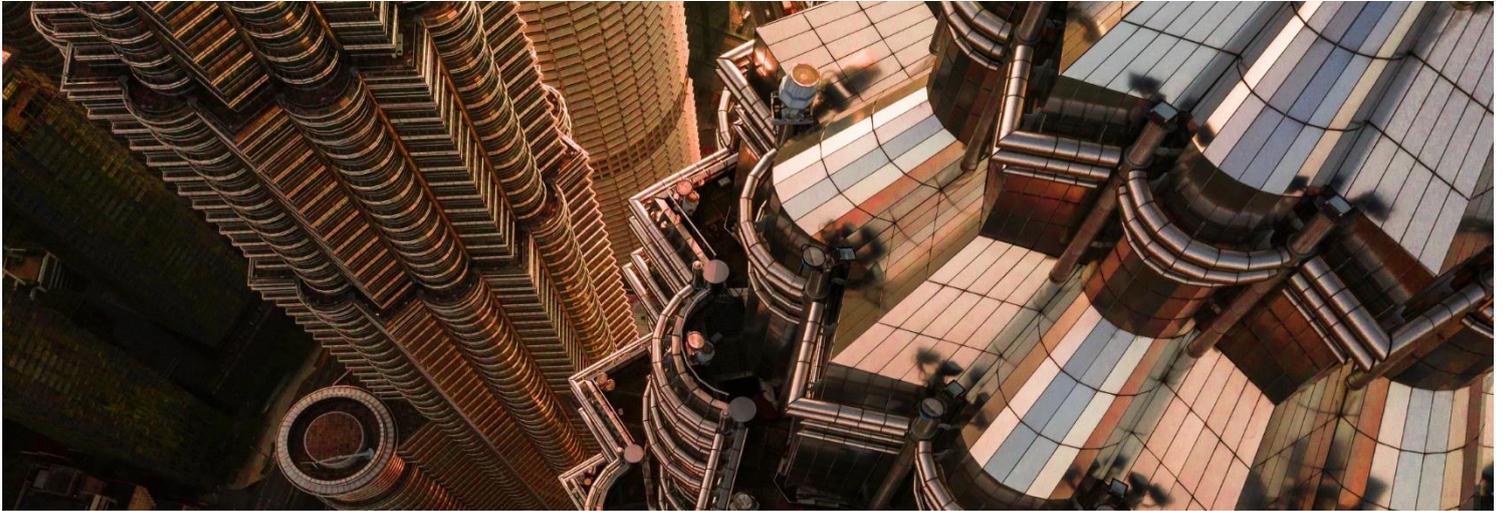


# CIO Academy

## Unpacking the 'SaaS-pocalypse' and the 'AI Fear Trade' - Will AI Eat Software & Other Sectors?

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### Written by:



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**Highlights:** Fear and herd mentality are back to haunt the markets with the onset of the 'AI fear trade'. It started with the recent release of Anthropic's legal AI plug-in which turbocharged AI disruption fears - triggering a sell-off even in the most well established, globally entrenched software companies. This so called 'SaaS-pocalypse' is now spreading to other sectors, from tax advisory to real estate services. To us, the market appears to be selling first and asking questions later.

**What are the market's fears for Business Software?** Pessimists fear that agentic AI will disrupt the traditional Software-as-a-Service (SaaS) model, and that the traditional 'System of record + Human workflow + User Interface' model could simply be replaced by vertically integrated AI agents that deliver both the intelligence and automated multi-step workflow execution, end-to-end, without any human intervention.

**Why is this fear is misplaced?** Because it's too simplistic and ignores crucial intricacies of business software, just like the DeepSeek moment of January 2025. We think it's not that simple or easy to replace well entrenched SaaS models with Agentic AI, overnight. Here's why:

- 1.) **Big SaaS companies have clear moats:** such as multi-year corporate contracts, proprietary IP, and pre-existing partnerships with leading companies. All these are extremely difficult and time-consuming factors to build and replace.
- 2.) **Proprietary data and domain IP:** Large, complex enterprise class system codes, data repositories and IP are proprietary. They're fiercely guarded by these companies and therefore are not available for training the foundational models. Therefore, big SaaS companies are unlikely to get '**vibe-coded**' out of existence by generic LLM models that are trained with mostly publicly available data on the internet.
- 3.) **The SaaS model is best placed to monetise Agentic AI:** We think it's the enterprise software companies that are best placed to embed AI's different use cases in their platforms and drive monetisation by expanding their and their clients' TAM (Total Addressable Market). Software companies should also be one of the beneficiaries of the \$650bn AI capex investment announced by big tech.
- 4.) **AI and SaaS are therefore complementary, not mutually exclusive:** We think AI's usefulness in an enterprise setting is likely to remain limited without a wholesome software ecosystem. For optimal productivity, software platforms are needed to orchestrate the interactions between the AI and non-AI enterprise components. History shows that the **cheapest solutions don't always win**. Just because AI can write code, doesn't mean it will be trusted. Longstanding credibility and seamlessness of established US enterprise vendors is crucial to minimise business continuity and reputational risks.

**What do long term investors need to mindful of?** a.) Agentic AI is unlikely to kill SaaS. It will make it more productive and alter its revenue model from effort based to outcome based. b.) Fear driven pockets of selloff often create attractive entry points. They reiterate our conviction in the broadening of the market and looking across and beyond AI for equity returns. From a purely fundamentals' perspective, software's earnings strength is intact. We like **software infrastructure** (cloud providers) & **cybersecurity software** providers because of rising demand and their impenetrable moats. Overall, we remain well diversified & focus on bottom-up stock selection.

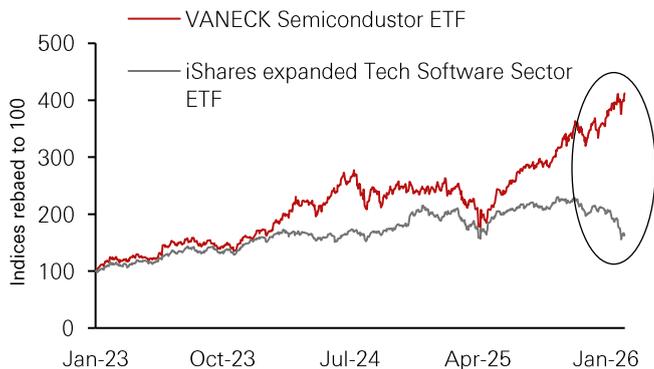
## Business software – the first one to be on the fear driven ‘AI hit parade’

Fear and herd mentality are back in the market. This time, it’s the fear of AI driven disruption for the longstanding enterprise software model, also known as SaaS. It started with the recent release of the Claude co-work legal AI tool by Anthropic in January 2026, turbocharging AI disruption fears, and triggering a sell-off even in some of the well-established, globally entrenched software companies.

### The fear

For decades, several IT service models were based on human effort utilisation and time-based billing. With the rise of AI agents, this model is ripe for disruption. The fear now is that Agentic AI will disrupt the SaaS model, whereby the traditional ‘System of record + Human workflow + User Interface’ model could simply be replaced by vertically integrated AI agents that deliver both the intelligence and automated workflow execution without any human intervention. To us, the market appears to be selling first and asking questions later.

### Performance of US software stocks has diverged from the hardware names



Source: Bloomberg, February 2026. Past performance isn't an indicator of the future performance

### We think this fear is misplaced. Here's why

What this sentiment driven sell-off appears to be discounting is that it's not that simple or easy to replace established SaaS models with Agentic AI, that too in the near term. There are several intricacies that this simplistic, fear-driven narrative misses, in our view:

- 1.) **Big SaaS has clear moats:** Well-established, AI resilient software companies have clear moats such as multi-year corporate contracts, proprietary data and patented IP, and pre-existing partnerships with leading companies. They have enterprise class sales teams; technology cross-licensing agreements; industry specific domain expertise; and aligned workflows with industry

practices. They also have brand awareness & scale, and effective go-to-market strategies. These are just the tip of the iceberg when looking into the key attributes needed to compete effectively in the software sector. All these factors are also extremely difficult and time-consuming to build and replace.

- 2.) **Data repositories and domain IP:** Large, complex enterprise class system codes, data repositories and IP are proprietary. They're fiercely guarded by these companies and are not available for training the foundational models. As such, big SaaS companies are unlikely to get 'vibe-coded' out of existence by generic LLM models that were trained with mostly publicly available data on the internet.
- 3.) **SaaS model is best placed to monetise Agentic AI:** If anyone, it's the well-entrenched enterprise software companies that are best placed to embed AI's different use cases in their platforms and drive monetisation by expanding their and their clients' TAM (Total Addressable Market). Our colleagues in HSBC Global Investment Research believe that within a full-stack enterprise application, AI is likely to be subordinate to the overall enterprise platform. Agentic AI can be seen as more of a learning algorithm or a thinking machine than software's replacement. Once all the analysis is done via the AI agents, enterprise software will act as the main execution machine.

We think enterprise software should also be one of the beneficiaries of the \$650bn AI capex announced by big tech in 2026.

- 4.) **AI and SaaS are complementary, not mutually exclusive:** We think AI's usefulness in an enterprise setting is likely to remain limited without a wholesome software ecosystem. For optimal productivity, software platforms are needed to orchestrate the interactions between the AI and non-AI enterprise components. As alluded to earlier, while AI will undertake the analysis and production of intelligent data, that analysis will be passed to the software stack to be executed. In essence, AI will be the brain or the intelligence of the overall system, whilst software will be the body that executes that intelligence into desired outcomes. Therefore, instead of threatening most of the enterprise software, AI will be domesticated within SaaS and should create significant value outcomes in doing so.

- 5.) **The Trust Factor:** AI can write the code. But just writing the code isn't enough. Trustworthy, seamless execution that minimises business continuity and reputational risks is key for big corporates. And whilst there's a focus on cutting costs and finding business efficiencies using AI, history shows that the cheapest solutions don't always win. **Just because AI can write code, doesn't mean it will be trusted** or widely accepted to execute. The longstanding credibility and seamlessness of established incumbent enterprise vendors matters.

## The Rise of agentic AI will not kill SaaS. It will reset its business model.

Until now, several enterprise software companies were built on revenue generation that came from their engineers' billable hours. Scaling the workforce meant increased utilisation and hence higher revenues. The rise of Agentic AI disrupts that equation.

### Now, Agentic AI can:

- Write the code
- Automate the testing cycles
- Reduce the need for human intervention and support
- Reduce implementation timelines
- &
- Improve developers' productivity

### Such a rise in productivity is likely to create a structural shift in business enterprise models from:

- 1.) Time/effort-based billing to outcome-based pricing
- 2.) Service contracts to platform and domain IP led solutions
- 3.) Scaling headcount to scaling AI-led productivity

## But instead of deciphering this structural shift, the market is stuck in AI duality

It's surprising how AI excites and scares the market – all at the same time. Currently, there's a strange duality of contradictory AI related investor anxieties triggering this doom loop sell-off.

**One is that AI will disrupt almost all sectors** of the economy and therefore the market is selling any company that could potentially be perceived at the slightest risk of being disrupted by AI.

The other is a **deep scepticism on the Return on Investment (RoI)** on the hundreds of billions of dollars that US big tech is committed to spending on AI capex in 2026 and beyond. The result is a rippling sell-off in various sectors, starting from enterprise software to wealth management stocks to real estate services and more – basically, any company that could be perceived to be disrupted by AI. As such, the market appears to be selling first, asking questions later.

But what investors need to be cognisant of is that **these two concurrent fears are contradictory** and can't be true at the same time.

## So, how should investors manage this fear driven sell-off?

Whilst we continue believe in the resilience of the US tech sector, this rippled sell-off reinforces our long-standing preference to **stay diversified** in our portfolio allocation. As the below chart shows, this time, it's the non-tech, cyclical sectors that are carrying weight of the market. A cross-sectional, diversified exposure to both tech & real economy sectors like industrials and materials should provide investors a good hedge against any concentrated, sentiment driven pockets of this AI fear trade. Similarly, a well-sized allocation to the digital and physical infrastructure's contracted and income protected long duration income flows should act as a decent portfolio hedge.

### Non-tech cyclical sectors are carrying the market on their shoulders



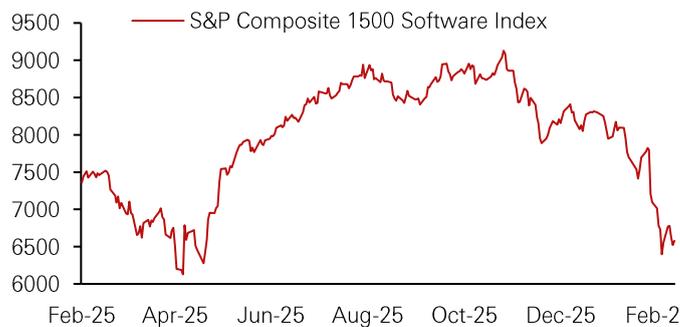
Source: Bloomberg, HSBC Private Bank, February 2026. Note: Data is normalised with percentage appreciation as of 28 October 2025. Past performance isn't an indicator of future performance.

## What do long term investors need to be mindful of?

### To not throw the baby out with the bath water.

Fear driven pockets of sell-off often create attractive entry points. They also reiterate our conviction in the broadening of the market and our preference for staying diversified. From a purely fundamental perspective, software's earnings strength is intact. The Q4 2025 reporting has been generally positive for software, with earnings estimated to grow by 16.8% in 2026 (Source: Bloomberg, February 2026). Yet, the sector is at its lowest since April's Liberation Day. We remain selective across sectors and marry the top-down macro drivers with bottom-up stock selection.

### Software sector is at its lowest since last April's Liberation Day chaos



Source: Bloomberg, February 2026. Past performance isn't an indicator of future performance.

**We think this is not the end, but rather an inflection point** that will sieve out software AI winners from losers.

### The winners will:

- Embed Agentic AI to build 'AI-native' delivery models and enhance productivity.
- Safeguard and invest in their proprietary data banks and domain Intellectual Property - which are their moats.
- Invest in and upskill their sales forces and relationship managers
- Move upstream into value driving verticals like corporate transformation projects.
- Invest in their brand and the ease of execution. &
- Refine their pricing models from labour-based pricing to outcomes-based pricing.

Yes, some software companies offering clerical solutions may get disrupted. But global software names that are already

deeply entrenched in corporates' business delivery models, such as **software infrastructure** firms offering technologies like cloud, that provide the foundational systems which support consumer and enterprise applications and those plumbing the internet and cloud services should benefit from AI induced enhancements. **Cybersecurity software** companies are another subset in the software universe which should benefit from increased demand.

## Summary

**Will AI eat software? The short answer is No.** Legacy software incumbents have deep moats that cannot be replaced so easily by Agentic AI. Writing codes is only a small technical side of big software firms. Whilst its important, there are other equally important technical and business reasons why we think deeply entrenched, enterprise class incumbents are unlikely to be displaced by 'vibe coding' AI agents. We think **Agentic AI and large software platforms are complementary in nature**, wherein AI does the intelligent analysis, while software delivers seamless execution. We expect various types of intelligent AI agents to be embedded and become an integral part of value driven enterprise technology solutions. However, Agentic AI is unlikely to become the whole tech solution, in and of itself.

**Monetisation via distribution** - To us, the software sector looks best positioned to deploy AI's ever-evolving use cases and monetise them via their deep distribution channels. What the market is failing to recognise is that the cheapest isn't always the best. The hard bit isn't creating a new AI capability; the hard bit is distribution - which decides how well a new tech capability is monetised. Legacy software platforms that build AI-native delivery models are best placed to do that.

**This isn't the end of the software businesses - it's an inflection point** where labour arbitrage may end and the winners will embed AI in their delivery models and invest in domain IP, whilst moving up the value driving verticals. Therefore, whilst business software's revenue model will evolve from scaling headcount driven billing to an outcomes and AI-productivity driven revenue model, it is unlikely to become irrelevant or outdone by Agentic AI.

**We find the duality in market mood contradictory** in nature. It is failing to recognise the inflection point in the software model. It also reinforces the need for diversification and selectivity across cyclical sectors of the market. This '**AI fear trade**' is creating attractive alpha opportunities in the market, in our view. We see opportunities in the **software infrastructure (like cloud)** and **cybersecurity software** names that benefit from ever-rising demand and have tailwinds of several megatrends behind them.

# Risk Disclosures

## Risks of investment in fixed income

There are several key issues that one should consider before making an investment into fixed income. The risk specific to this type of investment may include, but are not limited to:

### Credit risk

Investor is subject to the credit risk of the issuer. Investor is also subject to the credit risk of the government and/or the appointed trustee for debts that are guaranteed by the government.

### Risks associated with high yield fixed income instruments

High yield fixed income instruments are typically rated below investment grade or are unrated and as such are often subject to a higher risk of issuer default. The net asset value of a high-yield bond fund may decline or be negatively affected if there is a default of any of the high yield bonds that it invests in or if interest rates change. The special features and risks of high-yield bond funds may also include the following:

- Capital growth risk - some high-yield bond funds may have fees and/ or dividends paid out of capital. As a result, the capital that the fund has available for investment in the future and capital growth may be reduced; and
- Dividend distributions - some high-yield bond funds may not distribute dividends, but instead reinvest the dividends into the fund or alternatively, the investment manager may have discretion on whether or not to make any distribution out of income and/ or capital of the fund. Also, a high distribution yield does not imply a positive or high return on the total investment.
- Vulnerability to economic cycles - during economic downturns such instruments may typically fall more in value than investment grade bonds as (i) investors become more risk averse and (ii) default risk rises.

### Risks associated with subordinated debentures, perpetual debentures, and contingent convertible or bail-in debentures

- Subordinated debentures - subordinated debentures will bear higher risks than holders of senior debentures of the issuer due to a lower priority of claim in the event of the issuer's liquidation.
- Perpetual debentures - perpetual debentures often are callable, do not have maturity dates and are subordinated. Investors may incur reinvestment and subordination risks. Investors may lose all their invested principal in certain circumstances. Interest payments may be variable, deferred or cancelled. Investors may face uncertainties over when and how much they can receive such payments.
- Contingent convertible or bail-in debentures - Contingent convertible and bail-in debentures are hybrid debt-equity instruments that may be written off or converted to common stock on the occurrence of a trigger event. Contingent convertible debentures refer to debentures that contain a clause requiring them to be written off or converted to common stock on the occurrence of a trigger event. These debentures generally absorb losses while the issuer remains a going concern (i.e. in advance of the point of non-viability). "Bail-in" generally refers to (a) contractual mechanisms (i.e. contractual bail-in) under which debentures contain a clause requiring them to be written off or converted to common stock on the occurrence of a trigger event, or (b) statutory mechanisms (i.e. statutory bail-in) whereby a national resolution authority writes down or converts debentures under specified conditions to common stock. Bail-in

debentures generally absorb losses at the point of non viability. These features can introduce notable risks to investors who may lose all their invested principal.

### Contingent convertible securities (CoCos) or bail-in debentures are highly complex, high risk hybrid capital instruments with unusual loss-absorbency features written into their contractual terms.

Investors should note that their capital is at risk and they may lose some or all of their capital.

### Changes in legislation and/or regulation

Changes in legislation and/or regulation could affect the performance, prices and mark-to-market valuation on the investment.

### Nationalisation risk

The uncertainty as to the coupons and principal will be paid on schedule and/or that the risk on the ranking of the bond seniority would be compromised following nationalisation.

### Reinvestment risk

A decline in interest rate would affect investors as coupons received and any return of principal may be reinvested at a lower rate. Changes in interest rate, volatility, credit spread, rating agencies actions, liquidity and market conditions may have a negative effect on the prices, mark-to-market valuations and your overall investment.

### Risk disclosure on Dim Sum Bonds

Although sovereign bonds may be guaranteed by the China Central Government, investors should note that unless otherwise specified, other renminbi bonds will not be guaranteed by the China Central Government.

Renminbi bonds are settled in renminbi, changes in exchange rates may have an adverse effect on the value of that investment. You may not get back the same amount of Hong Kong Dollars upon maturity of the bond.

There may not be active secondary market available even if a renminbi bond is listed. Therefore, you need to face a certain degree of liquidity risk.

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### Risks of investing in private markets

**The value of investments and any income from them can go**

**down as well as up and investors may not get back the amount originally invested. Past performance information presented is not indicative of future performance. The return and costs may increase or decrease as a result of currency fluctuations.**

- **Liquidity Risk** - Investors may be unable to dispose of an investment quickly and at a price that's closely related to recent similar transactions. There is no guarantee of distributions and no established secondary market.
- **Event Risk** - A significant event may cause a substantial decline in the market value of all securities.
- **Long-term Horizon** - Investors should expect to be locked-in for the full term of the investment, which is subject to extensions.
- **No Capital Protection** - Investors may lose the entirety of invested capital.
- **Unpredictable Cashflows** - Capital may be called and distributed at short notice.
- **Economic Conditions** - Ability to realise/divest from existing investments depends on market conditions and the regulatory environment.
- **Risk of Forfeiture** - Failure to make call payments could result in forfeiture of commitment, including invested capital, without compensation.
- **Default Risk** - in the event of default investors risk losing their entire remaining interest in the vehicle and may be subject to legal proceedings to recover unfunded commitments.
- **Reliance on Third-party Management Teams** - Underlying investments will be managed by various third-party management teams that will in aggregate determine the eventual returns for the investor.

The risk factors listed above are not exhaustive, always refer to product specific documentation for full details and risk disclosures.

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The leverage of a product can work against you and losses can exceed those of a direct investment. If the market value of a portfolio falls by a certain amount, this could result in a situation where the value of collateral no longer covers all outstanding loan amounts.

This means that investors might have to respond promptly to margin calls. If a portfolio's return is lower than its financing cost then leverage would reduce a portfolio's overall performance and even generate a negative return.

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When an investment is denominated in a currency other than your local or reporting currency, changes in exchange rates may have a negative effect on your investment.

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