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RETHINKING THE AI "BUBBLE"

David Clark
Chief Investment Officer
VenCap International plc

Why AI Feels Like a Bubble

Over recent months, one question has dominated our conversations with investors: "Is AI in a bubble?" The concern is understandable. Valuations are high, capital is moving quickly, and the pace of technological change makes it hard to judge where we are in the cycle.

Much of this anxiety comes from what is happening in the public markets—volatile semiconductor valuations, hyperscalers issuing large amounts of debt, and an infrastructure build-out measured in tens of billions. These dynamics create the impression of a speculative boom.

But this paper is focused on something different: the venture-backed AI companies building and deploying the underlying technology. And when you look closely at the private side of the market, the bubble narrative begins to break down. What appears from a distance to be speculative momentum is, up close, driven by real adoption, real revenue, and real workloads. AI systems are being deployed into production faster than in any previous technology wave, and the leading model developers are generating multi-billion-dollar revenues only a few years after founding.

To understand whether this resembles a true bubble, it helps to step back and compare today's environment with periods in history that genuinely were bubbles. Those moments shared a clear set of characteristics: **prices detached from fundamentals, adoption lagging far behind investment, and heavy reliance on leverage**. By examining those patterns and comparing them to what we are seeing in AI today, a more accurate picture emerges — one that clarifies both the risks in the current market and the scale of the opportunity ahead.

The Anatomy of a Bubble

Financial history offers a clear record of how true bubbles behave. While each unfolds in its own context, they share a common pattern: prices detach from underlying value, adoption or usage lags far behind investment, and capital flows into assets or businesses with little real substance. When sentiment shifts, these markets unravel quickly because there is no fundamental base to support them.

- **Tulip Mania (1630s)** - Often cited as the earliest recorded asset bubble, tulip prices in the Netherlands soared to extraordinary levels despite having no intrinsic economic value. Trading was driven almost entirely by expectation and speculation. When buyers disappeared, prices collapsed by more than 90% in weeks.

- **The South Sea Bubble (1720)** - Shares in the South Sea Company surged on promises of vast trade profits that never materialised. Investors bought in on the expectation of future riches, not on the basis of actual operations. When it became clear the business had no underlying earnings, the market imploded.

- **The Dot-com Bubble (late 1990s)** - Technology companies with little revenue, no customers, and often no working product achieved valuations in the billions simply because they were "internet companies." Capital poured into firms long before viable business models emerged. When sentiment shifted, many collapsed entirely because there was nothing underneath the narrative.

- **The U.S. Housing Bubble (mid-2000s)** - Here, the underlying asset — housing — was real, but the pricing was not. Excessive leverage, weak underwriting, and financial engineering pushed prices far beyond sustainable levels. The moment confidence broke, the structure collapsed under the weight of debt, revealing how little true economic value supported it.

Across these examples, bubbles share several defining characteristics:

- **Prices detach from fundamentals** — assets are valued on expectation, not economic use.

- **Adoption or utilisation is weak** — products have limited real-world traction.

- **Capital flows to entities with little substance** — weak business models, no revenue, no customers.
- **Mass retail participation**—bubbles typically involve widespread public speculation—millions of non-experts buying simply because prices are rising.
- **Leverage amplifies fragility** — when sentiment turns, the absence of fundamentals becomes quickly visible.
- **Resets are severe** — because there is no underlying demand to cushion the fall.

These cases serve as a reference point. They allow us to ask a simple but critical question: **Does AI exhibit the same characteristics?**

Does AI Fit the Pattern?

1. Prices vs. Fundamentals

A hallmark of bubbles is prices disconnected from economic reality. By contrast, the largest AI companies are already generating substantial revenues. OpenAI projects around $20 billion in annualised revenue by the end of 2025, growing to hundreds of billions by 2030. Anthropic expects roughly $9 billion by late 2025, rising to $70 billion by 2028. These numbers reflect real enterprise demand and heavy utilisation, not speculative projections. Valuations are high, but they sit on top of meaningful, growing revenue streams.

2. Adoption vs. Investment

In past bubbles, adoption lagged investment by years. Investors funded companies on the belief that customers would eventually show up — often they didn't. In AI, adoption is, in many cases, moving ahead of investment. Enterprises are adopting AI technology at unprecedented rates. **Cursor**, the leading AI coding tool, is recently passed $1 billion in ARR within 24 months of launch, while **Harvey**, the legal AI startup hit $100 million of ARR in August 2025 and is now used by half of the AmLaw 100—the 100 largest US law firms. Companies such as Cursor and Harvey are the opposite of speculative overbuild. They demonstrate a market where demand is pulling investment forward.

3. Weak Companies are Funded

True bubbles funnel capital into companies with little substance. Today's AI leaders look very different. Many operate with strong recurring revenue, high retention, and deep integration into enterprise systems.

Databricks illustrates this clearly. The company has surpassed a $4 billion revenue run rate and continues to grow at impressive scale. Its valuation — around $100 billion, or roughly 25× revenue — is high by traditional software standards. But Databricks is not a niche SaaS vendor; it sits at the centre of enterprise data and AI infrastructure, serving a rapidly expanding market. Investors are not pricing it on story alone, but on a credible path to substantially higher future revenue.

This dynamic contrasts sharply with earlier venture bubbles. In 1999–2000 and again in 2020–21, capital poured indiscriminately into thousands of companies with little traction or real demand. Too many new managers entered the market, and too many weak businesses were funded. Today, the opposite is true.

Emerging managers from the late-2010s cohort are struggling to raise new funds. Many of the "tourist" VCs who drove excesses in the last cycle have disappeared. Rather than funding being sprayed widely across unproven companies, it is concentrating in a small number of AI leaders with exceptional customer adoption and real economic value.

This is not the profile of a narrative-driven bubble. It is a market where capital is following substance, not speculation.

4. Mass Retail Participation

Tulip Mania, the dot-com boom, and the housing bubble all drew in millions of individuals with little expertise, often using borrowed money, buying simply because prices were rising. This broad public participation accelerated bubbles and magnified their fragility.

Nothing comparable is happening in AI today. Capital flowing into the sector is overwhelmingly institutional—hyperscalers, corporates, venture funds, and sophisticated allocators. There is no mass retail speculation driving valuations, no influx of first-time traders, and no public mania pushing prices higher. This absence of retail-driven momentum further differentiates the current AI cycle from historical bubbles.

5. Leverage and Fragility

Historical bubbles were fuelled by leverage — margin debt in 1929, mortgage leverage in 2006. When sentiment turned, leverage amplified the collapse. AI shows no comparable fragility. Most of the industry is funded through equity and operating cash flow, and the major infrastructure players are among the strongest balance sheets in the world. Recent bond offerings by hyperscalers are being used to meet existing demand, not speculative bets on uncertain future customers. The system is not built on unstable financial foundations.

6. Likely Severity of Any Reset

A correction in AI is possible — and in some areas of the market, even likely. Valuations are elevated, fundraising is unusually easy, and there is no shortage of companies

raising large rounds long before their business models are proven. Parts of the market are frothy, and many of the companies funded at ambitious valuations today will not succeed. That is a normal feature of early technology cycles.

But froth is not the same as fragility. The strongest companies are generating real revenue, pulling forward enterprise adoption, and becoming embedded in core workflows. If a reset comes, it is more likely to take the form of a healthy repricing: capital shifting away from weaker companies and concentrating in those with durable demand.

In this sense, a correction in AI would look less like the bursting of a bubble and more like the normal process of sorting winners from the long tail of companies that emerge during any major technological transition. The key for investors is ensuring they have exposure to the companies that emerge from this correction as the undisputed market leaders.

Figure 1—The AI "Bubble"

Typical Bubble Pattern	AI in 2025
Speculative valuations disconnected from fundamentals	Valuations are high but broadly supported by revenue, usage and customer demand
Adoption lags far behind investment	Adoption is outpacing investment—demand is driving capital, not the other way round
Capital funding weak or unproven businesses	Capital is concentrating in companies with real product/ market fit and explosive revenue growth
Mass retail participation	No mass retail speculation. Capital is overwhelmingly institutional (hyperscalers, corporates, VCs)
Build-up of systemic leverage	Financing is heavily based on equity and cash flow. Debt is used selectively to meet demonstrated demand
High fragility when sentiment turns	Low systemic fragility. Any correction would be healthy and separate strong companies from weak ones

Taken together, these indicators show that while parts of the AI market are undoubtedly frothy, the underlying structure does not resemble a true bubble. Valuations are elevated but supported by real revenue; adoption is accelerating rather than lagging; capital is flowing into companies with clear traction; leverage remains limited; and any correction is likely to be selective rather than systemic. The overall picture is one of a fast-moving, uneven market — not an unstable one — and a technology cycle where the long-term opportunity is far greater than the short-term noise.

However, the bigger question is what all of this sets the stage for—because the real disruption is only just beginning.

The Transformation Few Are Prepared For

"Everything we've done for the last 25 years is finished"

Nabeel Hyatt, General Partner, Spark Capital.

Nabeel's quote crystallises what many of the best operators and investors are now saying quietly: **AI is not another technology wave. It is a foundational shift that will rewrite how large parts of the economy work.** And most people, including many investors, still underestimate how deep this change will go.

What makes this moment unique is that infrastructure and applications are advancing together. In past cycles, infrastructure was built years before real use cases emerged. With AI, both are developing in parallel, accelerating the pace and impact of the shift.
AI already performs tasks that traditionally required skilled professionals: writing and reviewing code, analysing documents, processing large datasets, generating creative output, and managing complex multi-step workflows. But the next phase — **agentic systems** — is where the impact becomes transformational. Agents don't just answer questions; they take actions, make decisions, and coordinate across systems. When this happens at scale, entire sectors begin to reorganise around machine-driven workflows rather than human ones.

I only appreciated just how far-reaching this would be during a recent Annual Meeting of one of our VCs in Silicon Valley. The founder of one of their portfolio companies, **Profound,** described a world in which agents, not people, navigate the web, evaluate information, and make purchases. This sounds abstract until you consider the implications: everything from search to marketing to payments is built for human decision-making. In an agentic world, machines interact with machines. They don't browse, compare, hesitate, or click ads. They transact. And they optimise.

Once you see the world through that lens, the scale of what changes becomes clear.

- **Search** stops being a human behaviour and becomes a machine-to-machine data exchange. Sites need to be optimised for agentic search, not for Google.
- **Marketing** collapses because agents don't respond to persuasion — they respond to facts.
- **Procurement** becomes fully automated as agents negotiate, evaluate suppliers, and execute orders.

- **Finance** shifts toward continuous, automated settlement as agents initiate and reconcile payments. A new set of payment rails will be required.

- **Operations** become real-time systems that self-correct without waiting for human intervention.

These are not incremental efficiencies. They reshape the architecture of commerce, the structure of industries, and the economics of entire markets. The bottleneck of human cognitive effort — which has constrained every sector of the economy — begins to disappear.

Figure 2—E-commerce vs Agentic Commerce

Source: https://www.checkout.com/blog/how-marketing-will-change-in-agentic-commerce

The repercussions of something like agentic commerce is just one of the reasons why most people are still massively underestimating the impact AI adoption will have on every facet of our lives. AI does not just make existing processes faster; it enables entirely new ways of organising work, allocating resources, and coordinating economic activity. The long-term impact compounds because capability improvements feed back into broader adoption, generating more data, enabling better models, and expanding the domains where agents can operate.

The real risk for investors is not overestimating AI's importance. It is **failing to appreciate the breadth, depth, and speed of the transformation that is now underway**. Agentic systems will not just enhance the existing economy — they will reshape it.

Investing Through the Inflection

AI is often discussed as if it might be another speculative bubble, but the underlying reality is very different. Adoption is accelerating, revenue is real, and the technology is advancing faster than any previous wave. At the same time, most investors still underestimate how profoundly AI will reshape how work is done, how decisions are made, and how economic activity is organised. The question is no longer whether AI will matter, but whether investors are positioned for the scale of what is coming.

- **AI is not a bubble**. Valuations are high, but they are supported by strong customer adoption, real revenue, and little reliance on leverage.

- **The long-term impact is being underestimated**. AI will automate reasoning, decision-making, and coordination — reshaping industries far beyond today's expectations.

- **A correction is inevitable eventually, but systemic fragility is low**. Any reset is likely to differentiate winners and losers, not unwind the entire sector.

- **The greatest risk is underexposure, not overexposure**. Missing the structural winners of this transition has far larger consequences than short-term market volatility.

While parts of the AI market are undoubtedly frothy, the overall structure does not resemble a true bubble. The underlying forces—rapid adoption, real revenue, institutional capital, and limited leverage—point in a different direction. **What we are witnessing is not the final stage of a speculative cycle, but the early stage of a major technological transformation**. The risk is not being caught in a collapse, but being underexposed to a shift that is likely to reshape the next several decades of economic value creation.