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Investment Perspective

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The Kindness of Strangers

In Tennessee Williams' *A Streetcar Named Desire*, Blanche DuBois epitomizes the degeneracy of delusion. At the start of the play, she presents as a harmless eccentric — a conceited and supercilious anachronism of a genteel planter aristocracy. But as her story arc reveals the complete fraud of her self-imagination, she slowly unravels. By the climax, when she can no longer square her internal world with reality, she collapses in a nervous breakdown. As she is led away in the final scene to the asylum, she turns to the orderly and declares "Whoever you are — I have always depended on the kindness of strangers." Surveying financial markets today, I observe a growing set of narrative inconsistencies and disturbing reliance on the kindness of strangers.

The leading U.S. data center operators (the 'hyperscalers') are fast approaching zero free cash flow (operating cash flow less capital expenditure). The transition of the largest free cash machines the world has ever seen to consumers of cash is a watershed event. While everyone can see that the tide of cash has turned, there is a reflexive assumption that it will return after a brief respite. This cash deficit is somehow a short intermission, after which regular service will resume. I wonder if that is a comfortable delusion. What is certain is that the companies will face an escalating depreciation charge weighing on earnings for years to come. Also certain is that the hyperscalers are increasingly tapping the debt and equity markets. The businesses are so profitable and so unlevered that their debt is easily absorbed. For the first time in decades, they have become dependent on the kindness of strangers.

But the hyperscalers' expenditures are only the most visible layer of the capex. So far this year the hyperscalers have issued about $200 billion of public debt. But the total AI-related debt raised year to date is $489 billion. Where did the rest come from? One project gives us a clue. Meta Platforms created a special purpose vehicle to fund the construction of a 1-gigawatt data center in Richland Parish, Louisiana. The budget for the project was $30 billion. But Meta's equity contribution was only $500 million. Blue Owl committed another $2 billion for 80% of the equity. The remaining $27-odd billion to ramp up the project consisted of private debt. Why would normally staid debt investors go on the hook for a (rather) speculative project? Because Meta has agreed to lease the project back in its entirety for 20 years. And if they decide to walk on the lease? Meta agreed to make the debt holders whole. Sounds like a pretty ironclad guarantee. But you won't find this obligation on Meta's balance sheet. Meta liked the arrangement so much, they just announced they were expanding the operation to 5 gigawatts and creating a similar structure for another 5 gigawatts in El Paso, Texas. So the debt we see is just the tip of the iceberg. Nikkei has calculated the combined off-balance-sheet obligations of the five hyperscalers at around $1.65 trillion.

Why are the obligations off balance sheet? The companies only need to convince their auditors that there is a reasonable likelihood that the obligation will not be exercised. At the same time, the $1.65 trillion of creditors are reasonably certain that they will be. In fact, the whole edifice rests on a kind of Schrödinger's cat-like duality. The leases and residual value guarantees can exist for the bondholders and not for Meta. The two counterparties may be strangers now. But I expect they will get to know each other a lot better when the box is opened, and we find out if the cat is alive or dead.

The other instantiation of the kindness of strangers is the rushing tide of momentum in today's markets. Momentum investing consists in buying assets that have gone up in price in the expectation that such will continue. If that sounds like it violates every sound principle of capital allocation, I concur. But it has a long empirical track record of success. So far this year it has made a mint in just about every corner of the financial markets. I know you tried to read Graham and Dodd and Warren Buffett's collected investor letters, and it's not in there. But it's real. Like all good things, it comes with a drawback. It's called a momentum crash. The problem is that these crashes are not predictable. In fact, by definition, they come when everything looks spectacular. Only when everyone is flush with paper wealth and full of supreme confidence does the blow come. Of course, everyone in the trade knows the game. They may falsely construe it as a game of musical chairs. That there will be some warning. Except that's not the nature of the game. In momentum investing, all the chairs are removed in one fell swoop. It doesn't falter. It goes from full-on to full-reverse. It is the most pure form of depending on the kindness of strangers.

The audiences of *Streetcar* have always taken Blanche's 'kindness of strangers' remark as the final expression of her hopelessness. She never 'depended' on strangers. She used them to indulge her own insecurities. And they used her likewise. There was never any kindness among strangers in Tennessee Williams' New Orleans. There were only bare motives that may have intersected for a brief second. The vast train of momentum surging through markets and the colossal financings behind today's buildout may look like a conjoined purpose. But cracks are starting to fracture the dominant narrative. The credit spreads of the hyperscalers and their projects have started to widen. The semiconductor stocks have rolled over ever so slightly. If there were ever a time to rely on one's own judgment and forgo the kindness of others, this is the time.

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