First to Market

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# WHY MOONSHOT'S KIMI IS A SOLVABLE PROBLEM – FOR COMPANIES AND INVESTORS

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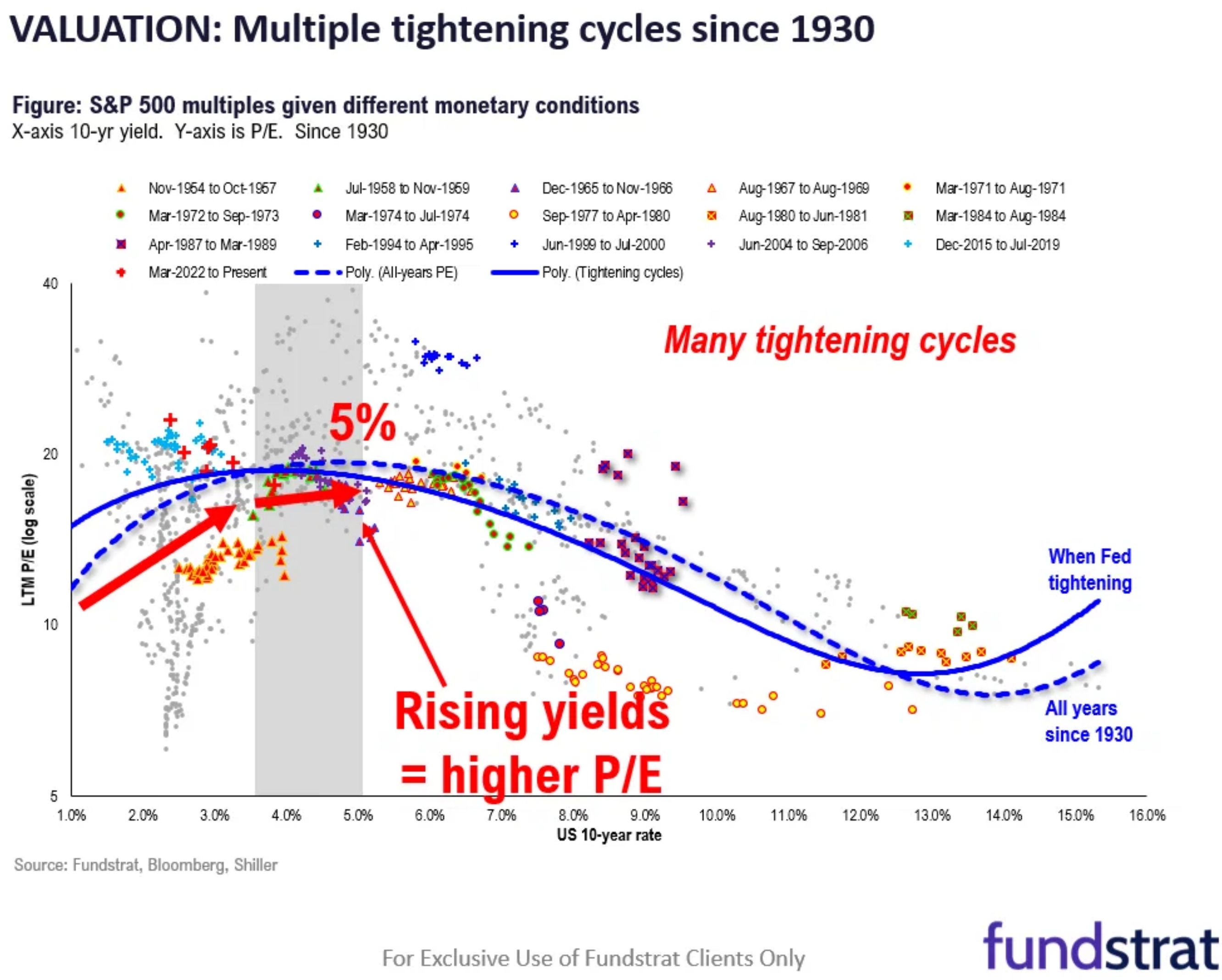
## Chart of the Day




**Good morning!**

Markets appear to have had another DeepSeek moment on Friday – a moment in which a Chinese AI startup released an LLM with a level of capabilities and/or sophistication that surprised users and investors alike. This time it was Moonshot AI, which on Thursday released its new Kimi K3 model, with a massive 2.8 trillion parameters – the largest open-weight AI model on the planet.

As has often been the case with Chinese AI, some of those acknowledging how capable the latest Kimi is are alleging that the model was achieved in large part through a distillation, a practice in which an existing LLM is used to train a newer model. Distillation enables a rival company to create its own model with significantly less time, effort, and money – to say nothing of access to the latest chips from Nvidia or AMD.

In the past, distilled models have shown themselves to be quite good at single-prompt responses. However, they have tended to fall short on long-horizon agentic capabilities. This had been thought to be a key technological moat on which Silicon Valley's best could rely even if their anti-distillation efforts fell short.

It's not clear whether Kimi K3 is the result of distillation. OpenAI's head of strategic futures, Dean Ball, asserted that Kimi's performance most likely cannot be "explained away by distillation or anything like that."

Either way, Kimi K3 has proven that the technological moat enjoyed by U.S. AI companies is quite shallow. Even if it was the result of distillation rather than human talent and ingenuity, Kimi's long-horizon agentic capabilities don't seem to show it: according to Moonshot, its latest model was able to work autonomously on a complex task with almost no human oversight for nearly 24 hours, successfully solving complex problems like optimizing a GPU kernel or building a functional GPU programming compiler from scratch. More impressively, K3 reportedly ran autonomously for 48 consecutive hours, successfully designing a simulated inference chip for a nano model built on its own architecture, using open-source EDA tools.

Although these feats have yet to be independently verified, investors on Friday worried that years of chip-export restrictions aren't working to hold China back. This, in turn, gave them doubts about the competitive advantage – and thus the bull case – of chipmakers like Nvidia and memory companies like Micron.

That's an understandable view, but I would suggest that those worries are perhaps overdone.

Look at what happened to the U.S. pharmaceutical industry in the 1970s, when Indian pharmaceutical companies reverse-engineered their latest medicines, using alternate manufacturing processes to exploit a patent loophole at the time that only protected processes rather than end-products. U.S. pharmaceutical companies forged forward and continued to advance and thrive. How? By innovating even harder, and by moving into medicines like biologics, which are harder to replicate in this manner.

It seems clear that Google, OpenAI, and Anthropic have no choice but to keep working to improve their own models. That still requires the latest and greatest GPUs and HBM chips, even if it turns out that Chinese companies have found a workaround that doesn't require them. One could plausibly argue that Kimi K3 thus strengthens the bull case for advanced chipmakers.

We can look to Silicon Valley history for a clue about how else to respond to Chinese advances. After all, China's tech giants have essentially replicated Silicon Valley products and services before, yet their originators continue to dominate around the world. Despite China's Kingsoft WPS Office, Microsoft Office continues to be the business software of choice around the world. For the most part, Google remains far more widely used around the world than Baidu. YouTube and Instagram remain the dominant social media networks rather than Tencent or Weibo. Oracle's enterprise database is more widely used around the world than Alibaba's OceanBase.

How did these companies overcome their versions of AI distillation?

For one thing, as with U.S. pharmaceutical companies, they continued to innovate, constantly striving to come up with something better. However, U.S. tech companies did something else: rather than just focus on cutting edge technology, they delivered attentive customer service and built platforms and ecosystems that made their technologies "sticky." Many of the leading AI companies right now – Alphabet, Microsoft, Amazon, Meta – are well accustomed to building sticky ecosystems to overcome earlier versions of tech-moat erosion. In fact, those same ecosystems can be used now. Meanwhile, Anthropic has taken pains to foster close ties with enterprise customers in an effort to make Claude more sticky, and OpenAI has come around to the concept lately as well.

In other words, nobody's denying how impressive Kimi K3 is, or the possibility that some other Chinese AI company might use U.S. innovation to do something else that's just as impressive. But the keys to overcoming that are easily found in historical precedent, and the playbook, in many cases, was developed by the same companies currently under threat.

## Share your thoughts

Does Moonshot's Kimi K3 affect your views on the U.S. AI play? Click here to send us your response.

## ✍Here's what a reader commented ✍

**Q:** What do you make of IBM’s declines?

**A:** Seems like the typical overreaction whenever a lumbering giant has a hiccup.

## Catch up with Fundstrat

The big stories last week were the continued selling in Korea/AI stocks and the downside surprise in CPI and PPI. In our view, the more important is the downside reading on inflation as this sets the stage for bond markets to flip from hawkish to dovish Fed. As for AI, we think margin call-related selling is likely at play, but the fundamentals remain intact.

## Technical

Technology’s correction has grown more pronounced this week and has been anything but stealthy. What’s notable is how little of this has bled into the broader market. Both the equal-weighted S&P 500 and the Dow Jones Industrial Average maintain uptrends which have not been broken, and following Thursday’s breakout in the DJ Transportation Average and $$RSP's new all-time high close, it’s difficult to view last week as anything more than rotation.

## Crypto

The biggest development today was the accelerating selloff across AI infrastructure beneficiaries, including the miners held within our crypto equities portfolio. While the broader rotation out of AI CapEx receivers has been underway for several weeks, today’s move was likely catalyzed by Chinese AI startup Moonshot releasing its new open-weight model, Kimi K3.

## News We're Following

***Breaking News***

- Yemen’s Houthis vow to impose maritime blockade on Saudi Arabia BBG

***Markets and economy***

- Oil retreats on report of proposal to pause US-Iran strikes BBG
- A statistical revamp is about to lower inflation, at a critical time WSJ

***Business***

- EU hits China’s Alibaba with €550M record fine over illegal products POL
- How PayPal went from Wall Street favorite to unwilling merger target REU
- AMC stock surges after the theater operator posts blockbuster earnings BAR
- Morgan Stanley cashes in on AI boom with debt deals FT

***Politics/U.S.***

- US bombs Iran for ninth day in campaign to reopen Hormuz BBG
- Taylor Farms lettuce sample that tested positive for cyclospora was a false positive, FDA says CBS
- Troy Jackson emerges as Democratic pick as top Maine Senate candidates step aside NBC

***Overseas***

- Jordan becomes new flashpoint in U.S.-Iran war as troop deaths rise WSJ
- Andy Burnham promises new economic model in first speech as UK PM BBG

- Spain's largest wildfire of the year burns for a fifth day as new heatwave looms REU
- Russians turn to cash putting more strain on slowing wartime economy BBC

***Of Interest***

- JD and Usha Vance welcome a baby boy, the first child born to a sitting VP in more than 150 years AP
- Food delivery rider wins China's top literary prize BBC

| Overnight | |
|---|---|
| S&P Futures | +22 ▲ point(s) (+0.29% ▲ ) |
| overnight range: | -16 ▼ to +24 ▲ point(s) |

| APAC | |
|---|---|
| Nikkei | -4.03% ▼ |
| Topix | -2.72% ▼ |
| China SHCOMP | +0.85% ▲ |
| Hang Seng | +2.36% ▲ |
| Korea | -4.46% ▼ |
| Singapore | -0.19% ▼ |
| Australia | -0.06% ▼ |
| India | -0.42% ▼ |
| Taiwan | -0.52% ▼ |

| Europe | |
|---|---|
| Stoxx | 50 +0.33% ▲ |
| Stoxx | 600 +0.14% ▲ |
| FTSE | 100 -0.32% ▼ |
| DAX | +0.40% ▲ |

| | |
|---|---|
| DAX | [illegible] ▲ |
| CAC | 40 +0.35% ▲ |
| Italy | +0.33% ▲ |
| IBEX | +0.37% ▲ |
| Canada | -0.22% ▼ |
| Mexico | +0.42% ▲ |
| Brazil | -0.06% ▼ |

### FX

| | |
|---|---|
| Dollar Index (DXY) | +0.04% ▲ to 100.81 |
| EUR/USD | -0.08% ▼ to 1.1430 |
| GBP/USD | +0.10% ▲ to 1.3465 |
| USD/JPY | -0.01% ▼ to 162.42 |
| USD/CNY | +0.14% ▲ to 6.7670 |
| USD/CNH | +0.12% ▲ to 6.7691 |
| USD/CHF | -0.11% ▼ to 0.8082 |
| USD/CAD | -0.08% ▼ to 1.4033 |
| AUD/USD | +0.21% ▲ to 0.6999 |

### UST Term Structure

| | |
|---|---|
| 2Y-3M Spread narrowed | -0.6bps ▼ to 36.9bps |
| 10Y-2Y Spread widened | 1.0bps to 37.5bps |
| 30Y-10Y Spread widened | 0.2bps to 52.0bps |

### USD HY OaS

| | |
|---|---|
| All Sectors | -26.4bps ▼ to 295bps |

| | |
|---|---|
| All Sectors ex-Energy | -9.4bps ▼ 291bps |
| Cons Disc | -29.7bps ▼ to 449bps |
| Indu | -23.0bps ▼ to 231bps |
| Tech | -1.8bps ▼ to 215bps |
| Comm Srvcs | -0.2bps ▼ to 280bps |
| Materials | 0.0bps to 264bps |
| Energy | -7.1bps ▼ to 276bps |
| Fin Snr | -3.3bps ▼ to 199bps |
| Fin Sub | +17.0bps ▲ to 307bps |
| Cons Staples | -19.9bps ▼ to 456bps |
| Healthcare | -14.2bps ▼ to 305bps |
| Utes | -2.4bps ▼ to 206bps * |

| DATE | TIME | DESCRIPTION | ESTIMATE | LAST |
|---|---|---|---|---|
| 7/24 | 9:45 AM | Jul P S&P Srvcs PMI | 51.5 | 51.2 |
| 7/24 | 9:45 AM | Jul P S&P Manu PMI | 54.5 | 53.9 |
| 7/24 | 10:00 AM | Jun New Home Sales | 605.5 | 580 |
| 7/24 | 10:00 AM | Jun New Home Sales m/m | 4.6 | -7.3 |

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