



# AI Valuations Face Macro Headwinds as Real Yields Rise

*Energy shocks, tightening financial conditions, and rising infrastructure costs reshape technology market leadership*

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- **Abstract 1:** U.S. Treasury yields moved higher during the week as geopolitical tensions and rising energy prices pushed real yields upward, tightening financial conditions and partially reversing February’s bond market rally.
- **Abstract 2** Higher real interest rates and increasing artificial intelligence infrastructure spending pressured large-cap technology valuations, with investors shifting focus toward companies demonstrating clearer near-term AI monetization.
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## Macro and Rates Overview

U.S. macro and rates markets reflected a more cautious tone this week, as investors weighed stable but persistent inflation, resilient economic activity, and renewed geopolitical risks in energy markets. US Treasury yields remain firm following a significant repricing during early March. The 10-year nominal yield remains close to 4.27%, while the 10-year real yield increased to around 1.89%. The increase in real yields, as opposed to a significant increase in inflation expectations, seems to have been the major contributor to tighter financial conditions during this period.

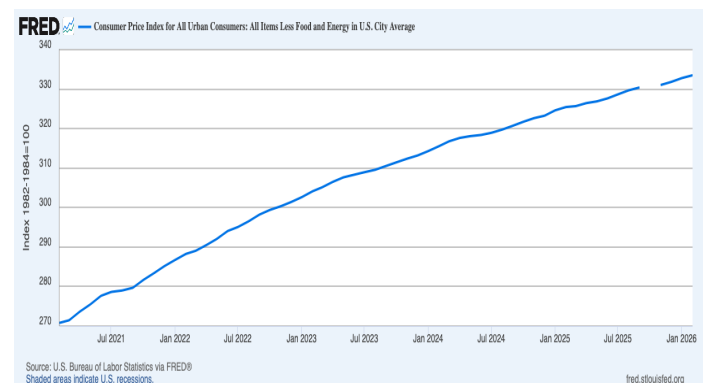
The move represents a partial reversal of the bond market rally experienced during February, when the 10-year US Treasury yield declined from roughly 4.27% to near 3.97%. The recent move upwards reflects a partial reversal of previous gains, which were achieved due to stronger economic growth, renewed inflationary pressures on energy prices, and rising real yields.

The inflation data also revealed that inflationary pressures continue to persist. The US headline Consumer Price Index increased by 0.3% month over month during February. The US core Consumer Price Index increased by 0.2%, which indicates that inflationary pressures continue to ease only gradually. On a year over year basis, US inflation remains steady at 2.4%, while core inflation remains steady at 2.5%,

slightly above the Fed's long-run inflation objective. Using the difference between nominal and real 10-year

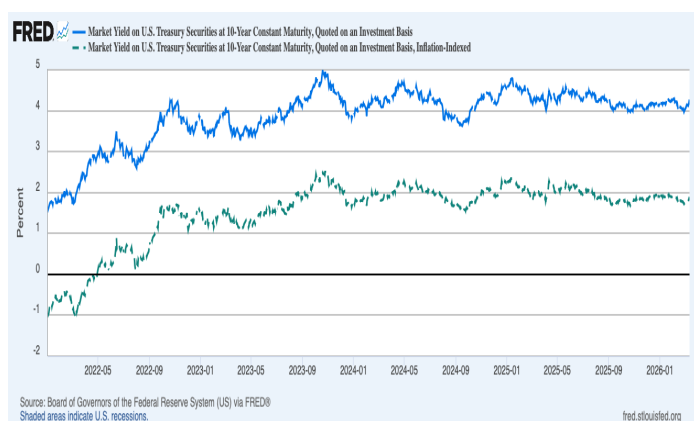
Treasury yields, 10-year breakeven inflation was approximately 2.38%, implying that long-run inflation expectations continue to remain anchored around 2.3-2.4%. This implies that the recent increase in US Treasury yields has been driven by rising real yields.

Figure 1: US Core CPI Inflation (Year-over-Year)



The increase in real yields has particular significance insofar as it reflects a tightening in financial conditions. The 10-year real yield rose from 1.71% to 1.89%, which effectively raised the discount rate applied to anticipated cash flows and intensified its impact on technology equities. This reflects that the easing in financial conditions that was registered in early February has reversed somewhat, with the cost of capital increasing once again in markets worldwide.

Figure 2: US 10-Year Treasury Nominal and Real Yields



The ISM Manufacturing Purchasing Managers' Index (PMI) registered 52.4 in February, a marginal fall from 52.6 in January. However, it is once again above the 50 threshold that denotes expansion. The slowing down also reflects that manufacturing activity continues to grow, but at a slower rate. More significantly, the ISM Services PMI registered a substantial jump to 56.1 from 53.8. This reflects robust momentum in the services sector, which remains the dominant driver of U.S. economic activity. Significantly, it is the services sector that is driving economic activity in the U.S. Additionally, the Manufacturing New Orders Index also remained in expansionary territory at 55.8. This reflects that forward demand conditions in industry also remain constructive.

The ISM Prices Index registered a substantial jump to 70.5, up from 59.0 in January and reaching its highest since mid-2022. This sharp increase suggests renewed cost pressure in the manufacturing sector, which is likely driven by a combination of higher commodity prices, tariff uncertainty, and expenditure pressures in production chains. Overall, these PMI indicators reflect a resilient U.S. economy with robust economic activity and a strengthening in inflationary pressures in production chains. These are likely to have driven Treasury yields to move higher over the course of the week, reflecting a reassessment of probabilities that the Federal Reserve will need to maintain a restrictive policy stance over a longer period.

The Treasury yield curve continued to reflect the soft-landing scenario, rather than a recessionary one, with the 10Y-2Y spread remaining around the 0.55% level, while the 10Y-3M spread remained around the 0.56% level. As a result, the yield curve continues to signal that the market is not anticipating a recession, but rather a slowdown in growth with a continued expansion. It is, however, important to note that the fact that the long-end of the yield curve moved, while the short-end

remained relatively stable, suggests that term premium has increased. This implies that the market is demanding a premium to hold long-dated bonds due to the uncertainty surrounding inflation, high fiscal deficits, high Treasury issuance, and rising geopolitical tensions.

Geopolitical tensions in the Middle East continued to add pressure to the macroeconomic environment, leading to pressure in the rates markets. The escalation of the conflict between the US and Iran has resulted in concerns over the impact it will have on the energy supply chain, particularly through the Strait of Hormuz, through which one-fifth of the world's oil is transported. As a result, Brent crude oil

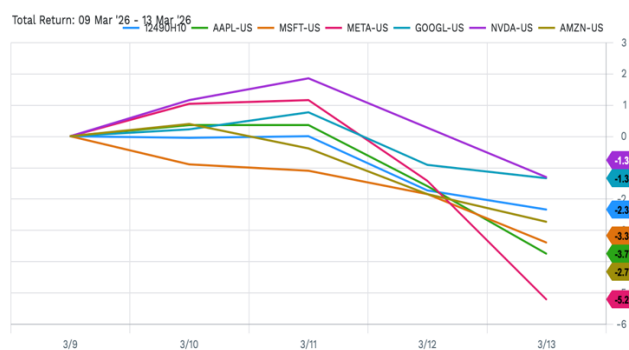
prices have risen by more than 40% over the course of the month, touching their highest levels since 2022, while the International Energy Agency has responded by releasing oil reserves to calm the markets. As a result, energy prices are high, leading to inflation, which has the effect of increasing uncertainty around the policy response, leading to a rise in long dated bonds, such as the 10Y, during the week.

The macroeconomic environment during the week has been consistent with a tightening market environment, with inflation remaining stable but not fully under control, the economy remaining active, and energy tensions rising, leading to upside pressure on price levels, with the rise in long dated bonds, such as the 10Y, during the week, while the positively sloped yield curve continues to signal that the markets are still positioned for a soft-landing, rather than a recession, given the term premium pressures, leading to a rise in real yields, making financial conditions still relatively tight compared to February.

## Technology Sector Overview

The equities within the technology sector experienced significant volatility during the period, impacted by various macro-economic and geopolitical events. The Nasdaq 100 index fell by (2.4%), which is a reflection of investor risk appetite during a period when oil prices were rising, real yields were increasing, and tensions were escalating in the Middle East. Technology stocks remain particularly sensitive to changes in financial conditions, and the increase in real Treasury yields during the week contributed to downward pressure on valuations across the sector

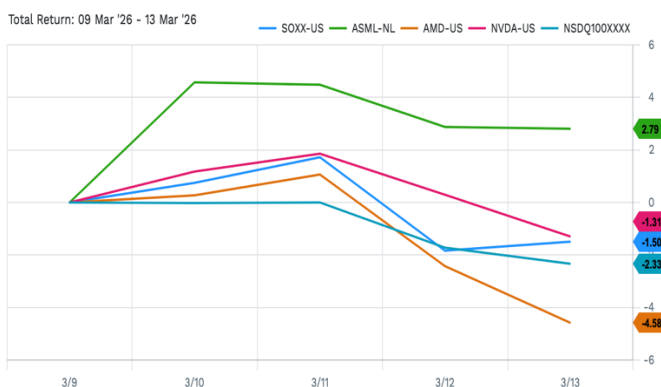
Figure 3: Nasdaq 100 and Magnificent Seven Performance



The Magnificent Seven, experienced significant volatility during the week. Meta Platforms (-6.1%) and Apple (-5.5%) led declines, with Meta under pressure following reports that the company may consider significant workforce reductions as it continues to invest heavily in artificial intelligence infrastructure. Alphabet fell by (1.3%), while Nvidia also fell by (1.2%) posting moderate losses. The equities within the technology sector that performed relatively better during the week were Microsoft (-0.75%) and Amazon (-0.35%), supported by strong cloud demand and ongoing efforts to monetise AI capabilities across enterprise platforms.

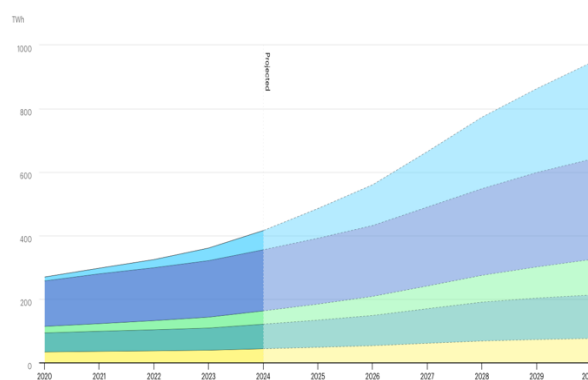
The semiconductor sector also declined during the week, which was more pronounced than the decline experienced by equities within the technology sector. The iShares Semiconductor ETF fell by 5.9%, which is a stronger decline than what was experienced by equities within the Nasdaq index. The decline was more pronounced for equities within the semiconductor sector. AMD fell by(2.6%), while ASML fell by (2.5%), and Nvidia fell by 1.2%. Even though equities within the semiconductor sector fell during the week. Nvidia’s relatively modest pullback suggests that investor confidence in long-term AI compute demand remains intact, even as short-term macro volatility pressures the sector.

Figure 4: Semiconductor Sector Performance



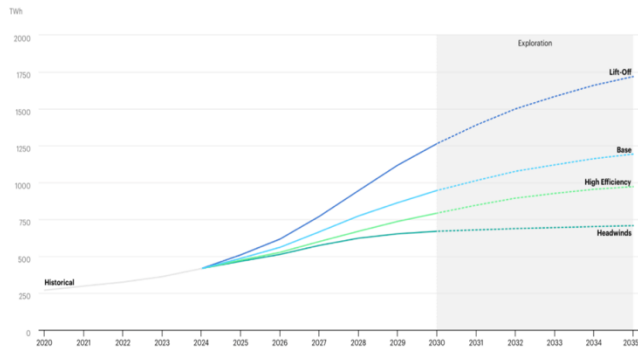
The recent developments within the artificial intelligence ecosystem have again highlighted the extent of investments that need to go into the next-generation computing infrastructure. The partnership between Nvidia and the AI startup Thinking Machines Lab, where the company will utilize large-scale GPU systems for model training, again highlights the investments that need to go into the next-generation computing infrastructure for the development of frontier level artificial intelligence models. At the same time, the large technology firms are facing increased pressure over the investments that need to go into the next generation artificial intelligence infrastructure, especially with regards to the costs associated with the data centre infrastructure and the associated energy costs.

Figure 5: Global Data Centre Electricity Consumption Forecast



The rising energy costs associated with the next-generation artificial intelligence infrastructure have become a major factor for consideration for the investors, where the total energy consumption by the data centers globally stands at around 415 terawatt-hours per year, accounting for around 1.5% of the total energy consumption globally, with the total energy consumption by the data centers expected to rise by more than two-fold by the year 2030, driven by the rising artificial intelligence workloads. Further, the total energy consumption by the data centers within the US stands at more than 4% of the total energy consumption, again highlighting the high energy costs associated with the next generation artificial intelligence infrastructure.

Figure 6: Electricity Consumption by Data Centre Equipment



Overall, the price action of the week reflects a short-term reallocation of focus away from the excitement over artificial intelligence and into the concerns over cost discipline, infrastructure investments, and macroeconomic pressures. While the long-term prospects for artificial intelligence compute remain robust, the increases in energy prices, real yields, and geopolitical tensions have created a more cautious tone in the technology sector.

Taken together, the week highlighted the growing interaction between macro conditions and technology valuations. The increases in real yields and the inflation concerns related to energy prices have impacted the growth stocks, and the uncertainty over the cost and scope of artificial intelligence investments has created a cautious tone. However, the ongoing growth in artificial intelligence compute provides evidence that the current weakness in technology stocks reflects cyclical macroeconomic forces and not a deceleration in the long term growth trend.

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