



Creative Destruction: Investing in a Schumpeterian World

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At a Glance

For generations, investors have relied on a familiar set of economic signposts. Inflation, employment, economic growth and interest rates provided a reasonably reliable roadmap for understanding markets because they helped explain where the business cycle was headed. When growth accelerated, certain sectors tended to outperform. When inflation rose, central banks responded. When recessions emerged, investors adjusted accordingly.

While those relationships still matter, they increasingly appear insufficient for explaining many of the forces shaping investment outcomes today.

One of the more surprising features of recent years has been the relative stability of the global economic backdrop. Labour markets have remained resilient, economic growth has generally avoided the severe contractions many economists anticipated, and inflation has moderated from its post-pandemic highs. U.S. unemployment, for example, remained near historically low levels throughout much of 2024 despite repeated concerns that tighter monetary policy would trigger a recession.¹²

Yet investors would be hard-pressed to describe the period as stable. Instead, global markets have been influenced by tariffs, industrial policy, geopolitical conflict, artificial intelligence (AI), supply-chain reconfiguration and regulatory intervention. Increasingly, the volatility investors experience

originates outside the traditional business cycle. Investors often focus on policy risk. Increasingly, however, the more important variable may be policy velocity—the speed at which governments, regulators and institutions change the rules of the game. A policy change can matter. A rapid policy change can matter even more.

This distinction helps explain one of the defining features of the current environment: economic volatility has often remained relatively contained while policy volatility has become an increasingly important driver of market outcomes. Understanding that shift requires a broader framework for interpreting markets. One useful lens is the contrast between economists Adam Smith and Joseph Schumpeter.

From Adam Smith to Joseph Schumpeter

Adam Smith’s economic framework remains deeply embedded in modern investing. His emphasis on competitive markets, specialization, trade and the efficient allocation of resources helped shape the foundation of modern capitalism. In a Smithian world, stable institutions, predictable rules and market forces gradually direct capital toward its most productive uses.

Many investors still operate within this framework, even if they do not consciously think about it that way. Traditional macroeconomic analysis, valuation frameworks and business-cycle investing all assume a world in which economic relationships are relatively stable and where investment outcomes are largely driven by growth, inflation and interest rates. Joseph Schumpeter viewed capitalism differently.

Rather than focusing primarily on efficiency, he focused on innovation. Rather than seeing competition as the primary driver of economic progress, he viewed entrepreneurs and technological breakthroughs as the engines of change. Most importantly, he argued that economies advance through waves of creative destruction, a process through which new technologies, products and business models continuously displace older ones.

Adam Smith	Joseph Schumpeter
Competition	Innovation
Market efficiency	Economic dynamism
Markets allocate resources	Entrepreneurs transform markets
Stability and predictability	Creative destruction
Trade and specialization	Technological disruption
Incremental progress	Transformational change

The distinction is more than an academic debate. For much of the post-war era, Smithian forces arguably dominated the investment landscape. Globalization expanded trade, institutions became increasingly integrated, supply chains grew more efficient and capital flowed relatively freely across borders. Today, many of those assumptions are

being challenged. Governments are becoming more interventionist. Industrial policy is returning as a strategic tool to adjust for weakness in supply chains. Trade relationships are evolving. Technological change is accelerating. AI is reshaping competitive advantages and entire business models. The outcome is higher nominal, but uneven, growth.

The Volatility Investors Experience Is Changing

Historically, investors spent most of their time analyzing economic volatility—changes in growth, inflation, employment and interest rates. Financial volatility, driven by leverage, liquidity and credit conditions, could occasionally amplify those fluctuations. Today, a third type of volatility appears increasingly important.

Type of Volatility	Examples	Typical Impact
Economic Volatility	Growth, inflation, employment	Traditional business cycle
Financial Volatility	Credit spreads, leverage, liquidity	Amplifies macroeconomic shocks
Policy Volatility	Tariffs, regulation, fiscal policy, geopolitics	Increasingly drives market outcomes

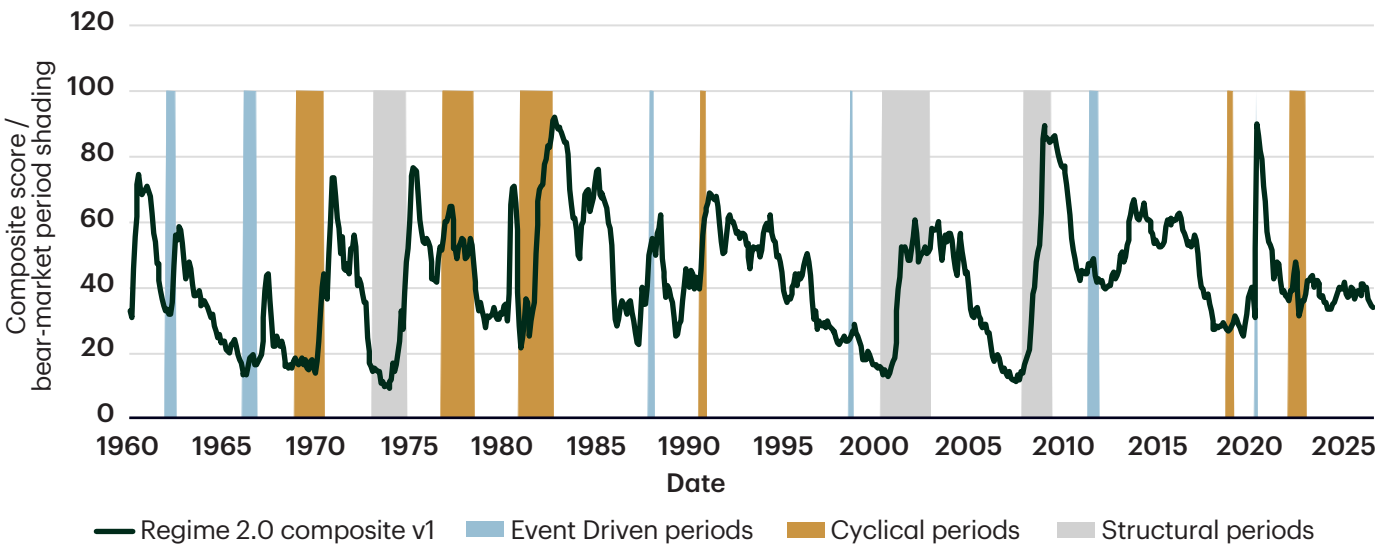
Unlike economic volatility, **policy volatility** rarely follows a predictable cycle. It can emerge suddenly, alter incentives rapidly and reshape industries in remarkably short periods of time. Despite frequent recession concerns and heightened market uncertainty, TD Asset Management Inc.’s (TDAM) Regime Composite (**Chart 1**) indicates

that economic volatility remains well below levels experienced during major crisis periods such as the Global Financial Crisis and COVID-19. The disconnect suggests investors may increasingly be responding to policy and structural forces rather than traditional macroeconomic instability.

Change

Chart 1: TDAM Regime Indicator

Economic Volatility Has Remained Contained



Source and Methodology: TD Asset Management Inc., Regime Composite Indicator is generated using monthly data from January 1960 through June 2026. The solid line represents TDAM’s proprietary Regime Composite Indicator, a multi-factor measure designed to assess the level of economic and market stress using a combination of macroeconomic, financial market and business-cycle-related inputs. Higher readings indicate elevated economic volatility and stress conditions, while lower readings indicate a more stable economic environment. Shaded regions identify historical S&P 500 bear market periods classified by TDAM as Event-Driven (e.g., exogenous shocks), Cyclical (economic slowdown/recession-driven) or Structural (financial system or economic imbalance-driven). Recession shading represents U.S. National Bureau of Economic Research (NBER) recession periods. Past performance or historical relationships are not indicative of future results. Data obtained from Bloomberg Finance L.P.

Key takeaway

The economy has often been more stable than investor sentiment implies. The source of volatility may be changing.

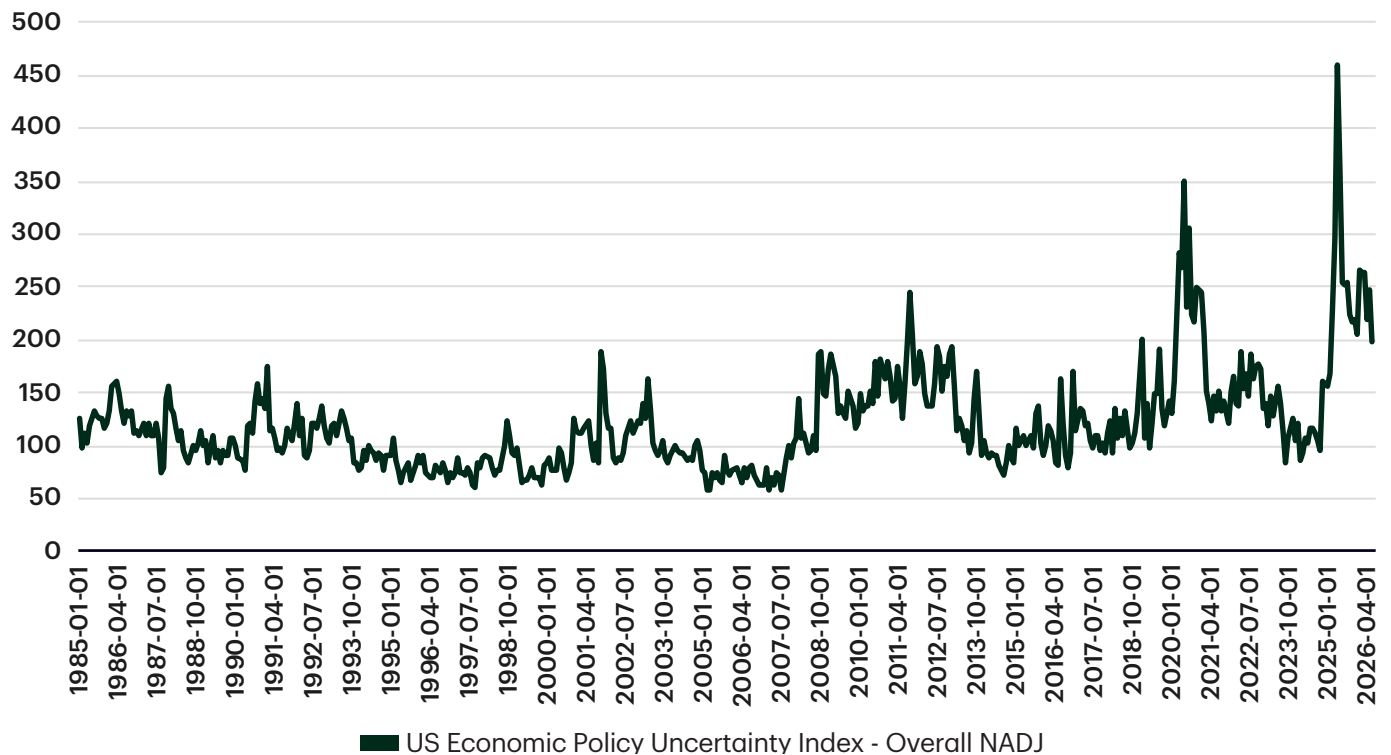
Stable

Measures of policy uncertainty have moved sharply higher in recent years. The U.S. Economic Policy Uncertainty Index (**Chart 2**) remains significantly

above its long-term average, reflecting uncertainty surrounding trade policy, regulation, fiscal policy and geopolitical developments.³

Chart 2: U.S. Economic Policy Uncertainty Index

Policy uncertainty remains elevated relative to historical norms



Source: Baker, Bloom and Davis Economic Policy Uncertainty Index, accessed via LSEG Datastream. The line represents the U.S. Economic Policy Uncertainty Index (Overall), a news-based measure of uncertainty surrounding economic policy. The index is constructed using the frequency of newspaper articles containing terms related to the economy, economic policy and uncertainty, along with policy-related components developed by Baker, Bloom and Davis. Higher index values indicate elevated levels of policy uncertainty, while lower values indicate relatively stable policy conditions. Monthly data from January 1985 through June 2026. Past performance and historical relationships are not indicative of future results.

Key takeaway

Economic conditions have been relatively stable, but elevated policy uncertainty suggests investors are increasingly navigating a world shaped less by the business cycle and more by policy volatility.

Taken together, these charts tell an important story. Investors often describe today's environment as unusually uncertain. It may be more accurate to say that the source of uncertainty has changed. Economic volatility has remained relatively benign. Policy volatility has not.

Why Policy Velocity Matters

Policy risk is familiar to most investors. Elections, regulatory changes and fiscal decisions have always influenced markets. Policy velocity is different. It reflects the speed at which policy changes occur and the speed at which businesses, consumers and investors are forced to adapt.

Economic volatility tends to unfold gradually. Growth slows. Inflation rises. Central banks respond. Investors can draw on decades of historical experience to assess how events may unfold. Policy volatility rarely behaves that way. A tariff can alter supply chains almost immediately. Industrial policy can redirect billions of dollars in capital toward preferred sectors. Regulatory changes can reshape

competitive dynamics across entire industries in months rather than years. One example would be wholesale regulation of AI.

The challenge is that investors often understand the first-order effects of policy decisions while underestimating second- and third-order consequences. The faster policy changes occur, the more difficult those consequences become to anticipate. As a result, policy velocity may be one of the most underappreciated drivers of investment risk today. It may also help explain why traditional macroeconomic forecasts often appear less effective in explaining market behaviour than they once were.

Why the Traditional Macro Playbook Is Becoming Less Reliable



Inflation still matters.



Growth still matters.



Interest rates still matter.

This does not mean macroeconomics no longer matters. However, many of the defining market events of the past two decades have not been traditional economic stories. The Global Financial Crisis emerged from excess leverage within the financial system. The COVID recession originated from a public-health shock. Trade wars were driven by policy decisions rather than macroeconomic imbalances. AI represents a technological disruption whose economic consequences are still unfolding.

In each case, traditional economic models provided only limited guidance. The challenge for investors today is that markets increasingly respond to forces operating outside the normal business cycle. Technological innovation, policy intervention and geopolitical realignment are becoming increasingly important determinants of both risk and opportunity.

Influence

Creative Destruction and the Battle for Future Profit Pools

Schumpeter argued that economic progress occurs when innovation creates new sources of value while simultaneously disrupting existing ones. For investors, this process can often be understood through the concept of profit pools.

Profit pools refer to where the majority of economic profits are earned within an industry or ecosystem. As innovation occurs, those profit pools migrate. History is filled with examples.

The Evolution of Profit Pools

Old Profit Pools		New Profit Pools
Traditional retail	→	Digital commerce
Legacy software	→	Cloud computing
Linear media	→	Digital platforms
Traditional IT infrastructure	→	AI infrastructure
Information assets	→	Data ecosystems

Viewed through this lens, much of the market leadership of the past fifteen years appears fundamentally Schumpeterian. The success of cloud computing, digital platforms, mobile ecosystems and AI represents more than a story of earnings growth. It reflects the migration of economic profits from older business models toward entirely new ones.

A Schumpeterian investor therefore asks a different question than a traditional investor. The question becomes less, “Which company is cheapest?” and more, “Which company is reshaping where future profits will be earned?”

The Paradox of Innovation

Creative destruction creates extraordinary opportunities. History offers numerous examples. Railways, telecommunications, the internet and other transformative technologies all generated tremendous wealth creation while simultaneously attracting speculative enthusiasm and excessive capital. AI may prove no different.

Investors often overestimate the short-term impact of transformational technologies while underestimating their long-term significance. As expectations rise, valuations can become detached from reality even when the underlying innovation ultimately changes the world. This creates an important implication for investors.

A Schumpeterian world is likely to produce larger winners than a traditional Smithian world. It is also likely to produce more dramatic losers. Paradoxically, periods of transformational innovation may increase the importance of diversification rather than diminish it. Participating in innovation is essential, but assuming every participant in an innovation cycle will ultimately succeed can prove costly.

AI: The Latest Wave of Creative Destruction

AI provides a contemporary example of how creative destruction unfolds. According to IDC, research based technology company, global spending on AI infrastructure reached approximately US\$318 billion in 2025 and is projected to exceed US\$1 trillion annually by 2029.⁴

Such investment reflects the belief that AI will create new profit pools while reshaping existing ones. Yet the ultimate winners remain uncertain. That said, we would favour highly regulated industries such as banking, infrastructure, commodities and materials, where we see significant opportunities.

History suggests that transformative technologies often create substantial value while simultaneously attracting excessive capital and unrealistic expectations. The challenge for investors is not simply identifying the technology itself. It is identifying which businesses possess the competitive advantages necessary to capture long-term economic value from that technology. Increasingly, those advantages may include proprietary data, network effects, scale and the ability to adapt quickly as technology evolves.

Investing in a World of Binary Outcomes

One consequence of creative destruction is that investment outcomes become increasingly dispersed. In more stable environments, successful investments may outperform expectations by a moderate amount. Periods of significant disruption tend to produce very different outcomes.

Companies positioned on the right side of technological and policy shifts can experience extraordinary value creation. Companies positioned on the wrong side may struggle to remain relevant. The gap between winners and losers widens.

This dynamic helps explain much of today's market concentration, whether in AI, platform businesses, semiconductor leadership or other innovation-driven sectors. In an innovation-led environment, outcomes become increasingly binary. Some businesses create entirely new profit pools and generate multiples of their original value. Others fail to adapt despite attracting significant attention and capital. The challenge for investors is not merely identifying potential winners. It is recognizing how wide the distribution of outcomes may become.



Portfolio Implications

If markets are becoming increasingly influenced by innovation-driven disruption and policy velocity, several portfolio implications emerge.

Diversification Takes on a New Meaning - Rather than simply diversifying across traditional sectors, investors may increasingly seek exposure across the AI ecosystem, including AI builders, AI enablers and scarce physical assets that stand to benefit from rising demand.

Active Management May Benefit From Greater Dispersion - As outcomes become increasingly binary, the gap between winners and losers should widen. This creates both risks and opportunities for investors attempting to identify businesses capable of adapting successfully.

Long-Term Structural Trends Matter More - While economic cycles remain important, long-term themes such as AI, automation, energy transition and demographic change may play an increasingly significant role in shaping future returns.

Innovation Exposure Requires Discipline - Periods of technological transformation often encourage excessive optimism. Investors should seek exposure to innovation while maintaining an appropriate balance between opportunity and diversifying assets.

Durable Competitive Advantages Become Increasingly Important - Companies with proprietary data, strong balance sheets, resilient business models and the ability to adapt may be better positioned to navigate an environment characterized by rapid change. At the same time, AI may pose existential risks to many businesses. Access to both public and private pools of capital becomes increasingly important.

Conclusion:

A Different Investment Playbook

For much of the last half century, investors operated in a largely Smithian world characterized by stable institutions, expanding globalization and the relatively efficient allocation of capital. Increasingly, markets appear to be entering a more Schumpeterian era, one defined by innovation, disruption, policy intervention and creative destruction.

Economic cycles have not disappeared, but they may no longer be the dominant force shaping investment outcomes. The critical challenge for investors is no longer simply forecasting growth and inflation. It is understanding how innovation, policy velocity and shifting profit pools are reshaping industries before those changes become obvious in economic data. Or put another way: in a Schumpeterian world, investors must think less like economists and more like students of innovation. That is where tomorrow's opportunities, and tomorrow's risks, are most likely to emerge. ■

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¹U.S. Bureau of Labor Statistics, Unemployment Rate Increases in the First Half of 2024, Before Leveling Off, While the Labor Force Participation Rate Holds Fairly Steady, Monthly Labor Review, September 2025.

²U.S. Bureau of Labor Statistics, Unemployment Rate Steady at 4.1 Percent in October 2024, November 8, 2024.

³Federal Reserve Bank of St. Louis (FRED), Economic Policy Uncertainty Index for the United States. June 2026 reading approximately 198 versus a long-run baseline of 100.

⁴IDC, AI Infrastructure Spending Caps Historic Year at ~\$90 Billion in Q4 2025; 2029 Spending to Eclipse \$1 Trillion, April 16, 2026. Global AI infrastructure spending reached approximately US\$318 billion in 2025 and is projected to exceed US\$1 trillion annually by 2029.

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