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Morning Briefing

AI Wrecks Tech & Finds Rare Earth Minerals

Check out the accompanying [chart collection](#).

Executive Summary: From AI-phoria to AI-phobia: Jackie reports on the recent shift in investors' attitudes toward artificial intelligence. Its vast disruptive potential is akin to the Internet's, dislodging some companies from their market positions and catapulting others into new spaces. The distinguishing factor may be incumbent companies' ability to adapt to an AI-transformed world. ... And in our Disruptive Technologies segment, a look at innovative efforts—some AI-enabled—to find alternatives to rare-earth minerals in manufacturing processes.

Information Technology: AI Takes No Prisoners. Fears that new companies using artificial intelligence (AI) will replace incumbent operators have hurt stocks across a wide range of industries over the past two weeks. Software companies, insurance brokers, data providers, alternative asset managers, and investment brokerage companies all felt the impact, with some of their stocks falling 10%-20% ytd and suffering even greater declines measured from recent years' peaks.

Despite this broad-based damage, the S&P 500 isn't in the red this week or ytd—it's roughly flat so far this week and up slightly ytd. The index is supported by double-digit gains in traditional sectors like Energy, Materials, and Industrials, which have offset the declines in AI-affected areas like Information Technology and Financials.

Here's the performance derby for the S&P 500 and its sectors ytd through Tuesday's close: Energy (20.2%), Materials (15.5), Consumer Staples (12.3), Industrials (12.1), Real Estate (6.4), Utilities (3.4), S&P 500 (1.4), Communication Services (1.0), Health Care (0.2), Information Technology (-2.1), Financials (-2.5), and Consumer Discretionary (-2.9) ([Fig. 1](#)).

For those who lived through the advent of the Internet, this feels like “déjà vu all over again.” Both AI and the Internet are technological disruptions profound enough to shift the behavior of just about everyone. In 2000, large companies that adapted remain dominant today

(Walmart), and small companies that hustled are small no longer (Amazon). We found new ways to do things, like watching videos on our phones; but old habits, like being a TV-watching couch potato, never died. In today's tech revolution, the beaten-down stocks of incumbents that successfully adapt may prove to be worthwhile investments.

With an eye to the future, let's look at the impact AI has had on several industries in just the past few days and weeks:

(1) *Software gets socked*. Software investors were spooked when Anthropic's Claude unveiled AI tools with applications for legal services, finance, and sales. Investors assumed this was only the beginning of Claude's offerings and that software companies faced the risk of being disintermediated.

The S&P 500 Application Software stock price index has fallen 22.8% ytd through Tuesday's close, making it the worst-performing of the industries we track in the S&P 500 ([Fig. 2](#)). Not far behind is the S&P 500 Systems Software stock price index, with a 14.9% decline ytd ([Fig. 3](#)).

Investors may be underestimating how quickly many software companies will incorporate AI into their offerings and how unwilling chief technology officers will be to risk vital operations by using software from an untested AI company.

Orlando Bravo, an investor known for investing in software companies, recently [said](#), "AI will disrupt a percentage of software companies ... especially if [their] core competency is technical. ... But ... an enterprise software company is about its domain expertise." In other words, software companies that have specialized, deep knowledge of a specific industry and its workflows, regulations, and market trends will remain valuable to their customers.

Data providers also got hit when Anthropic unveiled its new offerings. Thomson Reuters provides research and data to legal, tax, and financial professionals. Its shares have fallen 31.1% ytd and 57.6% from their high last summer. The ADRs of RELX, parent of LexisNexis, a provider of legal information, have fallen by 27.5% ytd and 47.4% from their May high.

Investors assumed that AI could disintermediate the financial industry's information services providers. Shares of FactSet Research Systems have lost 29.4% ytd and been cut by more than half, -57.3%, since their high on December 2, 2024. S&P Global has watched its shares tumble 23.3% ytd and 28.9% from their high last August. Both stocks are in the S&P

500 Financial Exchanges & Data industry, down 9.7% ytd ([Fig. 4](#)).

(2) *Investors in software hurt, too.* Alternative asset managers' stocks got clobbered because investors feared the managers owned too much AI-afflicted software equity and debt. Some \$25 billion of software loans were trading below 80 cents on the dollar at the end of January, up from \$11 billion a month earlier, the *WSJ* [reported](#). They represented nearly a third of all distressed loans. The software industry represents about 16%, or \$235 billion, of the \$1.5 trillion US loan market, according to Morgan Stanley [data](#).

A KKR official [says](#) about 15% of its private-equity assets and 7% of its \$744 billion of total assets are exposed to software. Blue Owl's [software investments](#) make up 8% of its \$307.4 billion of assets, and its loans backing technology companies averaged 30% of the value of the business when they were made. Even if these investments are all money good, the current selloff will likely mean that the asset managers will have difficulty selling equity stakes in their privately held software companies to the public markets.

Here's how some alternative asset managers' stocks have performed ytd through Tuesday's close: KKR (-15.9%), Ares Management (-15.2%), Blackstone (-13.2%), Blue Owl Capital (-13.2%), Apollo Global Management (-8.5%), and Carlyle Group (-2.4). Four of these six players are members of the S&P 500 Asset Management & Custody Banks industry's stock price index, which has inched up 0.4% ytd ([Fig. 5](#)).

The damage is even more dramatic when judged from these stocks' highest levels—most of which were reached between November 2024 and January 2025. Before worries about their exposure to software weighed on the stocks, they'd been facing investors' fears that credit losses in a wide variety of industries lurk in their private loan portfolios. Consider how their stocks have fared from their recent peaks: Blue Owl Capital (-51.4%), KKR (-35.8%), Blackstone (-32.8%), Ares (-30.9%), Apollo (-25.8%), and Carlyle (-16.8%).

(3) *Brokers hit.* AI's power was again on display when Altruist, a financial technology firm, rolled out an AI tool that recommends personalized tax strategies after an individual's financial documents are scanned into the system. Investors assumed that if AI could advise on taxes, it would eventually advise on all things financial.

Some notable casualties: Tax preparer H&R Block's share price has been halved since its August 2024 high, while those of financial advisers Raymond James Financial, LPL Financial Holdings, and Charles Schwab have slid 7%-10% from their recent high-water marks. The S&P 500 Investment Banking & Brokerage stock price index, home to Raymond

James and Schwab, has edged up 0.5% ytd ([Fig. 6](#)).

(4) *Insurers take a turn.* Later in the week, property and casualty insurance brokers were hit by fears that AI would take over their businesses. OpenAI approved an insurance application for ChatGPT developed by the Spanish digital insurer Tuio. It allows ChatGPT users to receive personalized insurance quotes directly within AI-powered conversations, Insurance Insider US [reported](#). OpenAI reportedly has many other insurance AI apps that are expected to go live in coming weeks.

Here are how some of the largest industry players' shares performed ytd and from their respective peaks: Aon (-9.9% ytd, -22.3% from February 2025), Marsh (-5.5% ytd, 28.2% from April 2025), and Arthur J. Gallagher (-17.9% ytd, -39.0% from June 2025). The S&P Insurance Brokers industry's stock price index has dropped 11.0% ytd ([Fig. 7](#)).

(5) *Looking at valuations.* Now for some good news: These industries' forward P/Es have plummeted to ridiculously low levels relative to current earnings projections. But will AI competition trigger downward earnings revisions as contracts are renewed? That's the risk.

Here are Wall Street analysts' consensus 2026 earnings growth estimate and the forward P/E for the S&P 500 industries mentioned above: Financial Exchanges & Data (7.6%, 22.5), Insurance Brokers (12.2%, 15.9), Investment Banking & Brokerage (14.4%, 16.9), Asset Management & Custody Banks (15.4%, 15.5), Application Software (17.3%, 23.7), and Systems Software (19.8%, 23.3).

Finally, take a look at how much valuations have compressed. Here's a comparison of the industries' recent high forward P/Es with current levels: Asset Management & Custody Banks (19.0, 15.5), Insurance Brokers (24.7, 15.9), Investment Banking & Brokerage (19.1, 16.9), Financial Exchanges & Data (29.8, 22.5), Systems Software (35.5, 23.3), and Application Software (35.3, 23.7) ([Fig. 8](#), [Fig. 9](#), [Fig. 10](#), [Fig. 11](#), [Fig. 12](#), and [Fig. 13](#)).

Disruptive Technologies: Making Rare-Earth Minerals Less Rare. We all learned the importance of rare earth minerals when China, the main supplier, temporarily cut off the sale of them to US buyers in retaliation against the Trump administration's tariffs: They're critical to the production of the electronics that we'd all feel crippled without. Now the US government is throwing money at the problem. It's investing in Western miners, [like MP Materials](#), that provide these critical inputs, establishing a \$12 billion rare-earth [stockpile](#), and [offering grants](#) to researchers looking for alternatives that could take the place of rare earths in manufacturing processes.

Despite their name, rare earth metals aren't rare; they're just difficult to mine, and refining them creates an environmental mess that no one wants in their backyard. Scientists are seeking environmentally friendly and less expensive ways to extract these materials. They're also using AI to find new materials that serve the same function.

Let's take a look at what they're up to:

(1) *Smart biomining viruses*. UC Berkeley-led researchers genetically engineered a virus to behave like a sponge that grabs rare earth metals from water. When the temperature and acidity are changed, the virus then releases the metals. The virus, known as a “bacteriophage,” was used because it infects only bacteria and is harmless to humans and the environment.

“[T]he researchers successfully tested the effectiveness of this system by adding the engineered viruses to acid mine drainage. The viruses immediately attached themselves to rare-earth element ions in the drainage, ignoring all other metals. By gently warming the solution, the researchers caused the viruses to clump together and sink to the bottom of the tank. After draining the liquid, the researchers were left with a concentrated sludge of viruses and captured metals. As a final step, they adjusted the pH of this stew, causing the viruses to release the pure metal ions for harvesting,” according to a UC Berkley [article](#).

Importantly, the virus is reusable and can be grown cheaply and easily. The scientists also believe it could be used to harvest rare-earth elements from e-waste (like cell phones or laptops) and to clean up the environment by removing heavy metals, like lead or mercury, from water.

Moreover, the virus can be modified to capture the desired element, like lithium, cobalt, or platinum. Next, scientists plan to program it to extract copper in research that's being supported by the Rio Tinto Centre for Future Materials.

(2) *Harnessing AI*. Materials Nexus has an AI platform that it says [identifies rare-earth-free magnetic material](#) in just days or weeks. The platform identified a new material, dubbed “MagNex,” after analyzing more than 100 million materials based on their cost, supply-chain security, performance, and environmental impact.

Materials Nexus synthesized and tested MagNex with the scientists at the Henry Royce Institute at the University of Sheffield. The whole process was 200 times faster than traditional research in this field—three months instead of many years. The result: discovery

of a material that can be produced at 20% of the cost of current rare-earth magnets while emitting far less carbon.

Beyond identifying rare-earth alternatives, the British company believes its AI platform can be used to develop materials for semiconductors, catalysts, and coatings.

(3) *AI digs deep*. Researchers at the University of New Hampshire [trained an AI system](#) to read and interpret decades of scientific papers. It took information about materials in the research papers and fed it into a computer to determine which are magnetic and how much heat they can tolerate before losing their magnetism.

The 67,573 magnetic materials then were entered into the newly created North Materials Database, which is available to researchers seeking promising candidates for future experimentation. Twenty-five of the materials were previously unknown. It's hoped that the database will accelerate the discovery of metallic materials that can serve as rare-earth alternatives.

Strategy Indicators

S&P 500 Earnings, Revenues, Valuation & Margins ([link](#)): During the February 5 week, the S&P 500's forward revenues gained 0.8% and forward earnings soared 1.8%, both to new record highs. The forward profit margin gapped up 0.2ppt w/w to a record-high 14.6%. The forward profit margin is now 4.3ppts above its seven-year low of 10.3% during April 2020. The consensus expectations for forward revenues growth rose 0.1ppt w/w to a 43-month high of 7.2%. From a longer-term perspective, that's well above its 20-year average of 5.2% and its 33-month low of 2.3% during the February 23, 2023 week. That compares to a pandemic-recovery boosted record-high 9.6% forward revenues growth at the end of May 2021 and 0.2% during April 2020, which was the lowest reading since June 2009. The forward earnings growth rose 0.2ppt w/w to 15.1%, down 0.2ppt from a 54-month high of 15.3% during the January 1 week. That's still up 4.2ppts from its 15-month low of 10.9% during the May 29 week and well above its 20-year average of 11.4%. That compares to its 23.9% reading at the end of April 2021, which was boosted by the recovery from the pandemic to its highest reading since June 2010 and up substantially from its record low of -5.6% at the end of April 2020. Analysts expect revenues to rise 6.6% in 2025 (up 0.1ppt to a new high), 7.3% in 2026 (up 0.1ppt w/w to a new high), and 7.4% in 2027 (up 0.1ppt w/w to a new high), compared to a 5.0% rise in 2024. They expect an earnings gain of 13.6% in 2025 (up 0.3ppt w/w to a 12-month high), a 15.2% rise in 2026 (unchanged w/w at 0.4ppt

below a 15.6 high during the January 1 week), and a 16.1% rise in 2027 (up 0.2ppt w/w to a new high), compared to 2024's earnings gain of 11.7%. Analysts expect the profit margin to rise 0.8ppt y/y to 13.3% in 2025 (unchanged at an eight-month high), 1.0ppt y/y in 2026 to 14.3% (unchanged at an eight-month high), and 1.2ppts y/y in 2027 to 15.5% (up 0.1ppt to a new high), compared to 2024's 12.5%. Looking at valuation data as of February 5, the S&P 500's weekly forward P/E tumbled 0.7pt w/w to a 33-week low of 21.7 from a five-week high of 22.4. That's now 1.6pts below the 25-year high of 23.3 during the October 30 week and is up 2.5pts from its 16-month low of 19.2 during the April 17 week. It also compares to 23.1 in early September 2020, which was then its highest level since July 2000, and to a 77-month low of 14.0 in March 2020. The S&P 500 weekly price-to-sales ratio fell 0.07pt w/w to a seven-week low of 3.16 from five-week high of 3.23. That's just 0.03pt from the 10-week low of 3.13 during the November 20 week, and is now 0.12pt below its record high of 3.28 during the October 30 week. That's up from a six-month low of 2.22 during the October 26, 2023 week and compares to a 49-month low of 1.65 in March 2020.

S&P 500 Sectors Revenues, Earnings, & Margins ([link](#)): During the February 5 week, forward revenues increased for all 11 S&P 500 sectors, forward earnings rose for 10, and forward profit margins were up for seven (and down for two). These seven sectors had post pandemic- or record-high forward revenues this week: Communication Services, Consumer Discretionary, Financials, Industrials, Information Technology, Real Estate, and Utilities. Health Care's is a hair below its recent record high, and Consumer Staples' would be at a record high too if Drug Retail hadn't exited in September; instead, it's 3.9% below. Energy's remains depressed at 29.6% below its September 2008 record and 17.0% below its cyclical high in October 2022. Materials' is improving now and 2.0% below its June 2022 record high. These seven sectors had record-high forward earnings this week: Communication Services, Consumer Discretionary, Consumer Staples, Financials, Industrials, Information Technology, and Utilities. Forward earnings remains close to the very recent record highs for two sectors: Health Care and Real Estate. Earnings remains depressed for Energy and Materials but is improving now for the latter. From their respective highs during 2022, Energy's remains mired near a four-year low at 42.2% below while Materials' is at a 39-month high and 16.4% below. Looking at the forward profit margin, these three sectors' margins were at record highs: Consumer Discretionary, Financials, and Information Technology. Just a short skip from their recent record highs are these three sectors: Communication Services, Industrials, and Utilities. Among the five lagging sectors: Consumer Staples, Materials, and Real Estate are improving somewhat from their recent multi-year lows; while Energy's and Health Care's are just a tick above their recent record lows. Here's how the S&P 500 and its 11 sectors rank based on their current forward profit margin forecasts along with their record highs: Information Technology (30.3%, up 0.3ppt

w/w to a record high), Financials (21.4, up 0.2ppt w/w to a record high), Communication Services (19.5, down 0.1ppt w/w and down from its 19.8 record high during the August 7 week), Real Estate (16.6, down 0.2ppt w/w from its 12-month high of 16.8 and down from its 19.2 record high in 2016), Utilities (15.0, up 0.1ppt w/w to a 48-month high and just 0.1ppt below its 15.1 record high in April 2021), S&P 500 (14.6, up 0.2ppt w/w to a record high), Materials (11.5, up 0.1ppt w/w to a 19-month high and up 1.0ppt from 51-month low 10.5 in late February and down from a 13.6 record high in June 2022), Consumer Discretionary (9.7, up 0.1ppt to a record high), Energy (8.4, up 0.1ppt w/w from a 51-month low of 8.3 and down from its 12.8 record high in November 2022), Industrials (11.2, steady w/w at 0.1pt below its 11.3 record high in January), Health Care (8.0, up 0.1ppt w/w from a record low and down from its 11.5 record high in February 2022), and Consumer Staples (7.1, steady w/w and up 0.4ppt from a 21-month low of 6.7 during the 9/4 week just before Drug Retail's exit from the sector, and down from its 7.7 record high in June 2020).

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