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Opinion **Unhedged**

A bubble in . . . defensive stocks?

Plus, crypto and desperation

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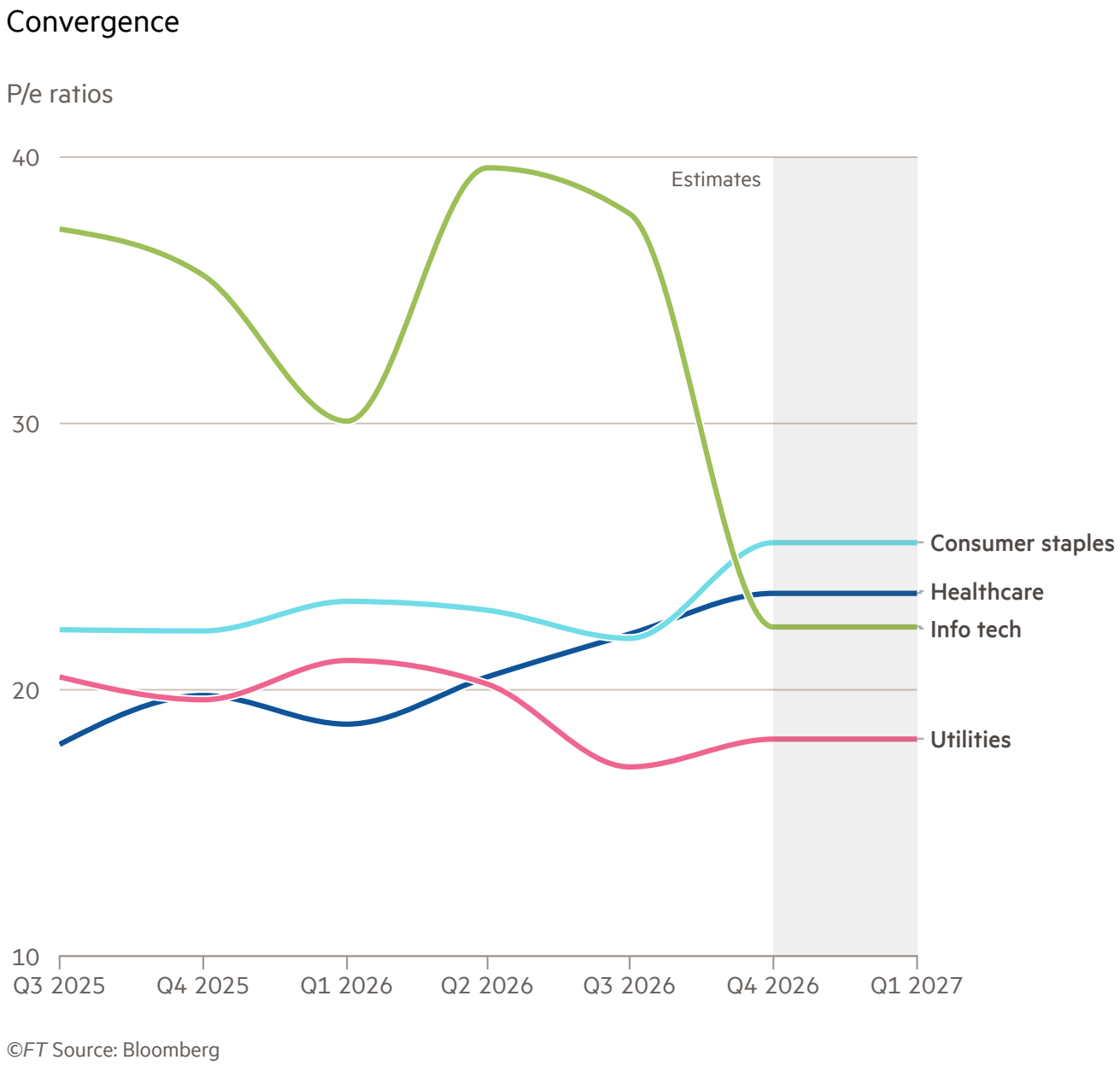
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Good morning. We now have a price tag on Anthropic: $1.75tn, at yesterday's closing price of $97 a share. The AI company is more valuable than (to pick five notable examples) Saudi Aramco, TSMC, JPMorgan Chase, Berkshire Hathaway or Walmart. On the other hand, it is only worth half as much as Nvidia or Microsoft, and it's only a third of an Apple. There are lots of ways to play around in a spreadsheet to justify the price (see here). It is equally easy to think up reasons why it is too high. Stay away from abstractions, and keep it simple: to justify its valuation, the AI lab has to grow much faster than any company has ever done. Are you ready to wager that it can? Email us: unhedged@ft.com.

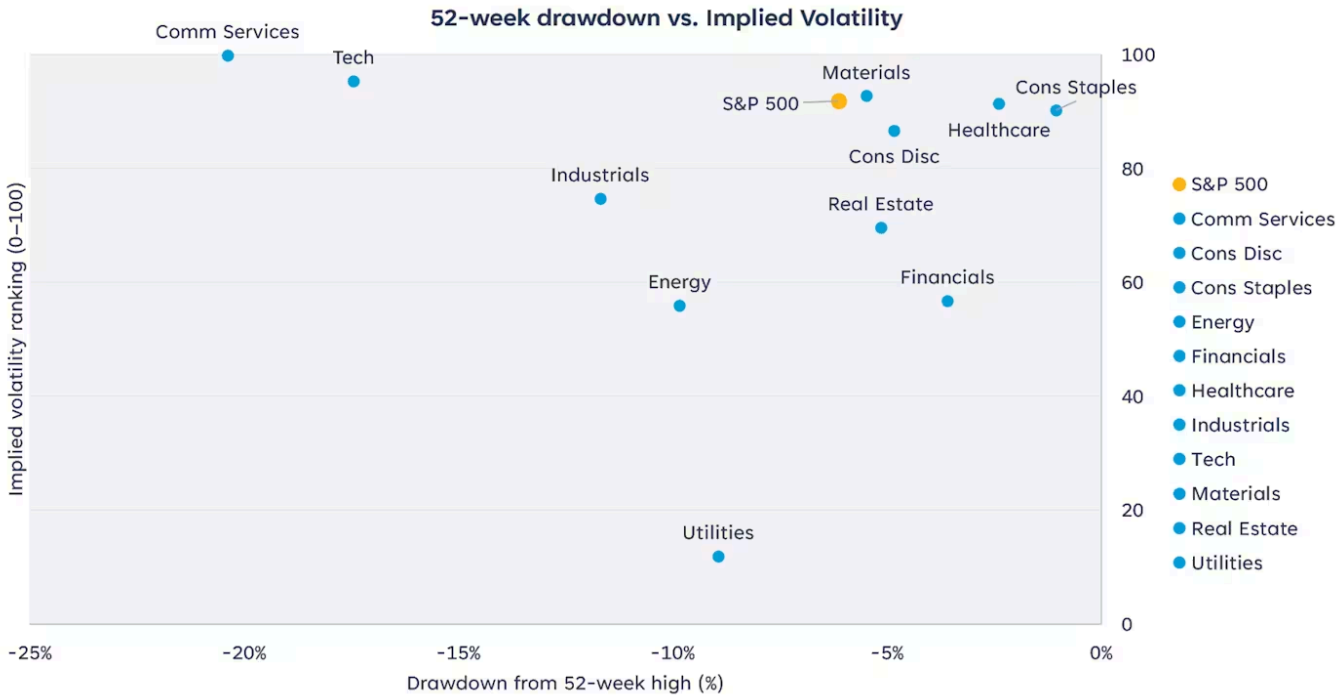
Indefensible?

The tech stock drawdown since October has been partially offset by a rotation into defensive sectors, as we charted last week. Given AI bubble and interest rate worries, it's not surprising that consumer staples, healthcare and utilities are gaining favour. Defensive stocks also often pay out steady dividends, which is appealing with the violent swings in tech stocks. "You can count on a dividend from these companies, while most technology companies don't pay you anything, many don't even give you a vote," says Matthew Hochstetler at First Principles Global Capital.

But the flight to safety is getting expensive. The valuations for defensives are rising as techs become less expensive. The price-to-earnings ratios for healthcare and staples are expected to rise above tech this quarter and into next year:



Another curious development: healthcare and staples are trading right around their 52-week highs, but their implied volatility (the three-month level against its one-year history) is also extremely elevated. Tech and communication services have implied volatility levels just above the defensive names, but they've suffered much deeper sell-offs. So while defensive stocks have managed to rally, options markets are pricing in large swings relative to their one-year histories. Chart courtesy of Adam Turnquist at LPL Financial:



Is there a mini-bubble happening in defensives right now? It sure feels like it to us: consider Coca-Cola trading at a price-to-earnings ratio of 29, against Microsoft at 26 times — with Microsoft expected to grow much more quickly.

Maybe Coca-Cola's is worth its rich valuation. But maybe the excessive enthusiasm for the AI trade has been transformed, through the alchemy of market sentiment, to over-enthusiasm for defensives. If the AI bubble crashes, defensives will outperform, but if they are too expensive at the outset, they will outperform by much less.

(Kim)

Crypto is so bleak

Cryptocurrency is not so much an asset class as a belief system. You either get it or you don't, and I don't. Occasionally, it can help desperate people get money out of ill-managed countries. More often, its key use case is crime. In both cases, it comes wrapped up in vapid finance babble designed to baffle the masses.

I don't intend to rehash the long list of reasons why this stuff is silly. I do, however, think it's worth looking again at why people buy it regardless. A new working paper by NBER does just that. It helps to explain why the soft marketing for crypto, through "finfluencers" and so on, is often about personal reinvention and jet-setting lifestyles.

The authors — Costas Arkolakis (Yale), Spencer Kwon (Brown), Dominic Russel and Claire Shi (Harvard) and Hyunjoo Yang (Sogang) — ask why certain households turn to lottery-like financial assets and others do not, despite the widespread proliferation of game-like trading tools that anyone can use. The answer is that a lot of people stumble into this space through a mix of pessimism and desperation. They want to buy a house, they want wealth, they often want to "increase their attractiveness as a romantic partner", and standard asset classes don't often offer quick wins. So they end up in "assets" with zero intrinsic value. Black Mirror, eat your heart out.

The study uses data from South Korea's leading credit bureau, telecoms provider and credit card issuer to try to figure out whether economic frustration (eg how tough it is for young people to buy a house) encourages people to take bigger risks. It pretty clearly does, and it's very goal dependent: for example, people's use of crypto platforms shoots higher when they become unemployed, and drops sharply when they win the right to buy price-controlled property through a lottery scheme. And it drops significantly once people buy property and achieve their goals. It's really quite striking.

The further away people are from their goals, the more crypto they accumulate, which "substantially increases the welfare costs of over-optimism".

From the paper's conclusion (with our highlight):

> When home ownership, family formation, retirement security or upward mobility seem unattainable through conventional saving, high-risk investment can become attractive as a means of pursuing those goals. **Speculative demand may therefore be a symptom of broader economic and social conditions**: frustration with the feasible paths to a better life, as well as changing beliefs about what a better life entails.

What to make of all this? Well, if you run marketing for a crypto app, then leaning into people's economic insecurity and specific, hard-to-reach life goals seems to be the way forward. For the rest of us, it's all another proof point that inequality drives a lot of people to places where they can be exploited, and that the boring practice of saving regularly to build a diversified portfolio of stocks and bonds is badly undersold.

(Martin)

One good read

Bats are conscious. AI models are not.

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