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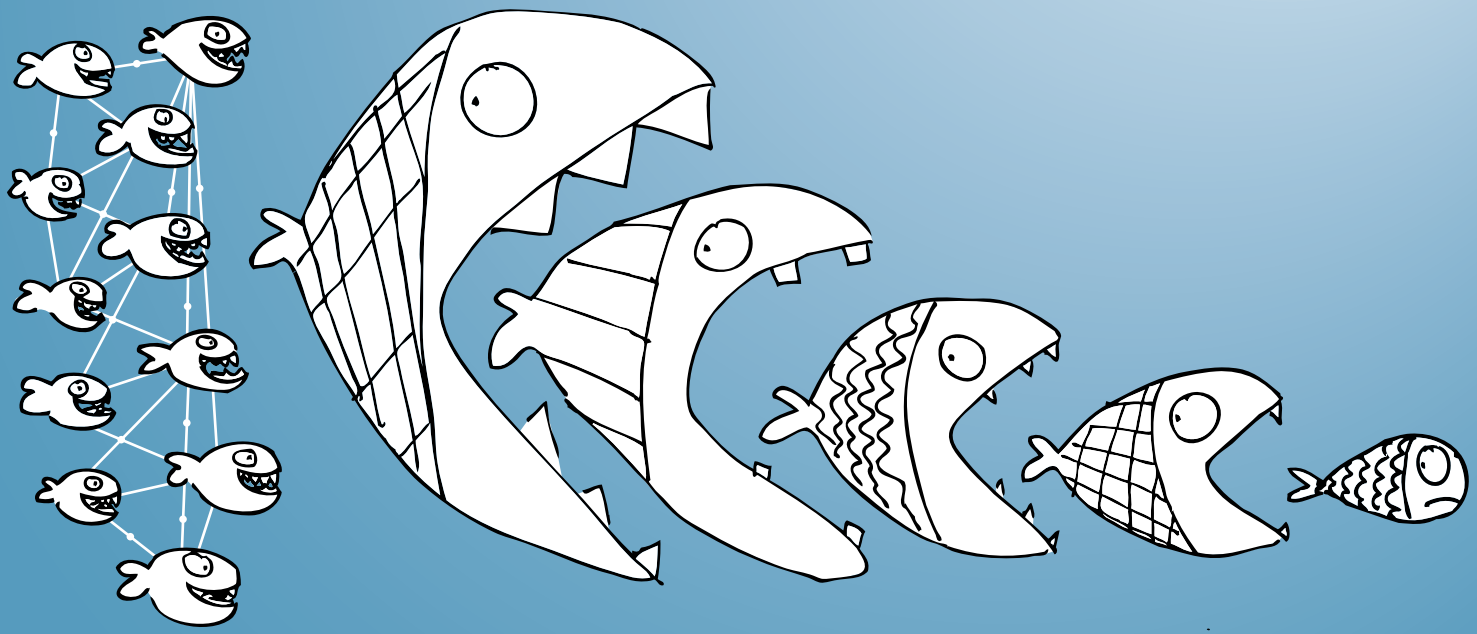


AI Eats the Software World?

Market Insights

February 2026

Wealth Investment Office

AI Eats the Software World?

AI-driven disruption is forcing a painful re-pricing in software, exposing concentration risk and reshaping the next phase of equity leadership.

By Brad Simpson, Chief Wealth Strategist, and Kevin Yulianto, Portfolio Manager | TD Wealth

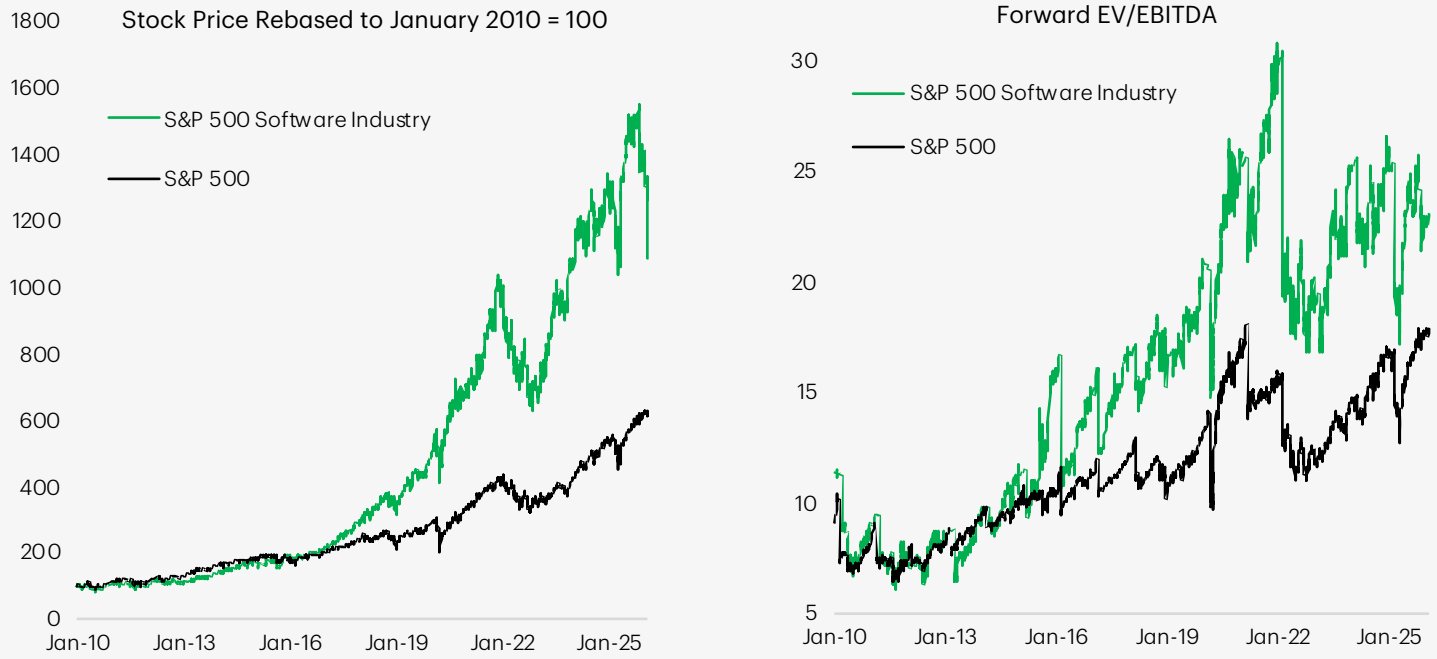
The current sharp correction in software and Big Tech is exactly the kind of market "reset moment" we explored in our latest *Portfolio Strategy Quarterly*, "The Brand New Renaissance" (click here). Our belief is that we are in an era where the speed of change will be exponential and compounding and that 2026 will be a critical year, when markets will forcefully re-price areas that are susceptible to the change that AI will bring. The selling pressure on software is a timely case study. Following its peak last September, a basket of software names (IGV ETF) has fallen roughly 30% even as the broader U.S. equity market continued to rise. The S&P 500 software sub-sector is now trading at 23.0x forward EV/EBITDA versus 17.8x for the S&P 500, narrowing the valuation gap from 78% in January 2024 to 29% currently (Figure 1).

2026 Theme 7: The waiting room of the J-curve

Anthropic's big week reinforces that AI is leaving the lab and entering the enterprise — but the payoff will come in stages. We remain in the waiting room of the J-curve: disruption and repricing are happening now, while the true productivity dividend is still ahead.

Touchdown | The Year Ahead: 2026

Figure 1: Software stocks have taken a beating of late



Source: FactSet, Macrobond, Wealth Investment Office as of February 5, 2026

Consistent with our Brand New Renaissance positioning, the recent correction has been concentrated in a narrow group of growth/momentum/software/tech names and not the market as a whole. We continue to advocate that investors shift allocation from growth-oriented tech stocks to a broader palette, given that an upswing in the U.S. (and the rest of the world's) business cycle should lead to a recovery for other sub-sectors. Lastly, we continue to believe that a broadening out of equity markets is exactly what extends cycles and sets the stage for even more diversified leadership in 2026.

How the sell-off began

The origins of this correction can be traced back to nearly 15 years ago, when Marc Andreessen — the cofounder of Andreessen Horowitz and Netscape — wrote an op-ed in *The Wall Street Journal* entitled "Why Software Is Eating the World." He highlighted that, at the time, valuation for many technology companies was only at par with the broader stock market despite having much higher profitability and stronger market position. (Of course, this has changed significantly over the past decade, with valuations for leading tech companies today often double or triple that of the median stock in the U.S. equity benchmark.)

Andreessen also highlighted that software and the online services built on top of it were disrupting various industries — from selling books (Amazon) and watching movies (Netflix) to listening to music (Spotify), recruiting (LinkedIn) and marketing (Google). Six years later, in 2017, Jensen Huang, the CEO of Nvidia, said in his interview with MIT Technology Review, "software is eating the world, but AI is going to eat software."

Over the past three months, investors have concluded that Huang's prediction eight years ago was prescient and have been aggressively selling software companies based on the investment thesis that AI has become the new "software layer," automating its creation and operation.

The catalyst for the most recent sell-off has come from Anthropic's upgrade of its Claude co-working tools, which has accelerated investors' fears, with many now expecting that businesses will opt to develop their own software rather than relying on third-party vendors in the near future. Claude Cowork, for instance, can help lawyers perform several clerical tasks, such as tracking compliance and reviewing legal documents — potentially circumventing the need for specialized legal software. The stock price of Thomson Reuters has fallen 58% from its peak in July 2025, despite the company reaffirming its targets for 2026 and the business continuing to grow at a healthy rate. Similar logic applies to software companies servicing the financial industry, human resources, and the design and creative sector, among others.

Although AI tools may help businesses develop their own software internally for simpler needs, software vendors often integrate multiple capabilities into one centralized application or platform that makes it easier for users to operate. Many also provide proprietary data that may be inaccessible to AI co-working tools. In addition, the majority of large software companies have developed their own agentic AI capabilities, which have been integrated into their platforms to compete against general-purpose AI tools. These are some of the reasons why we doubt that enterprise clients will start mass-cancelling their software and data subscriptions in the near term and migrate to internally built tools.

While investors were pricing in the most optimistic outcome for software companies back in 2021 — with EV/EBITDA multiples averaging 30x at one point — sentiment is pointing in the opposite direction today. We don't know how this will play out, but arguably some of the currently oversold software companies will be able to maintain their market share and business models by integrating AI into their processes.

Investment Implications

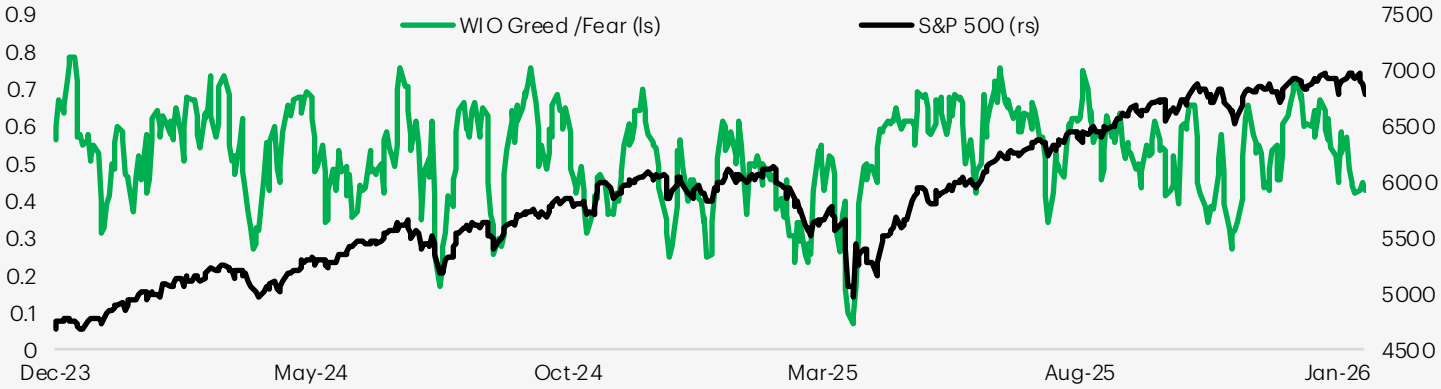
Given the tremendous growth of software stocks' market capitalization and weights in the equity benchmark, the recent sharp sell-off has translated into higher portfolio volatility for most investors. Although the U.S. and global equity markets are less than 5% below all-time highs as of the time of writing, investors with concentrated equity positions in the growth/momentum/software/tech complex will have seen materially higher volatility relative to a more diversified investor (Figure 2).

Figure 2: Global equity has become concentrated in mega-caps

Source: FactSet, Macrobond, Wealth Investment Office as of February 5, 2026.

There is also a psychological aspect. Following three years of double-digit returns in U.S. equities, many investors are expecting the asset class to continue delivering similarly high returns this year. Combined with a long period of low volatility in the market, many investors have become complacent. Investor sentiment was very bullish at the beginning of this year and has only moderated to around average levels currently (Figure 3).

Figure 3: Sentiment was uber-bullish going into 2026



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Underneath the surface, however, we saw healthy rotation in the U.S. equity market from growth into parts of cyclicals and defensives, which have delivered strong returns so far this year (Figure 4). For two quarters now, we have discussed the potential for an acceleration in cyclical activity in the U.S. and globally — now that's playing out, with old-economy industrial and materials sectors outperforming the benchmark, and January's ISM manufacturing PMI showing a sharp pick-up in new orders. Within equities, we continue to diversify exposure towards cyclical industries that could benefit from an upswing in the business cycle.

Figure 4a: Ongoing rotation has lifted cyclicals and defensives

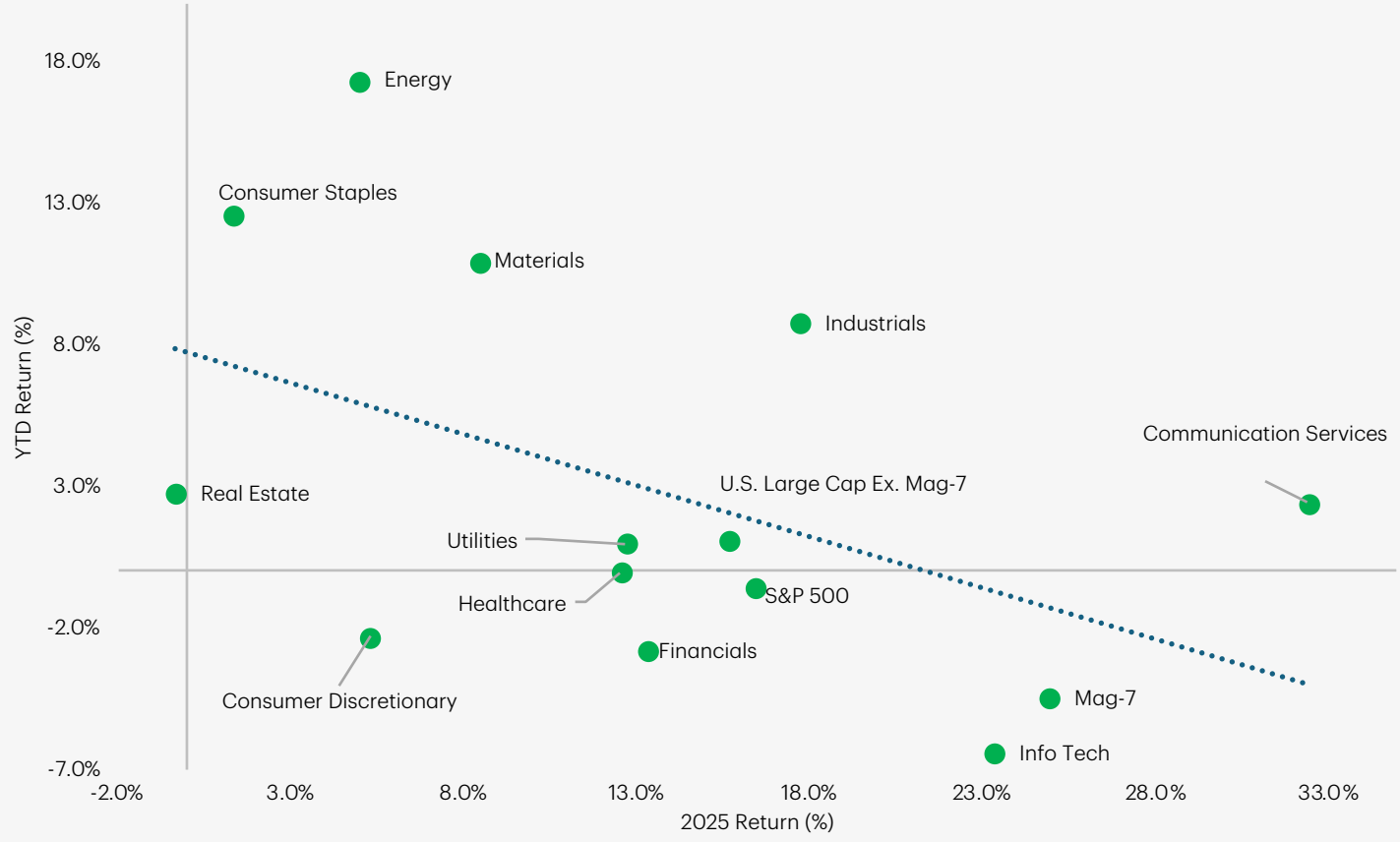

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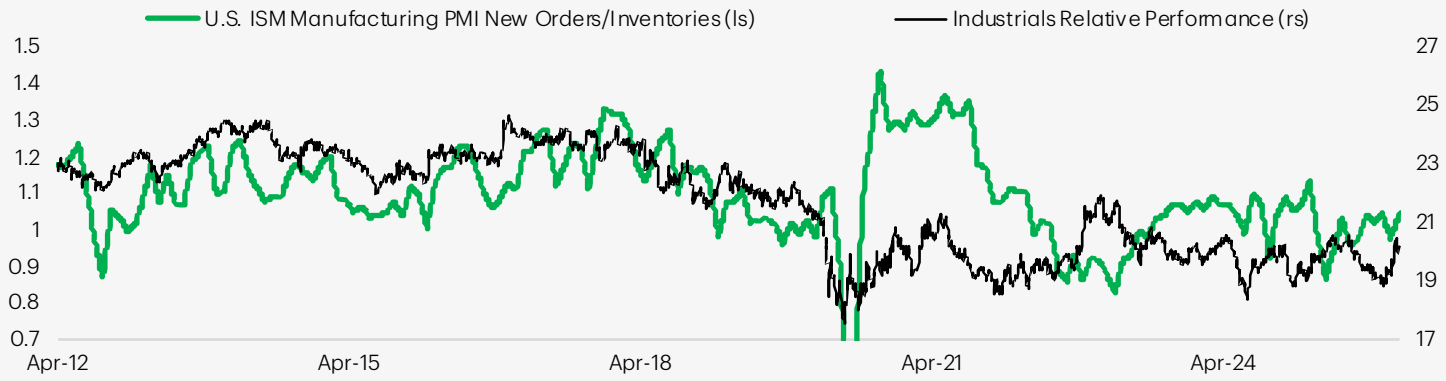
Figure 4b: Ongoing rotation has lifted cyclicals and defensives



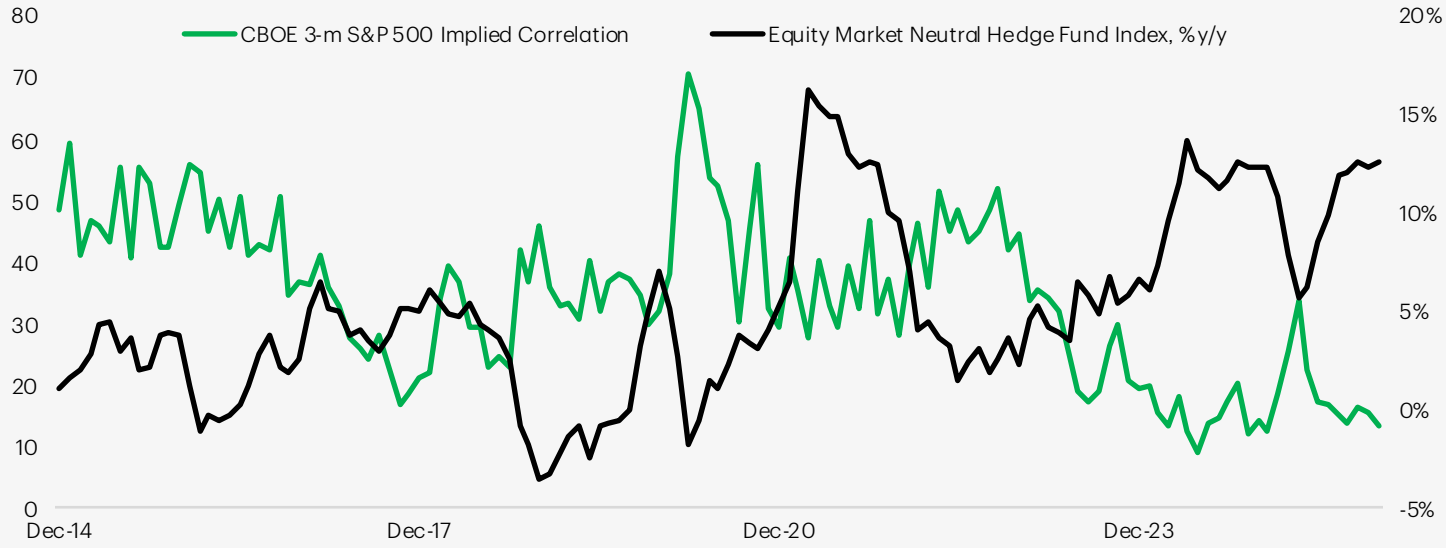
Source: FactSet, Macrobond, Wealth Investment Office as of February 5, 2026.

From an asset-allocation perspective, it's important to choose diversifiers carefully. Commodity exposure, including gold, proved to be a strong diversifier over the past two years amid a favourable supply/demand backdrop, given that governments are increasing their stockpiles of major commodities, while central banks are increasing their allocation to gold.

On the other hand, many investors thought that cryptocurrencies would be a strong hedge against inflation and fiat currency debasement. The recent downturn in bitcoin proved that returns are correlated to neither inflation nor the U.S. dollar. Despite heightened fears of dollar debasement, bitcoin prices fell 50% from their peak last October.

Against the backdrop of elevated concentration risk and an expensive equity market, investors would also do well to diversify into hedge funds that offers low correlation to public equity and fixed income. Rising dispersion in the equity market, which is the case today, tends to bode well for the returns of long/short equity managers and other relative-value strategies (Figure 5).

Figure 5: Low correlation among stocks bodes well for long/short strategies



Source: FactSet, Macrobond, Wealth Investment Office as of February 5, 2026.

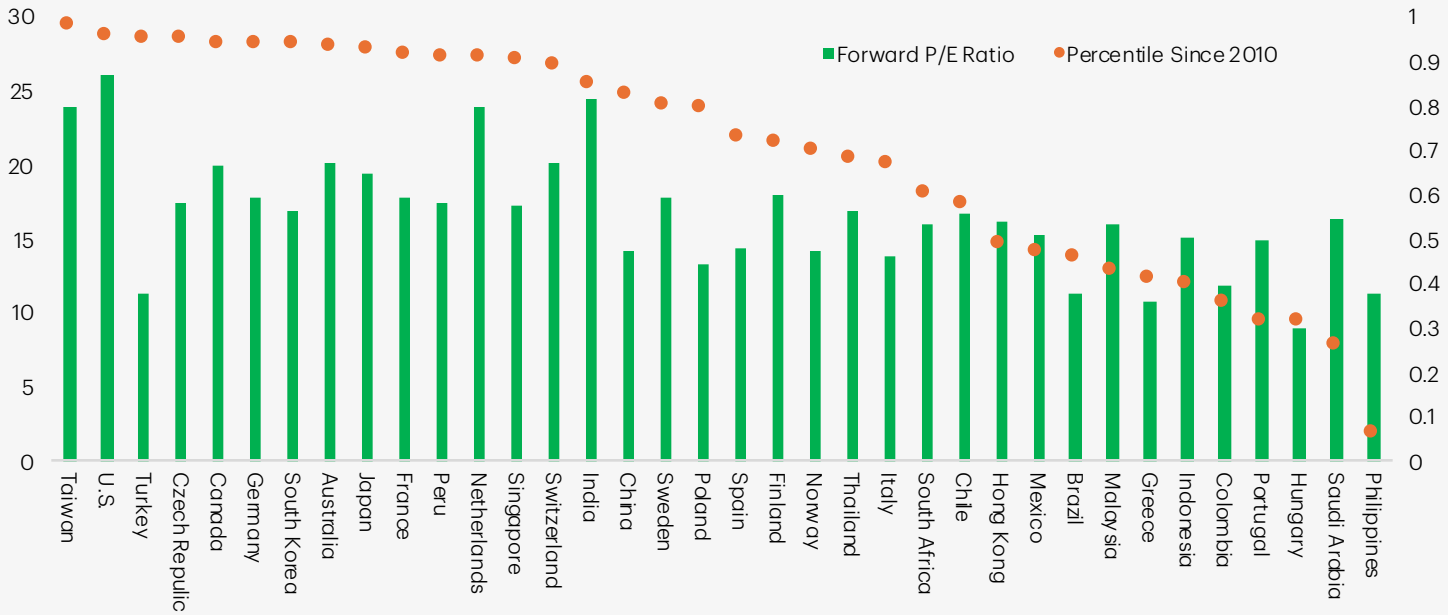
Lastly, emerging markets and international stocks also tend to benefit more from an improving global growth outlook and a weaker dollar. Both emerging-market and international equities have the potential to continue their outperformance relative to U.S. stocks following outsized gains last year. Since last quarter, earnings revisions for emerging-market equities have moved sharply higher (Figure 6), while select emerging-market countries still offer compelling valuations, albeit with some caveats (Figure 7). When it comes to investing in emerging markets, most investors would do well to approach the asset class with an active mindset and a deeper-than-usual due diligence process.

Figure 6: Earnings for EM have been upwardly revised

EPS Revision Since Sep 30, 2025	2025 EPS Estimate	2026 EPS Estimate	2027 EPS Estimate
MSCI Emerging Market	2.9%	9.6%	11.1%
S&P 500	1.8%	2.7%	5.8%
Equal-weight S&P 500	2.6%	0.6%	1.4%
MSCI Europe	1.3%	0.5%	0.6%
MSCI EAFE	1.1%	0.3%	0.4%
MSCI Japan	0.7%	-0.1%	0.0%

Source: FactSet, Macrobond, Wealth Investment Office as of February 5, 2026

Figure 7: Select EM countries still trading relatively cheap



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Final Thoughts

In this environment, portfolio construction matters. At the Wealth Investment Office, our positioning reflects a modest pro-growth stance for equities and fixed income, a consistent modest overweight position in alternatives and a structural role for commodities — aligning portfolios with the real-world buildout that underpins the next phase of this new Renaissance.

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