics, and the transition from model training to real world inference are redefining where risks and opportunities lie. Through a series of focused questions, we explore how the ecosystem is maturing, where value is likely to accrue next, and how investors should position for an AI cycle that is becoming more capital intensive, operational, and tied to physical infrastructure than ever before.



Jeremy Schaal, CFA

Managing Director and
Portfolio Manager,
U.S. Equities

JARISLOWSKY FRASER

GLOBAL INVESTMENT MANAGEMENT

Q. As we revisit the AI ecosystem in 2026, what has changed?

Jeremy: What has changed is not the structure of the ecosystem, but where economic power and investor risk now reside. The three-layer structure we previously outlined: chips, infrastructure, and applications, remains valid, but the balance of power within it is evolving.

At the chip layer, NVIDIA remains central to the ecosystem, but the market is now more attentive to cyclicity and substitution risk. Large customers are investing in internal silicon not to displace NVIDIA entirely, but to lower marginal inference costs and reduce long-term dependence on a single supplier.

At the infrastructure layer, “neoclouds” have sprung up to challenge the incumbents. When computing supply is short this is a viable strategy, enabled by NVIDIA which is actively diversifying its customer base through selective allocation. In the long run, it is likely that the winning strategy will be the full-stack approach, from chips to systems and middleware to applications, offered by incumbents that already store vast amounts of customer data under governance and security agreements.

At the application layer, the market is increasingly focused on risks to incumbent software vendors from AI-enabled new entrants and customer-developed software. We still see robust barriers to entry and high switching costs driven not by the code base itself, but by the deep integration of incumbent software into the enterprise IT estate, business processes, and workflows. Contrary to current market opinion, we see an opportunity for forward-thinking incumbents to invest in AI solutions, include them in existing licensing agreements, and enjoy incremental growth. From a cost perspective, thus far it would appear that the relative lack of differentiation of leading LLMs, the availability of open-source alternatives, and the ease of switching models means that software vendors should not see undue margin pressure.

Q. When will the industry decisively pivot from training to inference?

Jeremy: Thus far it would appear there have been good returns to building ever-larger, more capable models; however, we are seeing diminishing returns to scale, as model capability increases linearly but costs rise exponentially. If this trend continues, it seems that in the next 1-3 years the industry will pivot decisively from training to inference. This timing coincides with the scaling of enterprise AI adoption, as large businesses overcome roadblocks like data governance, security, workflow redesign, and employee retraining. We see risks to companies unduly reliant on LLM training, and opportunities for companies ready to drive enterprise AI adoption through efficient and well-integrated inferencing solutions.

Q. Apart from computing power, what other constraints exist?

Jeremy: Power availability is a key constraint. Turbines required for large scale gas-power generation have two-year lead times. Nuclear power plants take a decade to build. Even when data centers can draw power from an existing grid, utility connections can take 1-3 years. And we are already starting to see backlash from ratepayers who in some regions are seeing dramatically higher bills as the mismatch between power demand and supply has widened. Apart from the obvious slowing of computing power expansion, a side effect of scarce power is an increasing emphasis on power efficiency in the data center, most importantly in AI chips. The ability to provide not just fast model training but power-efficient inferencing has the potential to create a new class of winners over the next few years.

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Q. Who can build, and earn returns on, new power and grid capacity if electricity is the limiting input?

Jeremy: Unregulated utilities in jurisdictions with supportive regulatory frameworks and relatively low customer bills are well-placed to enjoy the higher prices that accompany surging AI demand. Ultimately prices will be capped by the ability of consumers to pay (or data centre operators, to the extent the burden is shifted). Another place to look is providers of electrical equipment in the data centre. These industrial companies are less constrained by regulatory or political considerations and can earn strong returns on differentiated and mission-critical equipment.

Q. What does this mean for AI investors?

Jeremy: The classic technology adoption cycle initially favours hardware providers and over time shifts to infrastructure platforms and software. The trick has been to get the timing of these shifts right. Currently, and for the near term, the hardware layer should continue to reap great rewards. But over the next few years, as the market shifts to inference and at-scale enterprise adoption of AI, value will likely accrue to platform and software providers. The investable universe has also widened beyond chips and cloud to include utilities, grid operators, transmission developers, datacenter REITs, and select energy producers and equipment manufacturers, which in cases may offer more stable returns while still giving exposure to AI-related upside.

We must also watch the pace of innovation and adoption. Currently there is a gap between model capability and enterprise AI adoption. If this gap continues to widen, it increases the risk of a “digestion cycle” where returns suffer and model training must pause to allow adoption to catch up. Alternatively, if chip innovation or model progress slows, it will likely encourage technology diffusion and allow lagging competitors time to catch up. While these developments would be positive for end users and application builders, they would have mixed effects on infrastructure platforms

(though likely net positive) and chip makers (though likely net negative).

Q. Is the AI rally showing any structural signs of bubble-like behavior?

Jeremy: Some areas of public and private markets appear to exhibit excesses, but in the main market participants appear to be behaving rationally, if somewhat optimistically. Areas of clear excess include venture funding for new AI labs and AI software companies betting on displacing incumbents. In public markets, bets on more advanced applications of AI like humanoid robots or the rapid adoption of full self-driving cars may be untethered from financial reality. And we are seeing some early signs of problematic circular financing deals as money flows from established companies to their customers and back again as revenue to the company that provided the funding.

Beyond this, evidence of a bubble is hard to find. The larger, well-known AI participants are trading at valuations that are not close to those seen in bubbles past. This may be because growth is being throttled by factors such as chip and power availability, preventing unbridled enthusiasm. It may also be because the risk of an AI bubble is so widely discussed in the markets, which has its own, perhaps psychological, dampening effect. It's also worth noting that unlike, for example, the dot-com bubble, capacity being built today is being immediately used – this is not the “build it and they will come” approach that led to miles of dark fiber 25 years ago. Most notably, this capacity buildout is being almost entirely funded out of free cash flow from established, highly profitable companies, which insulates it from the vagaries inherent in relying on third party financing.

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Q. How are your portfolios currently positioned with respect to artificial intelligence related investment opportunities?

Jeremy: Our portfolio positions AI as an embedded enterprise productivity driver rather than a thematic bet on standalone AI winners. We emphasize global platforms such as Microsoft, Amazon, Alphabet, and SAP, where AI strengthens cloud, software, and data layer economics through deeper integration, higher switching costs, and improved efficiency. These are also diversified businesses, with some cash flows from areas largely unrelated to AI, which provides some measure of downside protection should the AI buildout slow down or enter a down-cycle. This is complemented by selective exposure to semiconductors and incumbent application providers. These companies are typically underpinned in whole or in part by recurring cash flows that provide a further measure of downside protection relative to other AI participants.

Our Emerging Market AI exposure is anchored in the semiconductor ecosystem, which supplies the leading-edge memory and logic chips that power advanced AI computing. We are primarily invested in sector leaders such as TSMC and Samsung, which form the backbone of advanced semiconductor manufacturing and memory supply. We also maintain selective exposure to AI-enabled internet platforms where AI is being embedded to enhance customer engagement, logistics, and monetization and have targeted exposure to industrial applications of AI which support automation and edge computing.

Canadian equity exposure to artificial intelligence is expressed primarily through software, services, and platforms that embed AI as a productivity and revenue accelerator, with companies such as OpenText, Thomson Reuters, Shopify, and Descartes Systems Group leveraging proprietary data and advanced tools to automate workflows, improve decision quality, and shorten time to outcome for customers. Within financials, Canadian banks are deploying AI across sales, risk, and operations, creating meaningful cost and revenue opportunities that reinforce our focus on businesses where AI directly enhances core

economics. While human intensive industries, particularly software, engineering, and professional services, have come under pressure since mid 2025 amid concerns that internally built AI, lower development barriers, and customer automation could weaken demand or erode seat based revenue, we believe these fears overlook the fundamental advantages that sustain software moats, including proprietary metadata, domain expertise, scale, deep customer relationships, and ongoing requirements for maintenance, security, compliance, and workflow integration. All of our portfolio companies are integrating AI directly into existing offerings, making adoption seamless and minimizing disruption, and we have not seen meaningful evidence of customers replacing incumbent systems with internal solutions or “AI first” entrants given substantial switching costs associated with implementation, customization, and training. In fact, incumbents are poised to benefit from AI: modern development tools can materially reduce coding and maintenance costs while preserving competitive advantages, and providers with seat-based models are already transitioning to hybrid and consumption-based pricing for AI enhanced features, ensuring monetization evolves in line with usage.

We view AI as a long duration growth opportunity anchored in high-quality global franchises. Our diversified allocation across infrastructure, data platforms, software, and regulated incumbents reflects our view that scale, strong balance sheets, and proprietary data will likely capture most of AI’s economic value. By avoiding narrow AI themes, we retain exposure to durable cash flows, pricing power, and businesses integrating AI into existing workflows. This supports a defensive growth stance: solid growth driven by the ability to deploy significant capital at attractive return potential and aligned with established global leaders rather than hypergrowth disruptors.

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Conclusion

Artificial intelligence is entering a new phase, one defined less by breakthrough model performance and more by the practical realities of scaling deployment across enterprises and physical infrastructure. As the ecosystem shifts from training to inference and from experimental pilots to operational integration, the sources of economic value are migrating accordingly. Hardware leaders remain central, but power constraints, maturing competitive dynamics, and rising capital intensity are broadening the opportunity set well beyond chips and cloud.

For long-term investors, the implication is clear: the next stage of AI will reward scale, balance sheet strength, control of proprietary data, and the ability to embed AI into existing workflows at meaningful returns on invested capital. This favours diversified global platforms, regulated infrastructure providers, and incumbent software and service providers with deep enterprise relationships. At the same time, select semiconductor, utility, and equipment players stand to benefit from the physical buildout required to support AI's expansion.

AI remains a durable, multi-year growth theme but one that must be accessed with discipline. By emphasizing high-quality franchises with recurring cash flows and strategic positioning across the stack, investors can participate in AI-driven upside while mitigating the risks inherent in a rapidly evolving and capital-intensive cycle.

Contact

Toronto

40 Temperance Street
18th Floor
Toronto, Ontario
M5H 0B4

Tel: (416) 363-7417
Fax: (416) 363-8079

Calgary

Millennium Tower
440 2nd Avenue S.W.
Suite 700
Calgary, Alberta
T2P 5E9

Tel: (403) 233-9117
Fax: (403) 233-9144

Montreal

1010 Sherbrooke Street W.
20th Floor
Montreal, Quebec
H3A 2R7

Tel: (514) 842-2727
Fax: (514) 842-1882

Vancouver

650 West Georgia
Suite 450
Vancouver, British Columbia
V6B 4N7

Tel: (604) 676-3612
Fax: (604) 676-3616

Website: www.jflglobal.com

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