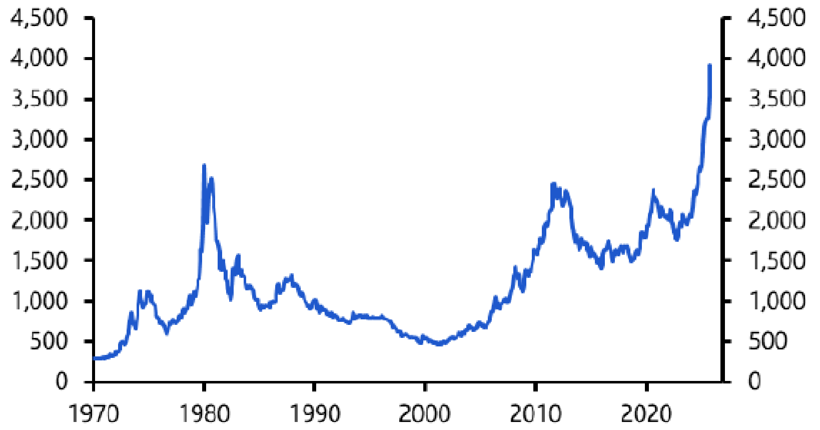
Tale of 3 Bubbles: Gold, Indian IPO & AI

The most often asked questions in all discussion over the past few months are about views on gold prices, Indian IPO's and AI Stocks. Let me get the caveat out of the way - I am not a subject matter expert on gold. Yet, we understand economics (despite being a dismal science), parse primary data and practice level-headed rationality. As a consequence, we have views, and more often, high conviction views based on fundamentals and can spot market irrationality. So, for the benefit of our clients, I thought of putting together some logical reasoning to gold price, IPO market behaviour and AI frenzy.

Gold Prices

In fact, to begin with, the pullback in gold prices over the past week shouldn't have come as a surprise. The yellow metal has been on such an extraordinary tear this year that it had become even more unmoored from any fundamental valuations and was ripe for a sharp correction. However, even after that sell-off – which included the biggest one-day fall in over a decade – gold is still at a record high in inflation-adjusted terms. (See Chart 1.) The run-up in prices over summer has prompted many forecasters to lift their gold projections, even as the rally becomes harder to justify. ***This is classical capitulation of the analyst community where price momentum forces them to raise their price targets.***

Chart 1: Monthly Real Gold Price (2024 US$ per Ounce)

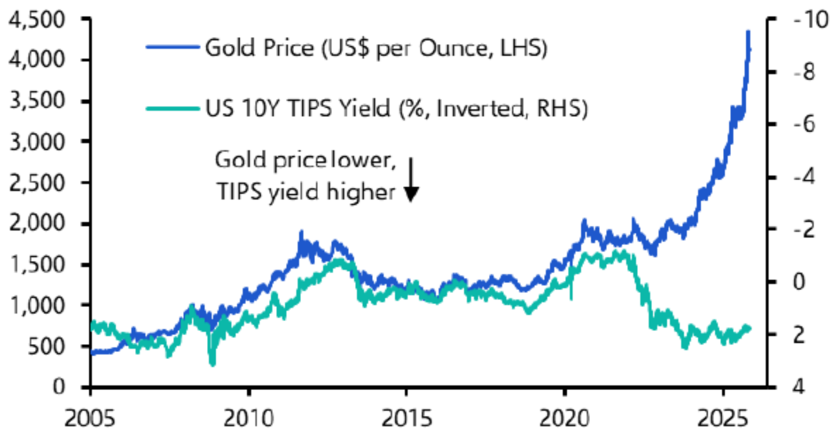


Source: CEIC

Fundamentally, the metal tends to move inversely with real yields on US government bonds – that is to say, the yield investors earn on Treasuries after adjusting for inflation.

The logic that underpinned this relationship was straightforward: gold pays no income, so when real yields increase, the opportunity cost of holding it increases and so its price falls; conversely, when real yields drop, that cost diminishes and gold looks more attractive. However, while this relationship held reasonably well for most of the past decade, it broke down in 2022.

Chart 2: Gold Price and 10-Year TIPS Yield



Source: CEIC

Since then, gold prices have been marching higher even as real yields have risen, suggesting that other forces have been at work.

<u>The breaking of correlation between fundamentals and underlying price is the start of bubble in any market. Gold Price is no exception. It's the same human psychology and behaviour.</u>

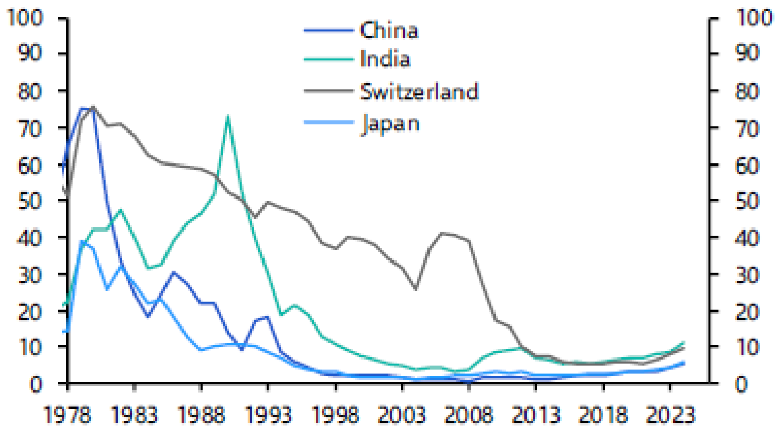
Two broad explanations have typically been offered to justify this year's price surge. The first centres on official demand and involves central banks – particularly in emerging markets – buying gold to diversify their reserves away from the dollar.

This behaviour can be seen most clearly with the People's Bank of China, whose official holdings of US Treasury securities have fallen from over $1 trillion in 2020 to around $700 billion today.

The freezing of Russia's reserve assets by Western governments following its invasion of Ukraine in 2022 was an inflection point for policymakers on the other side of the geopolitical divide. They have come to see gold as a "sanction-proof" store of value, and this has resulted in a structural shift in demand from these institutional sources.

As a result, reserve managers are diversifying out of the dollar; demand from China, where the property market remains in a funk; and asset managers increasing their exposure to the metal via ETFs have all played a role in ***<u>structural change in demand for gold</u>***. For example, gold's share of total reserves has already risen to more than 20% as per the latest data from World Bank.

Chart 3: Shares Of Gold in Total Reserves in Selected Countries: 1960 – 2024 (%)



Source: World Bank

The second apparent driver of this year's rally in gold has been the so-called "debasement trade" – the idea that political turmoil, particularly in Washington but also in other major economies such as Japan, has prompted investors to seek refuge from fiat currencies.

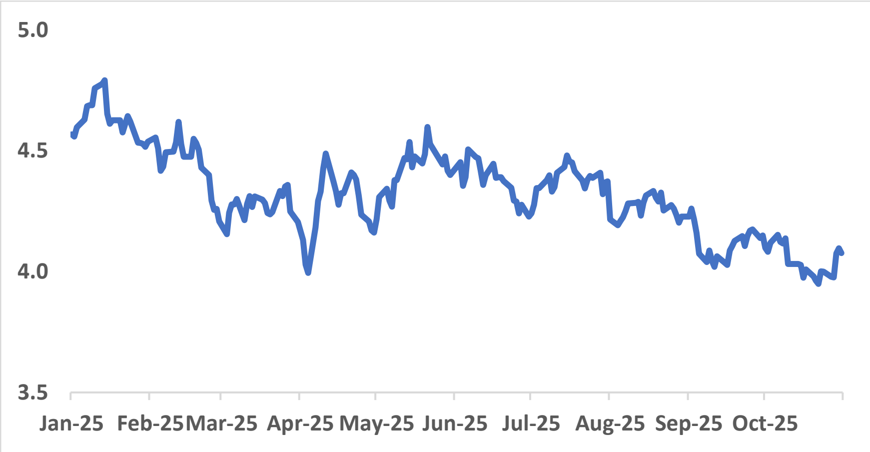
A common explanation for the surge in hard assets such as gold and silver is that political strains in the US – including concerns over challenges to the Federal Reserve's independence – could stoke inflation and weaken the dollar. Dubbed the "debasement trade," rallies in the prices of these assets are seen as a hedge against the erosion of purchasing power.

The idea that a debasement trade is driving the price of gold simply doesn't stand up to the evidence. On the contrary, the dollar has been relatively stable for months while US Treasury bond yields have been trending downward all year – precisely the opposite of what you would expect if investors were bracing for higher inflation and a weaker, or debased, currency.

Chart 4: DXY US $ Index

Source: Bloomberg

Chart 5: US 10Y Treasury Yield (%)



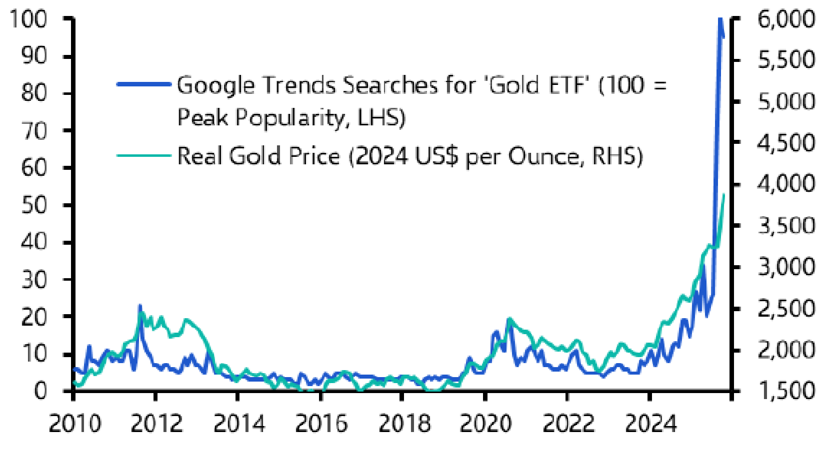
Source: Bloomberg

Perhaps gold investors are anticipating inflation or dollar weakness that hasn't yet shown up except in their anticipation. Trump constant rhetoric to undermine the independence of the federal reserve and to take over the US fed could act as fodder to gold speculators narrative, but none of this is in realms of possibility.

Likewise, while it's logical to expect heavily indebted governments to rely on financial repression to manage their debt burdens, this is likely to take relatively mild forms rather than deliberate efforts to inflate away the debt's real value. Governments would not want to spook the bond markets at any cost and the cost of doing that would be very high.

A more plausible explanation is that what began as a rise justified by the fundamentals – that structural increase in official demand – took on a momentum of its own. The surge in gold prices appears to have been increasingly driven by retail investor participation, with a striking correlation between real gold prices and Google searches for "gold ETF" (a proxy for retail demand). (See Chart 6.) It has looked more like a market gripped by FOMO (the fear of missing out) than one grounded in fundamentals. ***<u>We all know what happens to prices after retail frenzy takes over.</u>***

Chart 6: Google Trends Searches for 'Gold ETF' and Monthly Real Gold Price



Source: LSEG

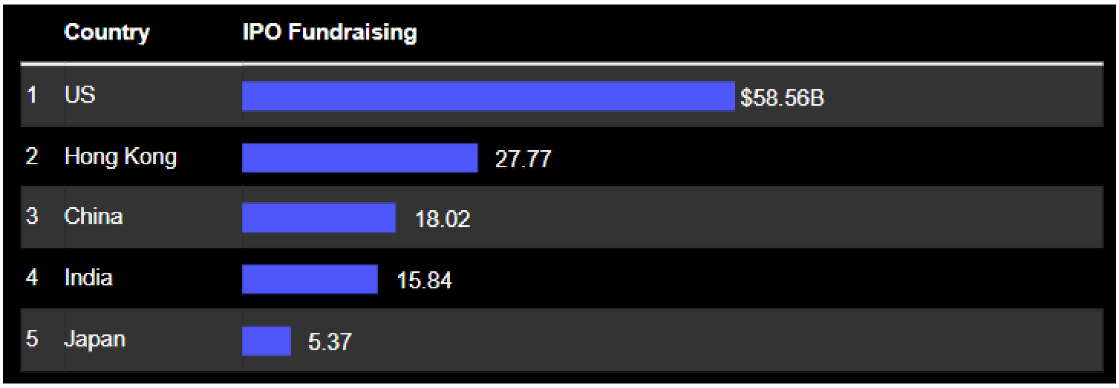
Central bank demand and geopolitical tensions may cushion the downside this time around. There are good reasons to justify a structural increase in gold prices. But for the time being, gold has run ahead of itself.

India's IPO Market

India has become the new IPO factory of the world with unprecedented enthusiasm in the primary markets driven by insatiable demand from naïve retail investors, lust for listing gains from flippant institutional investors, eye-popping IB fees driving ever pliant bankers to close deals at frantic pace and opportunistic businessmen raking the moolah by taking their company public with a promise for ride to fantasy to gullible investors.

India has now become the 4th largest IPO market in the world with strong momentum in listings and capital raise.

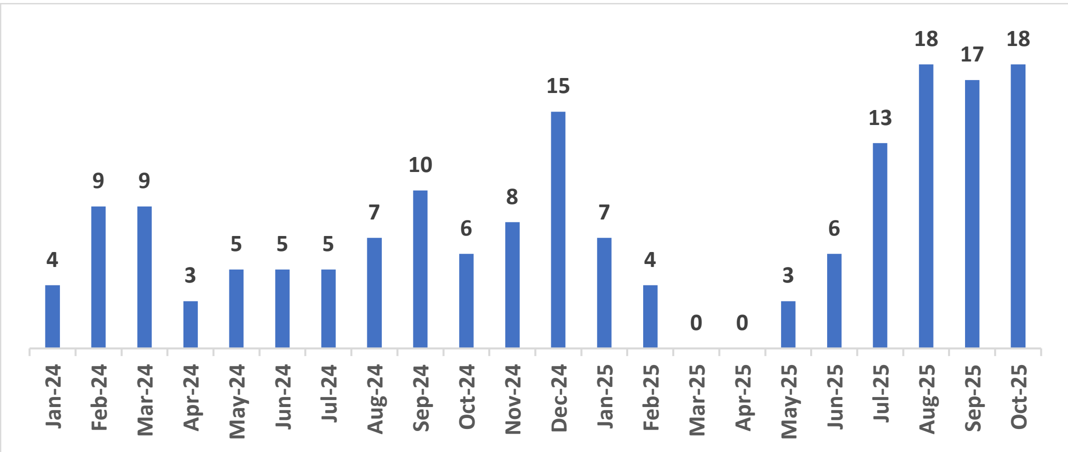
Chart: IPO Fundraising



Source: Bloomberg. Note: Figures cover offerings through Oct. 29, 2025.

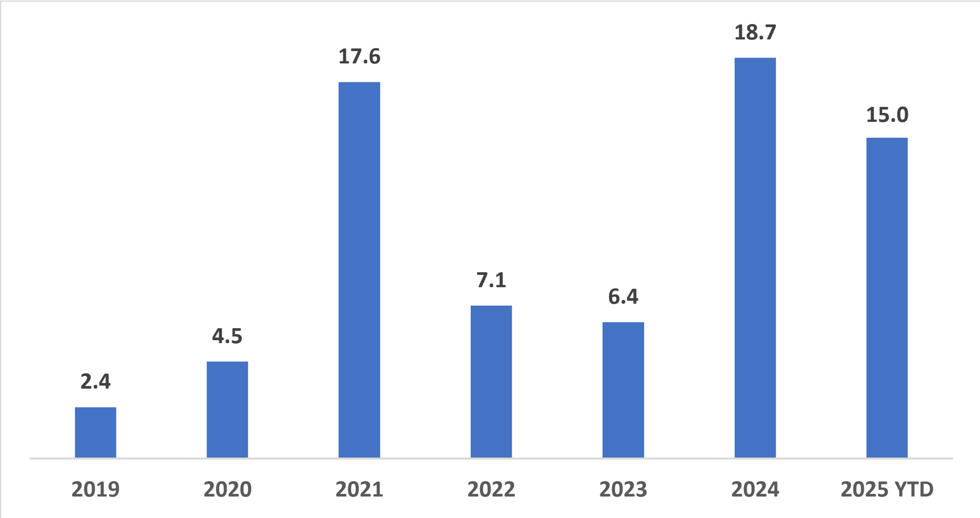
The contradiction is sharp – despite the secondary market not doing well, Indian primary markets have remained buoyant with record no of issuance and fund raising during the year.

Number of fresh listings (mainboard) in the Indian markets (BSE/NSE) since January 2024



Source: CLINE

India - IPO fundraising through the years (USD bn)



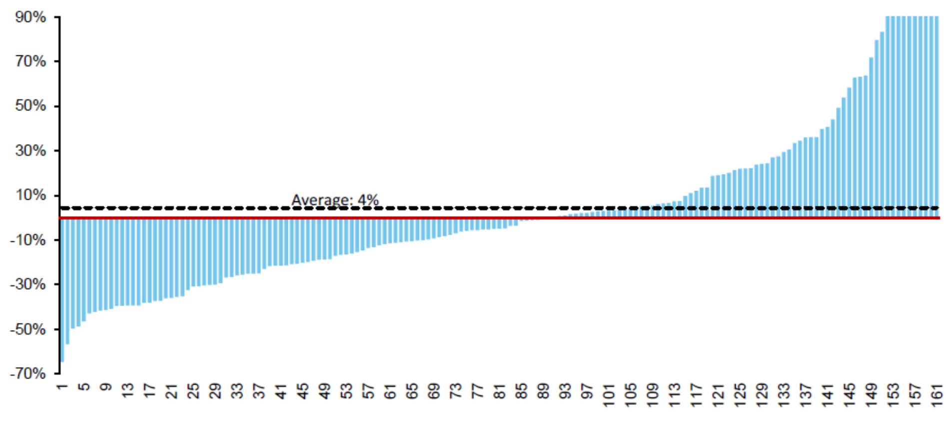
Source: CLINE (2025: up to 31st Oct,25).

More importantly, while domestic investors have been leading the march in IPO investing, yet even FII's have not shied away from the Indian IPO market investing over $5bn despite being sellers to the tune of $15bn in secondary market in this year. Institutional investors are fighting hand over fist to get place in anchor allocations of IPO to make some quick listing pops and that's the new game in the town.

One of the most satirical comments I heard recently was at trade fairs at Pragati Maidan in India's capital New Delhi, there are more investment bankers flogging stall after stall seeking SME's interest in getting listed on stock exchange and soliciting IB business than trade partners or business visitors at the fair.

Companies get to IPO when they are at their best, so it's very normal to see sharp improvement in profitability before IPO and for 4 quarters post IPO to seek optimum valuation in IPO markets. It's no surprise that the price performance post listing of IPO companies since Jan24 has been very modest with avg. return being underwhelming 4% and mean of 50% companies delivering negative returns post listing.

The cumulative returns: Return distribution of all IPOs that have opened since Jan 2024 (Listing gains not included). There is almost an equal split between stocks with positive and negative returns.



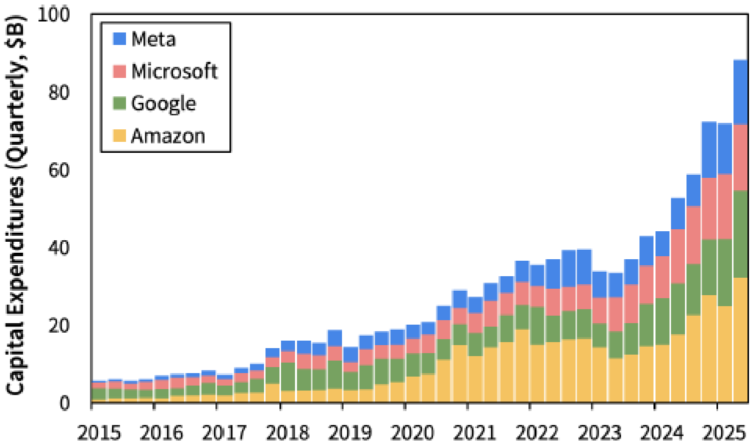
Source: Bernstein

More importantly, all these IPO companies business model are untested for longevity and resilience in economic downcycles. Over 60% of the companies that went IPO in 2007 (peak bubble before GFC) do not exist today. If you are dancing to this music, make sure you are dancing closer to the exit door so as to get out before the stampede.

AI Infrastructure Boom

Over the past year, the AI boom has reached a key inflection point. Fuelled by the promise of exponential “scaling laws,” capital expenditures have skyrocketed. The largest U.S. tech firms are on track to spend nearly $400 billion this year alone. Over the next five years, McKinsey estimates that cumulative AI investment will reach a staggering $5.2 trillion.

Chart 1: AI Investment Boom



Source: S&P. From Q1 2015 to Q2 2025, Bloomberg

So far, investors have looked upon these capital investments favourably. The so-called Magnificent 7, who are driving much of the buildout, have continued to outperform; Oracle’s stock surged 36% after announcing a deal to build OpenAI’s data center’s. However, it remains far from clear if these investments will ultimately deliver adequate financial returns. Bain estimates that, to justify their cost, these data centers will need to generate $2 trillion in annual revenue by 2030.

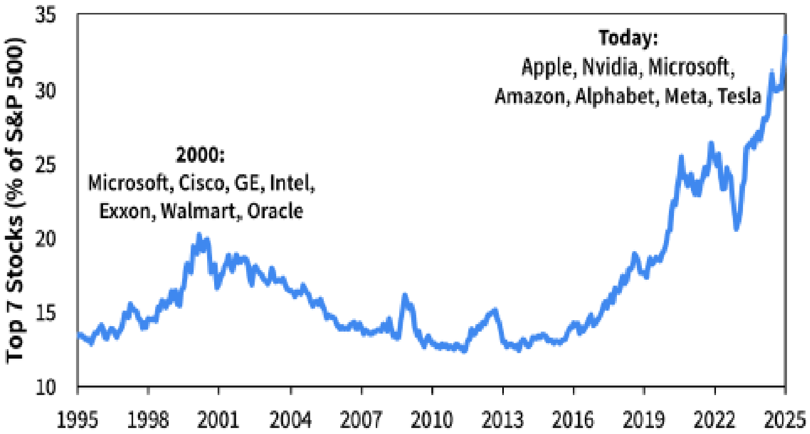
The parallels to past technology buildouts are hard to ignore. In the late 1990s, during the internet dawn telecom companies, such as Global Crossing and AT&T, spent over $500 billion laying fiber optic cable in anticipation of rapid Internet adoption. However, their projections proved overoptimistic, leaving the industry to suffer for years amid a glut of capacity and collapsing prices. But Investment in a productive asset also allows households and corporates to continue benefiting from cheap access to the technology after any potential bust, which should support productivity, as the computer hardware surge of the late 1990s did.

Whenever new foundational technology is introduced, it calls for making significant investments in hardware and infrastructure for implementation and future adoption of the technology. But its also usual for companies in the ecosystem to get overly optimistic and make significant over investments as the future potential is enormous and no one wants to miss the bus.

The US stock market is increasingly driven by a single theme: AI. According to JPMorgan, AI stocks have accounted for 75% of S&P 500 returns, 80% of earnings growth, and 90% of capital spending growth since ChatGPT's release in end 2022. **This doesn't mean that the growth of S&P 500 FTM EPS is unsustainable if demand for AI keeps growing. But it speaks to the reliance of the bull market on this transformative technology.**

The Magnificent 7, which represent both the largest AI stocks and those most exposed to a potential AI overbuild, now comprise over 30% of the S&P 500, a level of concentration exceeding even that of the dot-com bubble.

Chart 2: Top-Heavy Stock Market

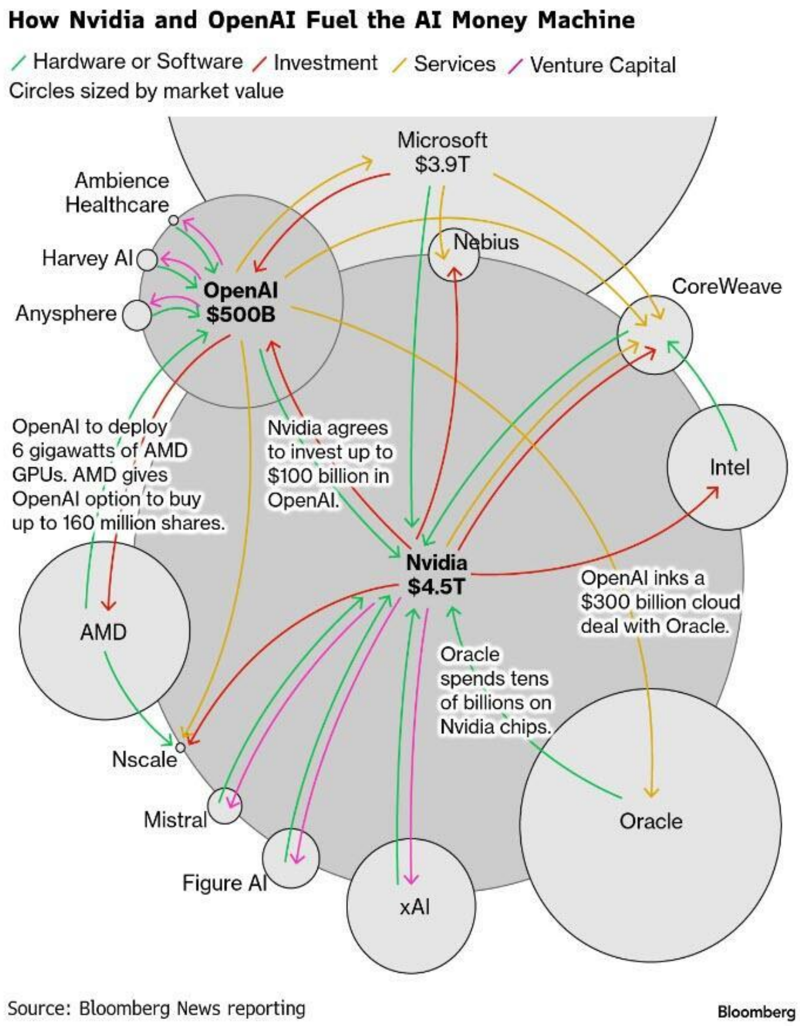


Source: S&P. Chart shows the total S&P 500 weight in the top 7 stocks at each point in time. As of 12/31/2024.

In fact, Big Tech's AI spending is now so large that it appears to be propping up the broader economy, accounting for an estimated 80bps of U.S. GDP growth so far this year.

And since the technology is still in early evolutionary phase, the circularity of revenues and interdependence and interconnectedness of the companies in the ecosystem is glaring. (See chart below)

To be very clear, while we remain big believers in AI, yet experience tells us that infrastructure investment in new technologies do tend to overshoot leading to periods of poor returns. While in the 1st phase it's the infrastructure companies that makes the most revenues and commit investment in these path breaking technologies, in the long run, service providers create most value for stakeholders.



There is a ‘S” curve demand for AI that lies ahead as the technology reaches inflexion point, but that doesn’t take away the risk of overestimating the demand in the short-term leading to overinvestments and poor business economics.

It is normal for new pathbreaking general purpose technologies to have always coincided with some sort of financial market bubble, as investors sought to capitalise on the gains before the true extent of the benefits was certain. This time is unlikely to be different, though we are still in the inflationary stage of the bubble. Selling early in the bubble could mean leaving money on the table.

Conclusion

Spotting bubbles is never an exact science, though when it looks and acts like one, it probably is. I have repeatedly said - ***“it’s the business of free markets to create bubbles and burst bubbles. Markets are good at doing their job”***

For a value investor like us, forecasting short-term moves in asset prices is not our forte.

There have been two previous episodes of similar exuberance in gold since the end of the Bretton Woods agreement that fixed the gold to the dollar: in the late 1970s and again in the early 2010s. Both ended the same way – with major falls in the price of gold. In the early 1980s gold fell 60% in real terms and in the mid-2010s by about 40% in real terms.

There have been similar bubbles in the Indian IPO Markets. Remember the infamous, Reliance Power IPO in Jan. 2008. The stock closed at 48% discount to IPO price on listing and crashed 99% from IPO price. After, 18 years the stock trades at 90% discount to the IPO Pirce. The question in town is which company will beat this track record in this cycle.

Grey haired investors would never forget the TMT bubble of 2000. The Nasdaq Index crashed 78% peak to trough and the leaders of that rally – Amazon (-75%), CISCO (-86%), Microsoft (-60%), had their stock prices crashing.

Bubbles in asset prices don’t have soft landing

I often get asked these questions: Is gold in a bubble? Is India’s IPO market in a bubble? Is there an AI bubble in the world?

My Simple answer is – Why are you asking this question? Isn’t it obvious!

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Pankaj Murarka

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