

## Remembering Schumpeter(ian) Destruction

*“Every evening I died, and every evening I was born again, resurrected” – Fight Club*

### In a Nutshell

1. Schumpeter’s **“creative destruction”** – driven by *constant innovation* – as *a feature of capitalism to deliver economic progress/growth* remains **highly pertinent**.
2. *Arguably, pronounced in the context of AI*, where *narrative-/aspiration-driven “overallocation”* accentuates the **risk of subsequent shake-down** (not unlike the experience with the “Dot Com”).
  - a. *How the trillions chasing “AI paydirt” will (eventually) be justified, and which “front-end” firms gets to keep the spoils are niggling questions.*
3. And in attempting to (re-)create the geoeconomic order (risking huge value destruction), an antagonistic/extractive **US may inadvertently trigger “destructive creation”** (“Reverse Schumpeter”).
4. The upshot is that the coincidence of both may however end up in perverse outcomes;
  - a. *Initially boosting aligning and amplifying bullish sentiments driven by FOMO (on AI bandwagon as well as tariff risk snapback on TACO\*\*).*
  - b. But *subsequently accentuate the threat of a shakedown* as **“Schumpeterian destruction” comes home to roost.**

5. Meanwhile, a **conspiracy of AI sucking up capital** and *geoeconomics elevating uncertainty* will catalyze “crowding out” risks”, lift long-end rates and prompt stark divergence in risk premium.

### Remembering Schumpeter

- The Austrian economist Joseph Schumpeter posited the idea of **“creative destruction”** as capitalism’s **intrinsic feature to ensure constant progress (economic growth)**.
- Specifically, recognizing that **constant innovation** – involving technology (and its impact on products and processes) – **resulting in displacement** (of incumbents) and **destruction** (of jobs, firms, and industries even).
- **Central to creative destruction** is the idea that there will be **cycles of overreach/overallocation** followed by a **subsequent shake-down** that **mercilessly separates losers from winners** (*albeit with collective gains realized over time*). *Business cycle theory borrows from this.*
- And **transformational technological leaps** imaginably involve **pronounced iteration of creative destruction** – like the Internet’s ‘Dot Com’ boom (of the ‘90s) and **subsequent bust in 2000**.

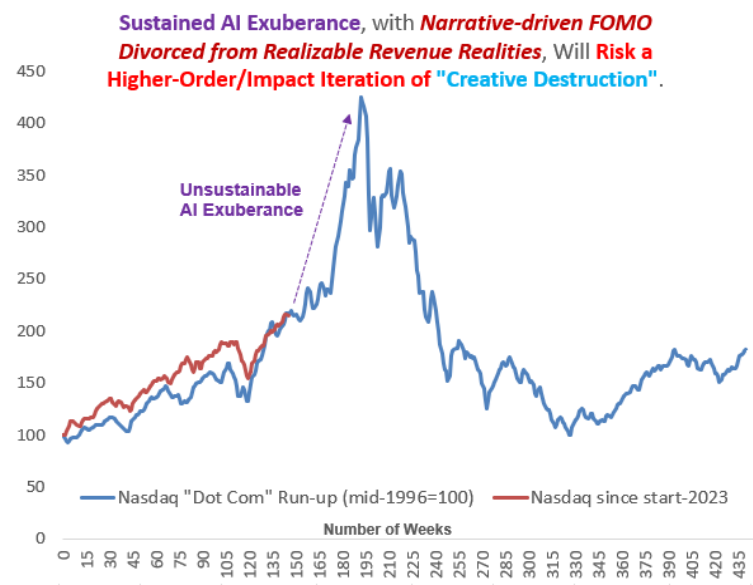


## AI & Schumpeterian Destruction

- Watching the current **AI exuberance**, it might be worth remembering that *“Schumpeterian Destruction” might precede durable breakthroughs.*
- *Drawing parallels from the ‘Dot Com’ era, the current ‘AI boom’ is merely in its aspiration-/narrative-driven “overreach/overallocation” phase – favouring “Architecture firms” (Nvidia) alongside “picks and shovels” (data center exposures).*
- Whereas **AI’s actual scalable, monetizable applications** are necessarily, *not* yet at its *revenue-/returns-realization form.*
- That’s to say, *it is at the awkward junction of the (existing vs. emerging) technology S-curves, defined by economic payout uncertainty (and likely prevailing shortfall).*
- Hence, the multi-trillion-dollar questions that need answering are;

1. *How the trillions chasing “AI paydirt” will (eventually) be justified, and;*

## 2. Which “front-end” firms gets to keep the spoils?



- Experience suggests *answers may not be evident now, and instead only be found in the rubble left behind by Schumpeter(ian destruction).*

## US-China & “Reverse Schumpeter”?

- If Schumpeter’s **“creative destruction”** is *how capitalism may be progressive*, then could it be that **“destructive creation”** may be the *calling card of forced geo-economic upheavals.*
- In other words, the **US’ adventurism aimed at (re-)creating geoeconomic order** may be a **“Reverse Schumpeter”** process *that necessarily leaves a trail of destruction* in its path.
- Admittedly, **“destructive creation”** could, and often does, result in **“winners”**.
- Obvious **examples from the US-China antagonism** have been security-sensitive sectors such as *defense, shipbuilding, strategic resources (steel, aluminum) as well as energy.*
- But **the forced, sub-optimal, re-allocations**, especially involving artificial support for when

economically unviable sectors, **tend to involve losses /larger gains forgone**.

### Competition vs. Repression

- For clarity, **technological progress from competitive geoeconomic rivalry** (e.g. “Cold War”) may, at heart, **still be “Schumpeterian destruction”**.
- **But unilaterally** and, **indiscriminately imposed geoeconomic shocks**– which has worryingly become **a feature of US-China rivalry** – have **greater risks of “Reverse Schumpeter” pitfalls**.
- That’s to say, **repressive geoeconomic misappropriations** (whether by way of tariffs, taxes, anti-competitive misallocations or confiscation) is the **anti-thesis of innovation-driven “creative destruction”**.
- Upshot being **value destruction from “Reverse Schumpeter”** is a **growing threat along the current trajectory of geoeconomic upheavals**.

### Perverse & Awkward (Bullish) Bedfellows

- **Perversely** though, **bullish intent/momentum** could **align/amplify** despite **“creative destructive”** and **“destructive” geoeconomic shocks**.
- Especially given a **bullish coincidence of gestational “AI boom”\*** and **opportunistic bets on winners through geoeconomic upheavals**. – **even if they make awkward bedfellows**.
- In fact, the **exuberance** may be **exaggerated** with markets **inebriated on awkward conspiracy of FOMO** (fear of missing out), which involves;

i. **The defining early-Schumpeterian inclination for excesses, desperate rush to get on the AI bandwagon**, even as stretched valuations push the envelope further and;

ii. Initial, **opportunistic Reverse Schumpeter bets positioned to take on more risks in defiance of lingering tariff risks** instigated by **expectations/anticipation of emphatic snapbacks when worst of tariff fears are averted** – the so-called “TACO trades”\*\*.

- The warning though is that the awkward cohabitation of the “AI Boom” and a highly extractive version of “America First (Only?)” could jolt nonchalant bulls abruptly.

\* This “gestational” phase of the AI cycle refers to the stage of excesses/over-investments (seduced by unquantifiable potential and dominant narratives), rather than accountability/reckoning.

\*\* TACO is the acronym for “Trump always chickens out”, referring to his propensity to dial-back aggressive tariff positions, especially on threat of hard-hitting China retaliation.

### Crowding, Rising & Diverging

- But **well before**, and **even without**, the **intervention of Schumpeterian destruction, stress has started to show up at some other corners** of financial markets.
- Specifically, perpetuating as **“crowding out” risks** and pronounced **rising long-end (real) yields**.

#### 1. “Crowding Out”

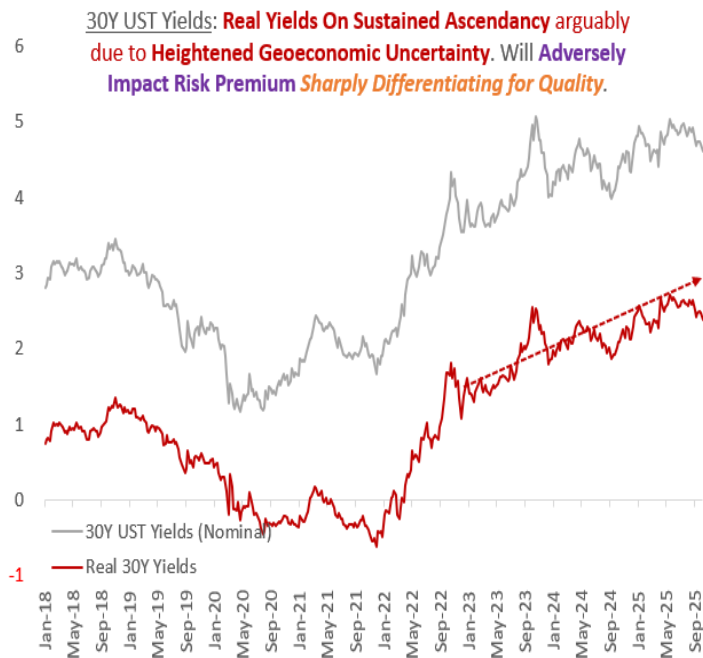
- For one, the **sheer force of capital appropriation by the “AI boom”** means

that a wider range of **non-AI sectors** get **“crowded out”**.

- What’s more, **crowding out”** is **exacerbated** by the *scramble for government funding amid heightened geoeconomic uncertainties*.“

## 2. Rising Long-End Rates

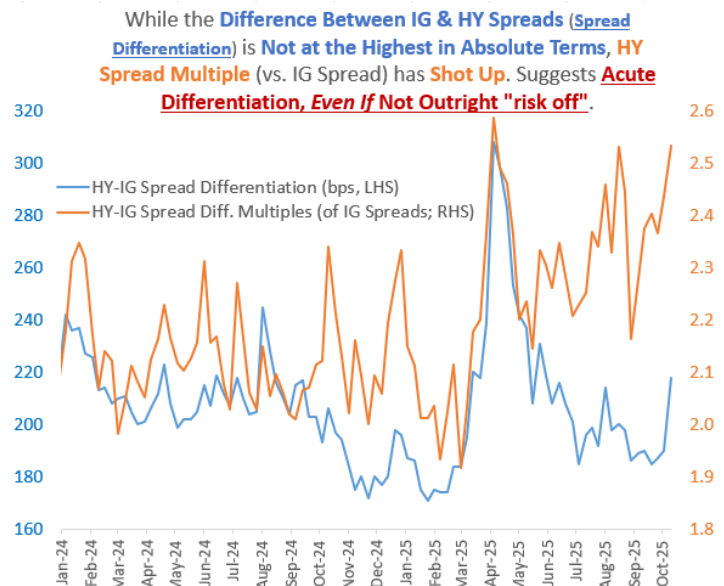
- Crucially, the *headlong dive into exorbitantly capital-intensive AI capex* means that **the cost of funding is driven sharply higher**, and *in real terms* as well.
- Moreover, **sharp upside in long-end yields are accentuated** by *geoeconomic shocks* that are inevitably *destructive for fiscal discipline/fiat value retention*.



## 3. Risk Premium: Stark Divergence

- The **conspiracy of rising rates and competing demand for capital** points to **significantly increased risk premium for sectors/firms without the favour of “AI halo” and/or geo-politics**.

- Notably, **risk premium** will also be *far more sharply differentiated for quality* as trade-offs sharpen.



- Schumpeterian destruction** may **not be imminent**, *but the conditions to get there are brewing*. As such, it certainly **warrants a lot more vigilance, if not caution**. *Especially as complex mix of factors – AI and geoeconomic upheaval – further obfuscate the picture*.

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