First to Market

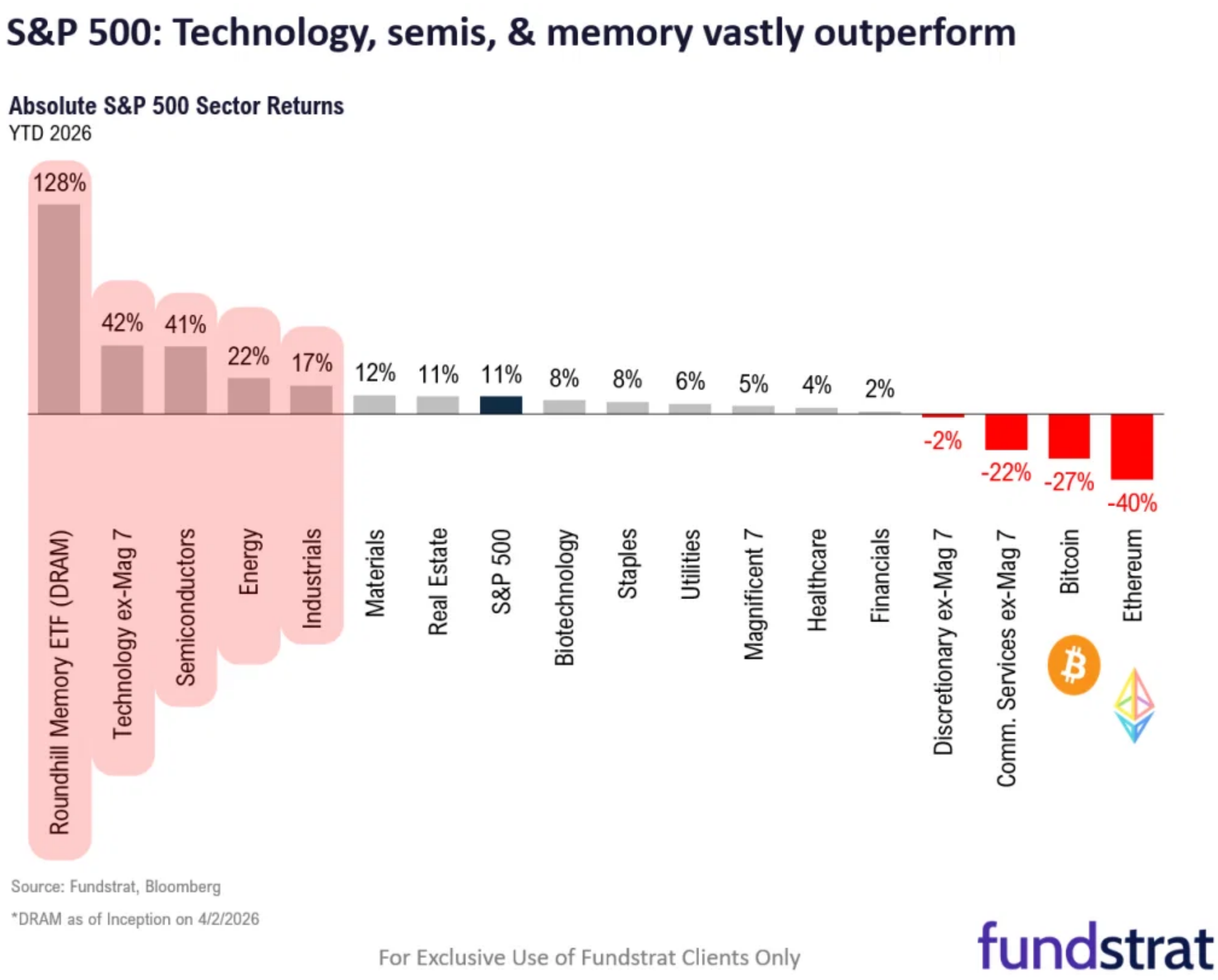
July 14, 2026

THE AI ARMS RACE ENCOUNTERS COLD-WAR GAME THEORY

Kent Fung

VICE PRESIDENT, MARKET INTELLIGENCE

Chart of the Day



Good morning!

It looks like the prisoner's dilemma is entering the age of AI. That might be a problem for U.S. companies like Airbnb $$ABNB and DoorDash $$DASH, which have been incorporating open-source Chinese AI models like Alibaba's Qwen and Moonshot AI's Kimi K2.6 into their operations in an effort to cut costs – and it has implications for any enterprises concerned about the cost of tokens in general.

A quick review: the prisoner's dilemma is one of the cornerstones of classic game theory, and it was developed in the era of the U.S.-Soviet Union Cold War and came to be used to assess strategy by both sides. Here's the scenario: Two prisoners, call them A and B, are being questioned in isolation, with interrogators trying to get at least one to comply. The prisoners must independently decide whether to remain silent (cooperate) or squeal (defect), knowing that the aggregate outcome and outcomes for each depend on both their choices. For prisoner A, defecting can result in the first- or third-best of four possible individual outcomes, depending on whether B stays silent or also defects. Staying silent results in the second-best or worst individual outcome, depending on B's decisions. Thus while a pretty good outcome could be achieved if both prisoners stay silent, the rational choice for both prisoners is to squeal.

As this played out during the Cold War and in various psychology experiments, however, repeated iterations of the prisoner's dilemma ultimately tend to result in both prisoners sometimes making the more benevolent, less rational choice and cooperating to a limited extent. According to many historians, this helped lead to a number of U.S.-Soviet non-proliferation treaties.

That brings us to today. The U.S. and China currently dominate an AI "arms race" of sorts, and the dilemma involves whether to encourage open-source models (cooperate, in prisoner's dilemma parlance) or closed-source models (defect). For the most part, U.S. AI developers have favored releasing closed-source models that protect proprietary technologies. As discussed above, this "defect" tactic is the rational choice, and to me, it's even more so when we consider the current U.S. leadership in the field.

China, on the other hand, had been stressing open-source LLMs, with startups like DeepSeek and Zhipu making their models largely open source. That's also been the case for more established Chinese tech companies like Alibaba and Tencent and their AI models (Qwen and Hunyuan, respectively). This makes sense when you consider that China is not in the lead. Open-source models can facilitate improvement, encouraging users and developers everywhere to make modifications and revisions whenever they see fit. The fact that the Chinese models have proven to often be both "fast and cheap," as Airbnb Chief Executive Brian Chesky described Qwen, is just a nice bonus.

President Trump's recent move to restrict the release of Anthropic's latest Mythos 5/Fable 5 models to any non-U.S. users – admittedly due to serious cybersecurity concerns – intensified interest in such Chinese open-source models. The administration's request for OpenAI to delay the rollout of GPT-5.6 did the same. In addition to being "fast and cheap," Chinese models thus gained the much bigger advantage of actually being, you know, *available*. Enterprise users started to worry that U.S. models might be pulled from availability on rather short notice, as Anthropic was. (The fact that Fable 5 access has been restored does not change the fact that the U.S. proved it could force a U.S. company to withdraw access to its AI models – and to do so with very little advance notice. It’s normal for companies to crave stability.)

China could have gained some "soft power" in response as it got the rest of the world more accustomed to using Chinese LLMs. Now, however, it seems like it might go the other way – joining the U.S. in opting for the prisoner's dilemma "defect" strategy. The *Wall Street Journal* and *Reuters* independently reported last week that Beijing is considering requiring Chinese AI companies to tighten up foreign access to its best models – including potentially going through a vetting process, delaying the release of new models, and at least partially restricting access to foreign entities.

The question arises: Is China merely considering some tit for tat, or does Beijing's reported ostensible concern for protecting proprietary technology hint at an internal assessment that Chinese advanced AI is starting to close the gap with U.S. leaders in the field? Alphabet's Sundar Pichai was once asked about U.S. enterprise adoption of open-source Chinese models, and he responded that "I worry less about, ‘Are we adopting open source models from China?’ and more, ‘Are we doing enough in the U.S. to make sure we are staying at the frontier?'" China might be starting to suspect – rightly or wrongly – that the answer is 'no.'

It seems logical to me that the world might ultimately be better off someday if both countries adopt the open-source approach, especially if AI is the fourth industrial revolution. Also, just as the world at large benefited from the mutual cooperation of the Cold War that reduced the threat of nuclear annihilation, it can be argued that the world would benefit from greater cooperation between the two major AI powers as it relates to the potential threats raised by the development of AGI.

On a more hopeful note, the Cold War also showed us that what mathematicians and psychologists posited about repeated iterations of the dilemma scenario holds true – a limited amount of cooperation and trust can develop over time. In the meantime, however, China's latest move is arguably a tailwind for investors assessing the U.S.-led AI play, as it makes a major group of competitors less attractive as alternatives to Silicon Valley's best – and priciest.

Share your thoughts

Should U.S. companies even be using Chinese-developed AI models in the first place? Click here to send us your response.

✍Here's what a reader commented ✍

Q: What do you make of the single-stock volatility?

A: I think everyone has the ability to trade on the latest headline in their pocket via smartphone and new investors shoot first, ask questions later. And there is no cost to trade so if I’m working and see a headline , I might sell to protect a gain on a headline and figure it out later once I’m home from work. I think this adds to the day-to-day volatility.

Catch up with Fundstrat

The macro has become a bit messy as war risks and the selloff in memory triggered margin calls in both the U.S. and Korea. We think the macro data this week will be supportive of lower inflation. And more importantly, we still believe the risk/reward remains positive for stocks.

Technical

Financials are the most important sector this week with the majority of banks beginning to report earnings, and it's thought that this sector's relative strength should continue.

Crypto

A combination of rising real yields, firmer energy prices, and a more hawkish rates market suggests the tactical rally we have discussed over the past week is beginning to lose momentum. Today's CPI report and Federal Reserve Chair Kevin Warsh’s comments will likely prove important in determining whether that view changes.

News We're Following

Breaking News

- Consumer prices rose 3.5% annually in June, less than expected as energy prices eased CNBC

Markets and economy

- US hits Iran with strikes, blockade as Trump plans Hormuz charge BBG
- U.S. IPO market poised to break records AX

Business

- Wall Street banks post blockbuster profits as equities trading booms FT
- Software stocks sink as IBM Miss delivers 'devastating blow' BBG
- 12 states including California challenge Paramount's takeover of Warner, say merger would 'extinguish competition' AP

Politics/U.S.

- Trump says he will give primetime speech Thursday amid flare-up with Iran HILL
- Judge says Trump tried to manipulate legal system with IRS lawsuit WSJ
- ICE agent fatally shoots driver in Maine, six days after similar death in Texas REU

Overseas

- Mexico pushes criminal probe into migrant deaths linked to ICE BBG
- Ukraine and 9 other countries announce a coalition to protect Europe from ballistic missiles AP
- Netanyahu opponent leads polls ahead of Israeli elections FT

Of Interest

- In a sweet discovery, astronomers find sugar lurking in the space between stars AP
- A cocaine bust in Spain leads all the way to Wall Street BBG

Overnight

S&P Futures	-5 ▼ point(s) (-0.06% ▼)
overnight range:	-32 ▼ to +12 ▲ point(s)

APAC

Nikkei	+0.74% ▲
Topix	+0.79% ▲
China SHCOMP	+1.36% ▲
Hang Seng	+0.52% ▲
Korea	+0.73% ▲
Singapore	+0.46% ▲

Australia	0.00%
India	-0.59% ▼
Taiwan	-1.42% ▼

Europe

Stoxx	50 -0.67% ▼
Stoxx	600 -0.64% ▼
FTSE	100 -0.57% ▼
DAX	-0.62% ▼
CAC	40 -0.83% ▼
Italy	-0.61% ▼
IBEX	-0.89% ▼
Canada	-0.15% ▼
Mexico	-0.79% ▼
Brazil	-1.20% ▼

FX

Dollar Index (DXY)	-0.14% ▼ to 101.09
EUR/USD	+0.17% ▲ to 1.1400
GBP/USD	+0.25% ▲ to 1.3381
USD/JPY	+0.15% ▲ to 162.19
USD/CNY	+0.03% ▲ to 6.7781
USD/CNH	+0.08% ▲ to 6.7796
USD/CHF	+0.34% ▲ to 0.8119
USD/CAD	+0.50% ▲ to 1.4084

AUD/USD	+0.51% ▲ to 0.6953

UST Term Structure

2Y-3M Spread narrowed	-2.9bps ▼ to 43.1bps
10Y-2Y Spread widened	0.6bps to 34.2bps
30Y-10Y Spread widened	0.6bps to 48.4bps

USD HY OaS

All Sectors	-2.5bps ▼ to 292bps
All Sectors ex-Energy	-1.2bps ▼ 285bps
Cons Disc	-0.2bps ▼ to 436bps
Indu	+0.7bps ▲ to 225bps
Tech	-4.8bps ▼ to 211bps
Comm Srvcs	+0.2bps ▲ to 284bps
Materials	+0.2bps ▲ to 260bps
Energy	-0.9bps ▼ to 266bps
Fin Snr	-0.6bps ▼ to 192bps
Fin Sub	+3.9bps ▲ to 299bps
Cons Staples	-7.8bps ▼ to 439bps
Healthcare	-1.5bps ▼ to 300bps
Utes	-0.4bps ▼ to 202bps *

DATE	TIME	DESCRIPTION	ESTIMATE	LAST

DATE	TIME	DESCRIPTION	ESTIMATE	LAST
7/14	6:00 AM	Jun Small Biz Optimisum	95.7	95.3
7/14	8:30 AM	Jun CPI m/m	-0.1	0.5
7/14	8:30 AM	Jun Core CPI m/m	0.2	0.2
7/14	8:30 AM	Jun CPI y/y	3.8	4.2
7/14	8:30 AM	Jun Core CPI y/y	2.8	2.9
7/14	4:00 PM	May Net TIC Flows	n/a	26.08
7/15	8:30 AM	Jun PPI m/m	0	1.1
7/15	8:30 AM	Jun Core PPI m/m	0.3	0.4
7/16	10:00 AM	Jul Homebuilder Sentiment	35	35
7/17	8:30 AM	Jun Import Price m/m	-0.6	1.9
7/17	10:00 AM	Jul P UMich 1yr Inf Exp	4.5	4.6
7/17	10:00 AM	Jul P UMich Sentiment	51	49.5

Disclosures

This research is for the clients of Fundstrat Global Advisors only. For additional information, please contact your sales representative or Fundstrat Global Advisors at 150 East 52nd Street, New York, NY, 10022 USA.

Conflicts of Interest

This research contains the views, opinions and recommendations of Fundstrat. At the time of publication of this report, Fundstrat does not know of, or have reason to know of any material conflicts of interest.

General Disclosures

Fundstrat Global Advisors is an independent research company and is not a registered investment advisor and is not acting as a broker-dealer under any federal or state securities laws.

Fundstrat Global Advisors is a member of IRC Securities’ Research Prime Services Platform. IRC Securities is a FINRA registered broker-dealer that is focused on supporting the independent research industry. Certain personnel of Fundstrat (i.e., Research Analysts) are registered representatives of IRC Securities, a FINRA member firm registered as a broker-dealer with the Securities and Exchange Commission and certain state securities regulators. As registered representatives and independent contractors of IRC Securities, such personnel may receive commissions paid to or shared with IRC Securities for transactions placed by Fundstrat clients directly with IRC Securities or with securities firms that may share commissions with IRC Securities in accordance with applicable SEC and FINRA requirements. IRC Securities does not distribute the research of Fundstrat, which is available to select institutional clients that have engaged Fundstrat.

As registered representatives of IRC Securities, our analysts must follow IRC Securities' Written Supervisory Procedures. Notable compliance policies include (1) prohibition of insider trading or the facilitation thereof, (2) maintaining client confidentiality, (3) archival of electronic communications, and (4) appropriate use of electronic communications, amongst other compliance related policies.

Fundstrat does not have the same conflicts that traditional sell-side research organizations have because Fundstrat (1) does not conduct any investment banking activities, (2) does not manage any investment funds, and (3) our clients are only institutional investors.

This research is for the clients of Fundstrat Global Advisors only. Additional information is available upon request. Information has been obtained from sources believed to be reliable, but Fundstrat Global Advisors does not warrant its completeness or accuracy except with respect to any disclosures relative to Fundstrat and the analyst's involvement (if any) with any of the subject companies of the research. All pricing is as of the market close for the securities discussed, unless otherwise stated. Opinions and estimates constitute our judgment as of the date of this material and are subject to change without notice. Past performance is not indicative of future results. This material is not intended as an offer or solicitation for the purchase or sale of any financial instrument. The opinions and recommendations herein do not take into account individual client circumstances, risk tolerance, objectives, or needs and are not intended as recommendations of particular securities, financial instruments or strategies.

The recipient of this report must make its own independent decision regarding any securities or financial instruments mentioned herein.

Except in circumstances where Fundstrat expressly agrees otherwise in writing, Fundstrat is not acting as a municipal advisor and the opinions or views contained herein are not intended to be, and do not constitute, advice, including within the meaning of Section 15B of the Securities Exchange Act of 1934. All research reports are disseminated and available to all clients simultaneously through electronic publication to our internal client website, fundstrat.com. Not all research content is redistributed to our clients or made available to third-party aggregators or the media. Please contact your sales representative if you would like to receive any of our research publications.