‘Classic Business’ - ‘The Week That Was’ Transcript 30 October 2026, with Michael Avery

Michael Avery:

Well, it's a fascinating week because almost everywhere you look, the headline and the underlying story pull in opposite directions. America is growing, with yesterday the economic growth rate was 3.4%. But voters are miserable, apparently. Big Tech is still making enormous amounts of money, but suddenly investors want to know what all this AI spending is actually going to earn. And South Africa has just discovered that its economy is bigger than we thought, while its biggest city can barely keep the taps running, or the lights on.

It's a big ‘Week That Was’. As always. I'm joined by Warwick Lucas, Private Clients Portfolio Manager at Vunani, and Professor Raymond Parsons from the North-West University Business School and the University of the Western Cape. Welcome!

Warwick, let's just start with the money and Alphabet, because it's quite a moment. The shares were down roughly 14% overnight, potentially. That must be its worst post-results reaction since listing, with almost half a trillion dollars in market cap evaporated.

And the problem seems increasingly to be not whether AI is exciting - we know it is. But whether investors can see the cash return from these vast sums that are being spent on it. Alphabet is producing negative free cash flow. And underneath all of that spending, there's probably a more ‘existential crisis’ because Google search advertising grew 12% to more than $63 billion, but still missed expectations. And management now acknowledges that ‘’ inside AI mode is currently lower.

And it sounds to me rather like the classic innovator's dilemma. Google's got to build the technology that could potentially undermine its astonishingly profitable search business model it already owns. So, how worried should Alphabet shareholders be about that?

Warwick Lucas:

Good evening, Michael. I think shareholders should be concerned. But you need to distinguish a few things here - namely, the capital expenditure; the underlying profitability; and then the threat to Google's traditional business model.

Alphabet is still very enormously profitable. Cloud revenue more than doubled to $30 billion, and the company generated some substantial operating cash flows. The negative free cash flow also included some inventory accumulation and a very large European fine, which tends to be a fairly lumpy problem in the lives of large American tech companies. I would not attribute the entire shortfall to AI investment, even though the market seemed

initially to do that. Still, the capital expenditure is extraordinary. And the return on that investment is, of course, incredibly difficult to estimate.

The second issue is more fundamental. It certainly has one of the greatest advertising businesses that's ever been created. And AI is threatening to completely upend the economics of that business because traditional search monetizes commercial intent very effectively. AI search can provide a better answer but also produce fewer advertising opportunities. So that's your kind of dilemma there. Could Google increase usage while reducing revenue per interaction? It's a dilemma with any innovator.

And fortunately, it goes back to discussions much earlier in the year and even last year that Google is in a position where it cannot ignore AI because competitors will inevitably try to displace its search franchise. So, it has to embrace the AI risk, but of course that means ‘cannabilizing’ the very business that's financing the whole investment.

But a positive counterargument for Google is how much of the whole AI and other tech vertical it has exposure to. It's got distribution, data, infrastructure, cloud, customer relationships, and advertising expertise to monetize all of this. In many ways, it's one of the most sort of complete bets, almost an ‘index-like’ bet in a way on what might happen. So, I wouldn't conclude that the franchise is broken, but I think it does highlight that investors might be moving from rewarding AI expenditure. They're going to start producing proof of its economic return.

Michael Avery:

Yes, we need receipts. And Raymond, if you look at it at a macro level, the amounts being spent by these hyperscalers and others on CapEx, I will argue it's becoming a macro story rather than merely a stock market story. Because we're talking about extraordinary expenditure - in the hundreds of billions of US dollars - on data centres and electricity networks and semiconductors and all that associated infrastructure.NCould this investment boom itself keep US growth and potentially inflation and interest rates higher than economists expect?

Raymond Parsons:

Hi Michael. Perhaps we should say at the outset — it's not just a stock market story or even also a macro story. It's now a global story. But nonetheless, we're looking in particular at what's happening in the US, and the AI investment boom is certainly now pushing various boundaries in the US economy. Let me mention three of them.

First, the US economy, as you mentioned, expanded by 3.4% in the third quarter of this year, with AI-related business spending as the main driver of economic growth

Then secondly, you've got the heavy pressures on supply chains and costs, which already has pushed headline inflation higher. Higher inflation now happens to coincide with the impact of the higher gasoline prices in the US as a result of the Middle East situation, as well as the impact of US tariff policy. The latest headline inflation rose again this week

And thirdly, it's clear that, although the US Fed has kept rates unchanged this week, markets are now firmly expecting that it will raise rates in December. And I see that the probability surveys are now about 75% to about 80% of that happening. So, that's where the economic scenario of the US is at the moment.

Michael Avery:

What were your thoughts initially, Warwick, from that Fed meeting? The market wasn't surprised that rates were held, but inflation is still uncomfortable. The US economy is ' firing on all cylinders'. Does the old 'higher-for-longer' interest rate outlook problem now collide maybe more directly with that AI trade?

Warwick Lucas:

Well, it certainly is a bit of an issue because, of course, the whole valuation process obviously entails, well - what are the revenues going forward? And if the market conclusion is that they are, they are struggling, then quite clearly it's going to take a negative view of that. And then, of course, the rates themselves increasing the return required inevitably, again, see a compressed market. So, it's quite convoluted.

But a part of the problem weighing in here is the degree to which the demand for CapEx for AI is also leaning on long bond rates. So there's a little bit of 'a loop' here that is coming into play. And for now, it hasn't kind of folded in on itself, but it's always a risk.

I think there's one other thing to point towards, and that is depreciation. The big problem with a lot of this kind of equipment that all of this CapEx is going into is that it has a relatively short life. These cash returns are going to have to not only justify the cost of capital as such, but it's also going to have to justify a situation that - when the replacement CapEx starts coming up - the returns are actually there to justify it.

We may very well be looking at a similar sort of scenario from the days when South Africa in the '90s was looking at the costs of cell phone networks. And there were periods when it was quite 'frothy', but also returns were very lacking, and for a long, long time.

Michael Avery:

I think that's a great comparison. It does also take us, Raymond, quite neatly to Tuesday's US midterms. If you strip away Trump and the personalities and the polling for a moment, what is on the economic ballot?

America goes into these elections with unemployment around levels most economists once called ‘full employment’ and with substantial investment, thanks largely to AI and remarkable corporate dynamism. Real GDP came in at 3.4% yesterday and that’s a nominal, 5.6%.

We're talking about the world's biggest economy, and yet, if you look at what the polls are saying, apparently voters are still deeply unsatisfied with the economy. What's the macro data missing about the lived economy ahead of these US midterms?

Raymond Parsons:

Well, Michael, in simple terms, it's all about ‘affordability’ on the ballot and the factors around it that have shaped US voters' perceptions as they move toward these elections. When we look at the degree of dissatisfaction, or the gap that you've mentioned, it seems to go beyond just the gasoline or fuel prices.

The unhappiness there seems also to have been driven by a combination of cumulative rising living costs and sluggish wage growth relative to those costs. if we look at the numbers there, we see that US consumer prices are about 30% higher than they were before the pandemic. And if you look at the AI investment boom, which we've discussed, it's driving up the stock market and, of course, corporate profits, whereas real wages have been struggling in the US to keep pace with the increase in the cost of living.

So, in a nutshell and in common language, there is the gap between good macroeconomic performance and what is called ‘kitchen-table economics’. There a view among many Americans of not sharing in all this better economic news. That's what matters now, and what's creating the pressure and dissatisfaction. We’ll see how it all plays out in those US elections next week.

Michael Avery:

And Warwick, that ‘disconnect’ fascinates me as an investor too, because the American household can be unhappy while the S&P 500 and the Nasdaq are perfectly happy. Could we be making the mistake of treating the stock market as a proxy for economic well-being when the ownership of those assets and the gains are so concentrated?

Warwick Lucas:

Yes, absolutely, Michael, it’s a common mistake quite frequently made in economic commentary. The stock market is not the economy, and it's not a representative sample of household well-being. So, any large stock market index, particularly something like the S&P 500, is heavily influenced by large, successful multinationals with global earnings, easy access to capital, and profits that can grow while smaller businesses and households experience real pressure. And then there's ownership. Financial assets are

disproportionately held by wealthier households. And so rising share prices do distribute the benefits unevenly.

And then a final complication. The same technology that's supporting these high equity valuations can also be threatening employment or wage bargaining power in parts of the economy. So, a strong stock market can coexist with household insecurity for very obvious reasons, or very rational reasons. From an investment perspective markets are doing their job, discounting earnings, etc. But they're not measuring the distribution of economic benefits. So, there is a little bit of a lid on the pot here that's getting 'puffed off' with hot steam.

Michael Avery:

And that 'affordability' issue as well that Raymond mentioned around gasoline prices and everything else isn't going away with the oil price now at $117 a barrel. Raymond, let's just now interrogate the US industrial policy experiment and the interaction between the intended benefits of higher tariffs in the US and whether a strong dollar undermines them?

Raymond Parsons:

Michael, you've highlighted what I call the 'industrial policy paradox'. What a strong dollar could do is to undermine US industrial policy because , in principle, it makes US production and what is produced there less competitive for the global buyers. It makes the foreign imports cheaper and exports costlier relative to whatever is intended by the tariffs to support industry. One piece of evidence and data I note is that employment in the manufacturing sector in the US has actually fallen in recent years.

It's nonetheless very important to monitor this particular overall effect, it all depends on where the average level of US tariffs eventually settles in order to give a definitive answer. We don't quite know that, because we know there has been retaliation from some other countries, there are on-going tariff negotiations, and so forth. So this is an important paradox to talk about. But the jury's still out as to these 'inner contradictions' between a tariff-driven industrial policy, on the one hand, and the stronger dollar on the other. These inner contradictions still have to play themselves out.

Michael Avery:

Given that, though, Raymond, has Trump already won the argument on trade regardless of what happens on Tuesday? Because even if Democrats take Congress, which the polling seems to suggest, I struggle to imagine Washington returning to the pre-2016 gospel of and ever-lower trade barriers. Has protectionism effectively become bipartisan, with the disagreement now mostly about 'how' you practice it?

Raymond Parsons:

I agree. I don't see the US going to go back to the pre-Trump era in trade policy But whatever changes may come next week from the midterm elections and changes in the political composition of the US Congress may indeed create a better climate of opinion as to how trade policy is to be done, and in what ways it might be better pursued globally. In other words, you might get a return to a little more certainty, and a little more of a 'rules-based' trade outlook, than might have been possible, before the outcome of these elections.

But I just also want to put on record that the WTO has recently reminded us that, despite the negativity of the US trade actions and its policies in recent years, about 70% of world trade still takes place under the WTO rules. And for South Africa and other smaller economies, it's very important that we uphold what is still intact in terms of a 'rules-based' world trading system. So hopefully a political shift in the US may at least help to inject more US trade cooperation into the world trading system. But it's still an uncertain; scenario

Michael Avery:

Warwick, let's now put the three election results into perspective from an investment perspective. We see Republicans retain Congress, or Democrats take only the House, or Democrats somehow take both chambers. Which one genuinely changes any assumptions about how you're positioning or your asset allocation? Because markets traditionally rather like divided government. But with US debt now at $40 trillion, is gridlock still benign if the consequence is repeated debt-ceiling brinkmanship and no credible fiscal reform?

Warwick Lucas:

I would say that we've already seen the Republicans with close to unfettered power, and not necessarily liked what we saw. As you are fond of pointing out, Michael, politicians are like 'babies nappies', and need changing a lot for the same reasons.

I would be careful of making major asset-allocation decisions based purely on which party controls Congress. Markets might focus on political outcomes initially, but the more durable effects are going to come through and will be focused on policy, what earnings look like, what interest rates look like, and what risk premium.

And, for example, what's going to happen with the war in the Middle East? Is that going to get dealt with appropriately now? And are tariffs going to be something that gets, at least in some way, some kind of more benign resolution than we had , where they are is very messy. They're not properly enshrined in law in any way or shape or form - the Republicans have pretty much been making it up as they go along.

And as we know, I mean, the first set of tariffs were struck down, and they're now using another emergency legislation to persist with it. So even if there is acceptance for tariffs, there actually isn't an appropriate legal framework for them, which is, of course, very messy.

And finally, if we look at the history of Democrats versus Republicans, there's this perception about, well, Democrats are less market-friendly than Republicans. But the statistics don't back that assertion up. It is, in fact, the history is remarkably ‘agnostic’ as to market returns versus who's been in power. So I wouldn't put a great deal on that.

I think what one must watch for is whether any new incoming person or entity will severely disrupt the growth coming through in the AI space. And I suspect probably not. It could but I hope not, because for all its faults, that is what is propping up and propelling the US economy.

Michael Avery:

It certainly is. And then we come home, where we have our own local government elections next week, Raymond. And we’ve yesterday received one of those wonderful pieces of economic news that immediately needs an asterisk yesterday. Stats SA is ‘rebasing’ the economy, and the ‘denominator’ has improved. GDP is bigger. So debt-to-GDP, the deficit-to-GDP ratio, and several other fiscal metrics immediately look better.

But nothing has happened, or should have really happened, under the surface. It's just statistical sleight of hand. But could there nevertheless be a genuine second-order benefit, if better ratios help ratings agencies and foreign investors, and ultimately improve the government's cost of capital?

Raymond Parsons:

Michael, at the outset, of course, better data on the structure and changes in the South African economy provide an updated, more accurate tool for both policymakers and business planning. But absolutely, yes, we must understand that, although various ratios such as public debt will look better, the fundamental metrics remain the same. The challenges are still there - the economy is bigger but not richer - we just have a better statistical grasp of the dimensions. And so what I briefly see in this data are really two things.

Firstly, yes, our economy is shown to be resilient, Despite various setbacks, we have shown ourselves to have built some economic buffers. But as the SARB Governor has previously said: ‘The economy is resilient, but it’s not flourishing’. And what's important from the point of view of the future is that the headwinds and tailwinds for South Africa are still the same irrespective of the statistical updates - we just still need to navigate them effectively.

Then, from the point of view of the credit rating agencies, it’s likely they will applaud the updated and revised GDP figures because it confirms the positive direction in which key debt ratios are going. So, basically, I believe that's the way we should look at it - that it alters key ratios, but it doesn't alter the fundamental challenges.

Michael Avery:

But this is where our two South African stories collide, Warwick. The sovereign ratios look better on Thursday. Next Wednesday, voters decide who gets to run municipalities that increasingly threaten the growth rate underneath those ratios. And you look at Joburg, for example, responsible for roughly 16% of the national economy. Yet infrastructure and finances are in an extraordinary mess, just driving around the streets and seeing the uncollected trash piling up. There's a quite clear and stark choice confronting voters next week. Which way do you see it going?

Warwick Lucas:

Well, I think it's going to be a fiercely contested election no matter what. The key issue that we're going to find here is - what alliances get made? if I'm sort of even thinking about a theme generally - financial and technological progress and the distribution of its economic benefits - that's really all we've been talking about today, haven't we?

And in South Africa, yes, the DA could, for example, do well in Johannesburg. But so what? Is 35% enough to rule? So, there has to be more than that. There needs to be a very clear distinction and view on where to go, because the simple fact of the matter is that Joburg cannot carry on the way it is at the moment.

Because if it's politicians choose to carry on the way they are, they are going to ‘go down the toilet’, and in a rather spectacular fashion, because it is unsustainable. And as you point out, the way it has been, it was rescued in the past, is a reset that needs to get hit, because it is the most crucial city in this country's economy.

Michael Avery:

On that point, Raymond, you know, we do have that history, technically bankrupt around the turn of the century. Ketso Gordhan was then parachuted in as city manager. Ring-fenced utilities then, professionalized management, regained access to capital markets, before much of that discipline was gradually flitted away and dismantled. Does that tell us that the problem is just less about discovering new policy and just more about rebuilding those institutions we already know can work

Raymond Parsons:

As in Johannesburg and elsewhere, the local elections next week are now all about governance, institutions, and accountability. I think most of the technical and economic solutions at local government level are ‘hidden in plain sight’ - we know what needs to be urgently done. So, it needs good leadership and strong capacity to immediately implement what needs to be done and to make effective delivery happen sooner rather than later.

At a technical level, there's also a very important White Paper on the reform of local government now available to dig down into longer term sustainable structural changes at municipal level. That's apart from the outcome of those crucial elections next week, which can also make a big difference on the ground where it matters. The prospect of political change concentrates the mind wonderfully, once new leadership emerges to get things moving. So, I think that's where we are at the moment in terms of the future performance of local government in South Africa

Michael Avery:

Well, I think what we can do is just encourage listeners to get out there and to vote, to make their mark and ensure that it isn't because of a low turnout that we don't get the requisite change that is so desperately needed.

Raymond Parsons, thank you very much, from North-West University Business School, and Warwick Lucas of Private Clients at Vunani, with The Week That Was on Classic Business.