

Special Report

When Capex Booms Turn Into Busts: Lessons From History

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Dear Client,

As I will be travelling in Asia next week visiting clients, we will be sending you a Special Report from BCA's Chief European Strategist, Jeremie Peloso, on Germany. Jeremie will assess the cyclical economic outlook for Germany in light of upcoming fiscal spending, and will discuss the structural challenges still facing the country.

Best regards,

Peter Berezin

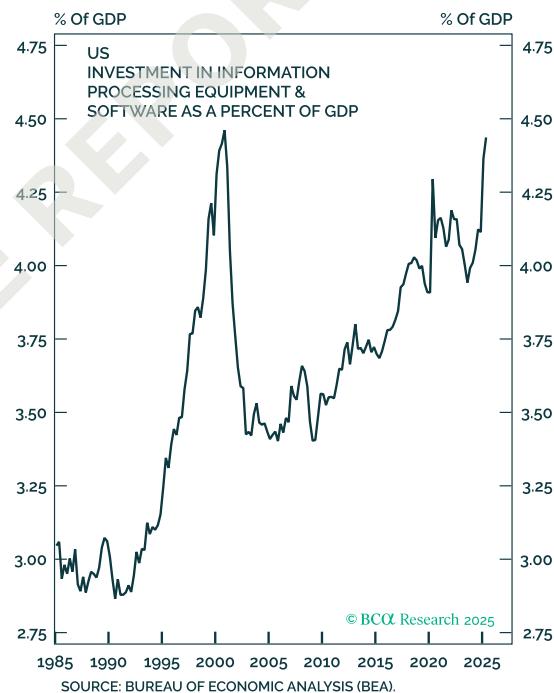
Chief Global Strategist

Executive Summary

Top Takeaway: We examine past capex booms which turned into busts. Our analysis suggests that AI is following the same script as those ill-fated booms.

- We draw five lessons from the following capex booms: The railway booms of the 19th century; the electrification boom of the 1920s; the internet boom of the late 1990s; and various oil booms.
- **Lesson #1:** Investors failed to appreciate the S-shaped nature of technological adoption.
- **Lesson #2:** Revenue forecasts underestimated the degree to which prices would fall.
- **Lesson #3:** Debt became an increasingly important source of financing.
- **Lesson #4:** Asset prices peaked before investment declined.
- **Lesson #5:** The capex busts weighed on the economy which, in turn, further hurt asset prices.
- We expect the AI boom to end within the next 6 to 12 months. We remain on watch for a "Metaverse Moment" to inform us when to turn maximally defensive on stocks.

Investment Spending Often Gets Ahead Of Itself During Booms



SOURCE: BUREAU OF ECONOMIC ANALYSIS (BEA).

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When Capex Booms Turn Into Busts: Lessons From History

In this week's report, we examine a number of historic capex booms, all of which turned into busts. We then proceed to draw some lessons for today's AI capex boom.

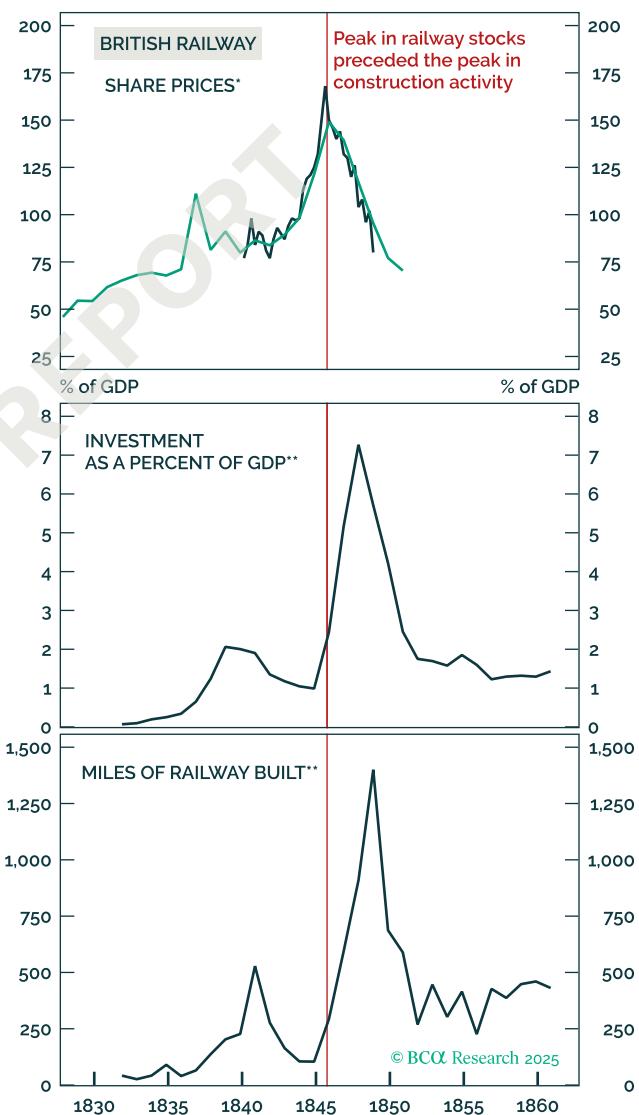
The Railway Booms in the UK and the US During the 19th Century

The first British railways utilized steam locomotives to carry coal. That changed in 1830 when the introduction of the Liverpool and Manchester Railway showed that passenger travel could also be highly profitable. This led to the construction of new railway lines and growing interest from investors. Railway stocks surged, nearly doubling between 1843 and 1845.

Even though stock prices began to fall in mid-1845, Parliament continued to sanction new projects. By 1847, construction outlays exceeded a record 7% of GDP. Tightening liquidity conditions culminated in a crisis in October 1847. By the end of that decade, the rail index had fallen 65% from its peak (**Chart 1**).

US railway construction exploded after the Civil War. Railway stocks rose over the course of the 1860s and early 1870s, ultimately peaking towards the end of 1872. The subsequent decline in railway stock prices culminated in the Panic of 1873, which saw the New York Stock Exchange close for ten days in September of that year. Corporate bond defaults soared, with losses totaling 36% of par value between 1873 and 1875.

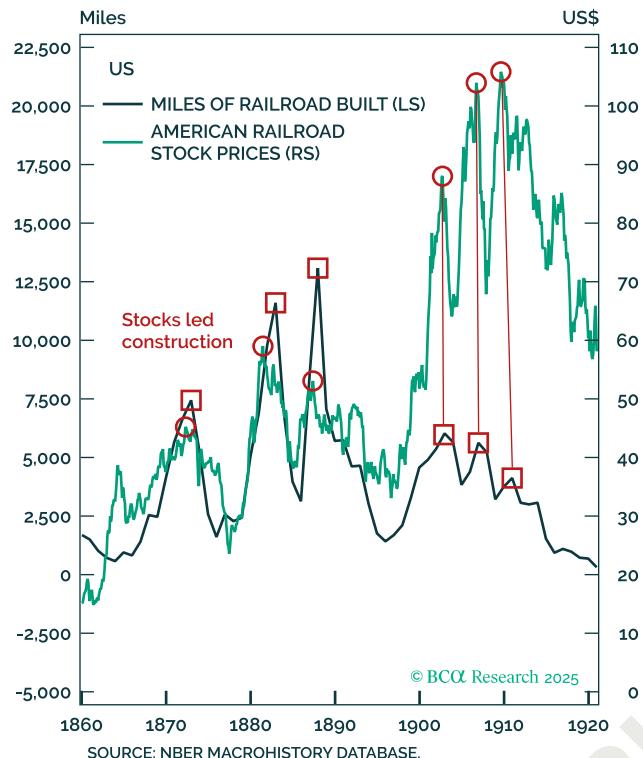
CHART 1
UK Rail Stocks Peaked Before
Construction Activity



* SOURCE: ARTHUR D. GAYER, W. W. ROSTOW, AND ANNA JACOBSON SCHWARTZ, WITH THE ASSISTANCE OF ISAIAH FRANK, "THE GROWTH AND FLUCTUATION OF THE BRITISH ECONOMY, 1790-1850," OXFORD : CLARENDON PRESS (1953); AND A.J. ARNOLD AND SEAN MCCARTNEY, "THE RAILWAY MANIA OF 1845-1847: MARKET IRRATIONALITY OR COLLUSIVE SWINDLE BASED ON ACCOUNTING DISTORTIONS?" ACCOUNTING, AUDITING & ACCOUNTABILITY JOURNAL, 16-5, 821-852 (2003).

** ANDREW ODLYZKO, "COLLECTIVE HALLUCINATIONS AND INEFFICIENT MARKETS: THE BRITISH RAILWAY MANIA OF THE 1840S," SCHOOL OF MATHEMATICS AND DIGITAL TECHNOLOGY CENTER, UNIVERSITY OF MINNESOTA (2010).

CHART 2

The Boom-Bust Nature Of US Railway
Construction

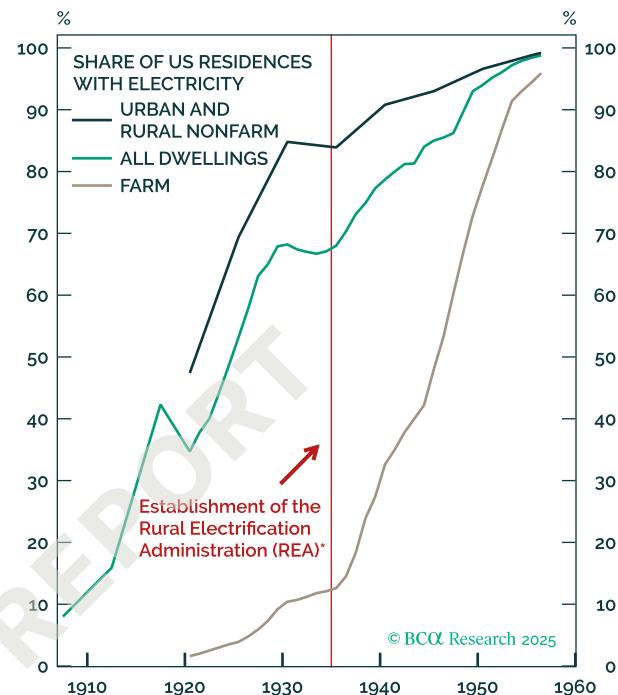
The subsequent 15 years saw two more booms and busts (Chart 2). The number of railway miles laid ultimately peaked in 1887 at a little over 13,000. The resulting glut caused transport prices to collapse, leading to the Panic of 1893. By 1894, about 20% of US railway mileage was in [receivership](#).

The Electrification Boom of
the 1920s

The share of US households with access to electricity rose from 8% in 1907 to about 35% in 1920 and 68% by 1930. The rollout was concentrated in urban areas, with rural electrification lagging behind until the New Deal arrived (Chart 3).

CHART 3

The Electrification Of The US Economy



* THE RURAL ELECTRIFICATION ADMINISTRATION (REA) WAS A GOVERNMENT AGENCY DESIGNED TO "INITIATE, FORMULATE, ADMINISTER, AND SUPERVISE A PROGRAM OF APPROVED PROJECTS WITH RESPECT TO THE GENERATION, TRANSMISSION, AND DISTRIBUTION OF ELECTRIC ENERGY IN RURAL AREAS." THE REA WAS PART OF A SET OF MEASURES UNDER THE NEW DEAL AIMED AT COUNTERACTING THE GREAT DEPRESSION.

SOURCE: SOURCE: TOM SABLICK, [ELECTRIFYING RURAL AMERICA](#), FEDERAL RESERVE BANK OF RICHMOND (FIRST QUARTER 2020).

SOURCE: U.S. BUREAU OF THE CENSUS, HISTORICAL STATISTICS OF THE UNITED STATES, COLONIAL TIMES TO 1957, WASHINGTON, D.C., (1960).

THIS IS A SAMPLE REPORT.

Our team will be in touch shortly with the full report.

If you do not receive a call, please contact our Client Services team
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