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EPISODE 53

CoreWeave in a Coal Mine? No Contagion, Yet

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CoreWeave delivered a preview of possible bond market turmoil yet to come. Bond investors panicked after comments from its co-founder, who reportedly said it would seek an investment-grade credit rating so it could access "unlimited" pools of capital.

The deafness of the comment was startling. "Unlimited borrowing" sounds like the road to ruin for existing debt holders. CoreWeave's primary debt offerings in public and private markets carried 9% coupons at issue and traded at par as recently as June 30. Last week, sellers had to offer a 15% yield to find buyers, and there weren't many.

It's More Than Size, It's Profitability

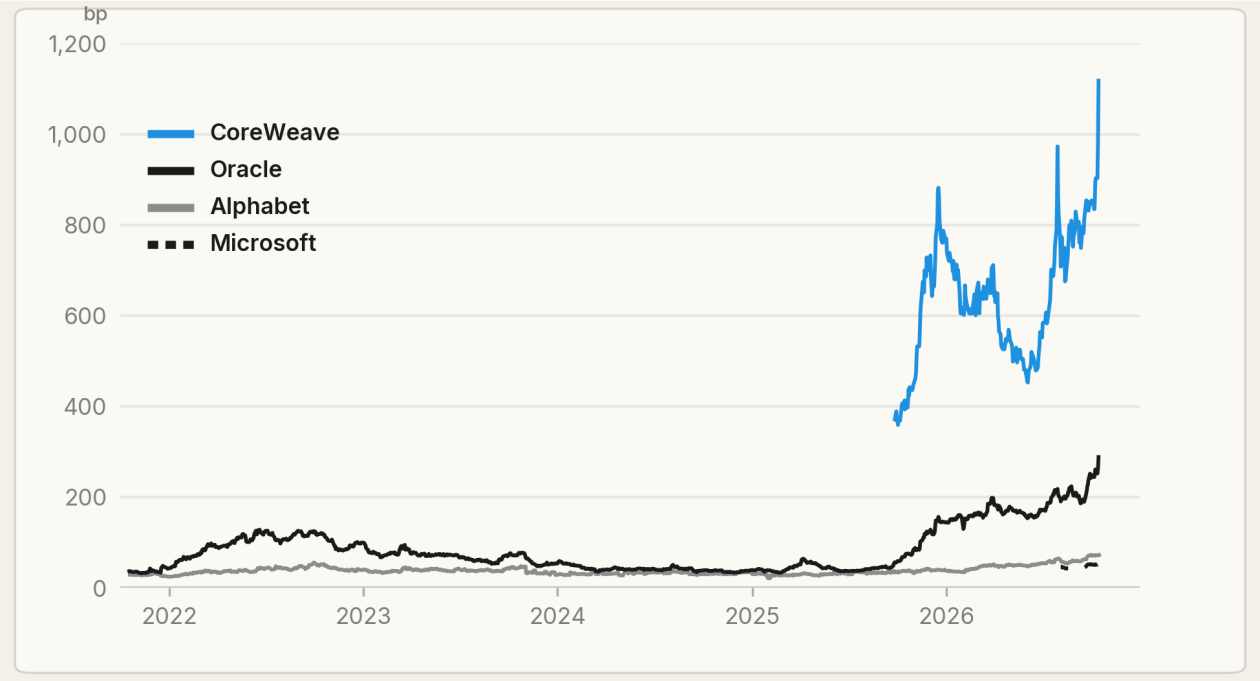
CoreWeave owes $52 billion (gross) for its data center investments to date. In contrast, the top five cloud services/data center builders, all diversified public companies, owe $770 billion. Perhaps you are wondering if this is too much. A single year of EBITDA for the group is $651 billion. Their EBITDA in the coming two years could pay down much of their direct debt – though this excludes their substantial off-balance-sheet obligations.

With a combined equity market cap of $13.2 trillion, there was no contagion from CoreWeave to the strongest borrowers last week (Figure 1). Even after CoreWeave's bond blowup, both high-grade corporate and high-yield bonds have still outperformed US Treasuries this year (Figure 2).

The present pace of the AI infrastructure investment spending boom is unsustainable. Difficulties with debt funding have been predicted for quite some time (see our Point last week). Yet the growth in AI demand is outstripping supply. Computing components, energy, water, land and now credit will constrain the growth of data center capacity. If data center development slows – as the CoreWeave episode suggests – it could very plausibly improve the economics for CoreWeave's competitors.

FIGURE 1

CoreWeave, Oracle, Alphabet and Microsoft 5-Year CDS



SOURCE: CIO GROUP, BLOOMBERG

FIGURE 2

US Corporate High Yield, High Grade and Long-Term US Treasury ETF Price Performance



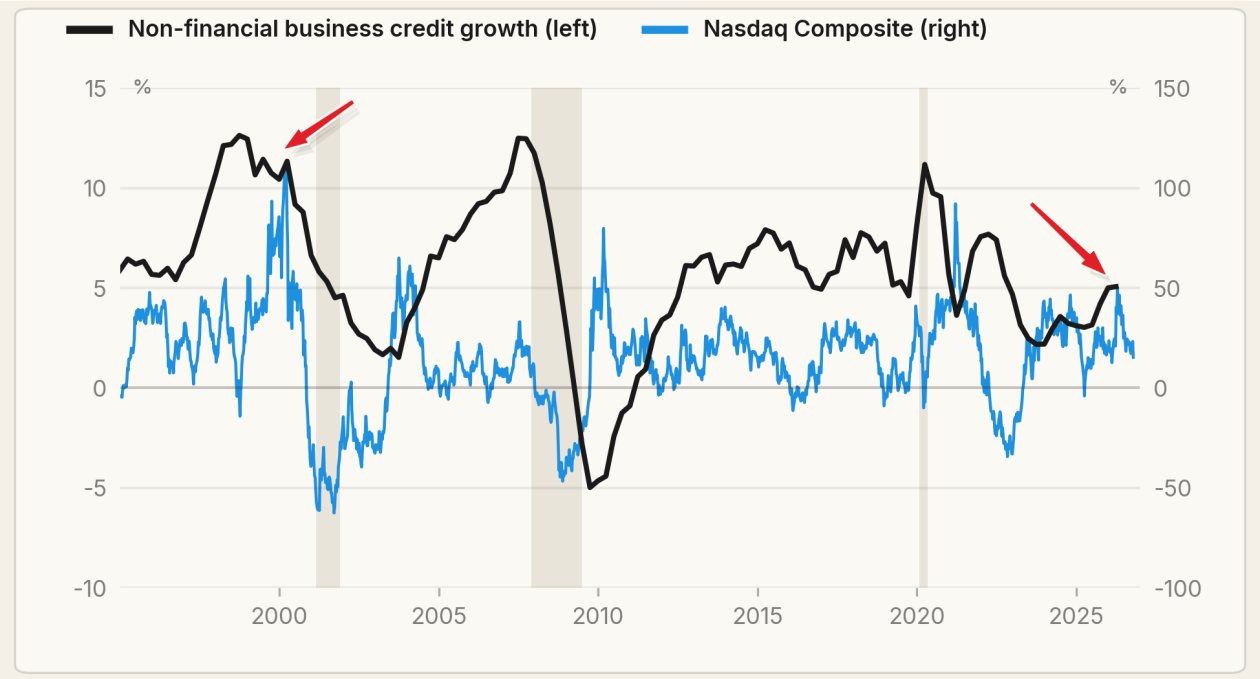
SOURCE: CIO GROUP, FINANCIAL MODELING PREP

Good and Bad News in Parallel

The market reaction to CoreWeave seems emblematic of a burgeoning confidence crisis in AI investing. Yet, it is potentially a welcome restraint that may avert a bigger future crisis. As figure 3 shows, the current period stands in notable contrast to the peak of the internet boom. Quite simply, today's total corporate debt growth is half the pace of 1999. The Nasdaq Composite has risen 16% over the past 12 months. In 1999, that figure was +86%. This suggests that risk-taking now is high, but not absurdly so.

FIGURE 3

US Non-Financial Business Credit Growth (Black, Left) vs Nasdaq Y/Y% (Blue, Right)



SOURCE: CIO GROUP, HAVER ANALYTICS

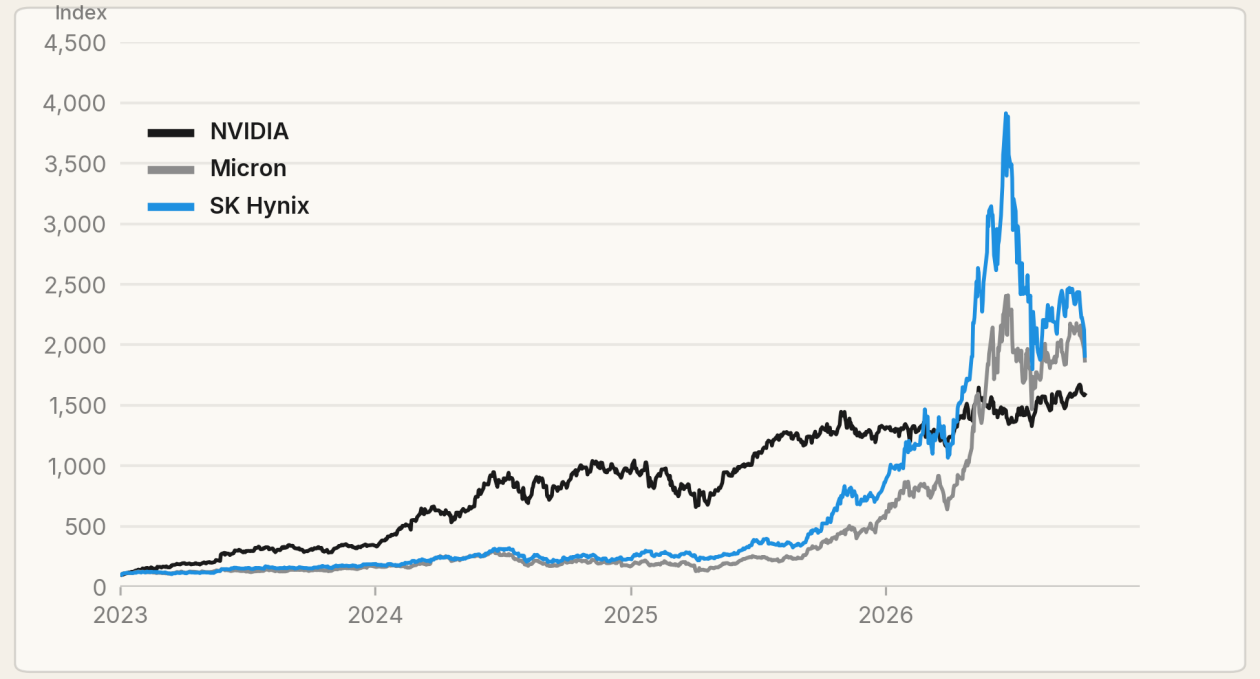
Sorting Out Winners and Losers

A slowdown in data center investment growth will not materially slow AI innovation and AI utilization. Markets believe new memory supply from China is likely to help rebalance supply and demand for memory chips. Corrective forces in the DRAM boom have resumed (Figure 4). Yet,

actual AI data service providers (Anthropic is one) and critical beneficiaries such as cybersecurity and cloud services should be assessed independently. CIO Group continues to favor software and cloud services over tech hardware (Figure 5).

FIGURE 4

NVIDIA vs Micron and Hynix
(Cutting-Edge Processors vs Memory Chips)

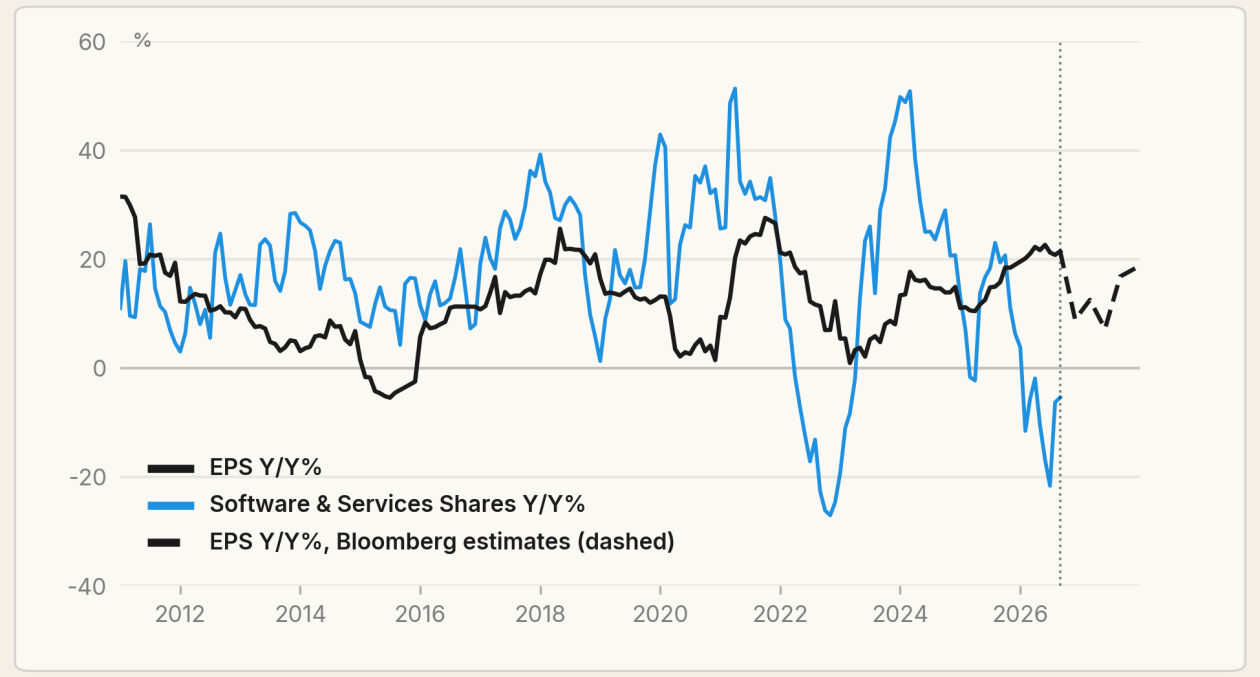


SOURCE: CIO GROUP, BLOOMBERG

Today, the data-center-only providers and the hyperscalers are claiming higher spending intentions for the year ahead. But CoreWeave is the market's shot across those ambitions.

FIGURE 5

S&P Software and Services Share Prices, EPS Y/Y% With Estimates



SOURCE: CIO GROUP, HAVER ANALYTICS, BLOOMBERG

Now, Keep Your Eyes on Warsh

As we've noted recently, the Fed's new chair, Kevin Warsh, has an "unforgiving" approach to managing supply shocks. He believes that higher rates are needed to temper inflation whether monetary or shock-driven. (See Points #49 and #50.) Therefore, how much US monetary tightening is ahead truly can't be known given the unpredictable nature of shocks.

Today, there seems more fear over the CoreWeave episode than fundamentally warranted over the debt outlook for the stronger hyperscalers. Yet the Fed will interact with credit markets as risk-free rates climb. That is why investor portfolios should be strong and diverse enough to withstand a far more substantial credit event.

FIGURE 6

High Yield Credit Spread Over US Treasury (pts)



SOURCE: CIO GROUP, HAVER ANALYTICS

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