

**August 29<sup>th</sup>, 1997 - The Day the World Changed**

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What is so special about August 29<sup>th</sup>, 1997?

**Is it the day that D.C. resolved the debt ceiling once and for all?** Clearly not, as we are just finishing this round of debt ceiling debates and headed for another round in 2 years (after the next presidential election). Markets can breathe a small sigh of relief as default doesn't look imminent, but the market always treated this as theatrics, so the relief rally (if any) will be small. There is an argument to be made that the government (the Fed and the Treasury) will **pull back on providing excess liquidity**, which could create some selling pressure in risk assets.

**Was it the day the Berlin Wall fell?** Nope, that was November 9, 1989. While the Berlin Wall will never be rebuilt, relations with Russia are back to Soviet-era levels of distrust.

**Was it Tiananmen Square?** Nope, that was June 4, 1989. While the COVID protests in China never escalated the way that Tiananmen Square did, we did see those protest shape policy in China. Xi ended the lockdowns (at least partly) in response to the protests, which is one bright spot in a year where he largely seemed to consolidate power (not just the CCP's, but also his own).

**What is so important about August 29<sup>th</sup>, 1997?** In fact, the [event can be pinpointed](#) to 2:14am ET on that fateful day. That is the precise moment that **Skynet became self-aware**.

Okay, even in the *Terminator* series we don't see the exact moment when it became self-aware, so that might explain why it doesn't register as an important date for many people. Maybe (I guess) it is because it is just a movie, but let's ignore that criticism and run with Skynet.

**AI**

About the most useful thing from [last weekend's T-Report](#) was stating that **NVDA earnings would be the most important earnings report of this earnings season**. That turned out to be an **understatement** as it may have been one of the **most important earnings reports in years**.

NVDA added about \$200 billion of market cap and is posed to join the \$1 trillion club. Semiconductors and anything with even a hint of AI did well on the back of those earnings.

**That report is making everyone re-think the importance of AI** (even more than they already were).

At one end of the spectrum, doubters believe that companies are **merely attaching themselves to the latest "craze" or "fad"**. It isn't difficult to pick some potential examples from the days of FOMO, TINA, and ZIRP where anything disruptive could raise money, but I'll just go with the **Long Island Iced Tea Corp**. The company changed its name to **Long Blockchain Corp**. and managed to get the stock to pop spectacularly. That ended badly for everyone as the SEC got involved. I'm almost reluctant to mention KodakCoin in this paragraph, but it too helped propel valuations (at least briefly). Anyways, it is that type of "attachment" to a "fad" that some people see occurring with AI.

**The next level of doubt or skepticism is more along the lines of "AI is going to change the world, but are we valuing the right companies?"** For this we can look to companies like pets.com which grew to incredibly high valuations (that management failed to justify). The valuations placed on anything dot-com dwarfed anything brick and mortar. But some winners did emerge and an investment (at the time) in Amazon paid off incredibly well! So, this level of investor skepticism is about whether the right companies are being valued correctly or whether we don't even know what companies will emerge as successful in this nascent space.

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**A similar (but different) concern is about potentially getting ahead of ourselves in valuing the “infrastructure”** (for lack of a better word). The first thing that comes to mind is “fiber”. During the dot-com boom, many believed that an increased use of the internet was going to require immense growth in bandwidth. At the time, the belief was that fiber was going to be key (back in the early 2000s “ethernet wired” homes attracted a premium value). In any case, companies like Global Crossing commanded high valuations (only to fail). Eventually, the bandwidth turned out to be insufficient. In many cases, too much capacity was built too quickly leaving much of the fiber “dark”. This whole story is another example of “even if the tech is right, investing in it can be tricky”.

**So far, the beneficiaries (at least in terms of market capitalization) have been the companies building, organizing, selling, or creating the AI tools and equipment.**

**When do we really price in the fact that “this is changing the world”?** I think that this is the real question.

**AI Changing the World**

If AI is going to be as successful as the “believers” believe, then when do we start pricing that transformational technology into overall valuations? When do we really start thinking about the impact on the economy and potentially the country? I brought up the Skynet reference because I thought it would be a “fun” way to take us to this next step. This is the step beyond just rewarding the companies that will directly benefit from people using AI.

- Shouldn’t we be able to price in improved earnings for all companies that are able to use AI successfully? Given the scope of what AI can provide, that means that almost every company can benefit – from sole proprietorships to large multinational companies. **Efficiencies beyond anything we’ve thought about should be possible, so AI should be lifting the entire market.**
- **How many jobs will be lost?** The flipside of these efficiencies seems to be that companies should be able to reduce their headcount (potentially dramatically). This might be where the darker side of the Skynet analogy comes in. Do servers (the computer type, not the waiter/waitress/bartender type) go on vacation? If AI can truly deliver on its potential for efficiency, when do we completely change our way of life?

Whether this iteration of AI can deliver in such a way remains to be seen, but it seems likely that even if this generation doesn’t figure it out, a future generation will.

**I think that the promise of AI is starting to make me bullish on the market, but a little nervous about what the country will look like.**

I certainly don’t have all the answers, and I’m sure that we will see some companies attempt to attach themselves to this theme for a quick gain. Some other promising companies or areas will fail to deliver and won’t live up to current expectations. On the other hand, some companies might continue to ride the wave and this will have turned out to be “bargain basement” entry levels. There will probably be some companies where we wonder (in hindsight) why we didn’t see them emerging as the dominant players. Finally, if AI really can deliver on even a fraction of its promise, it should transform how we think about existing companies, businesses, and potentially our workforce.

I do think that it is interesting (at least in terms of the *Terminator* series) that we are behind the AI timeline predicted by those writers!

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**Back To Today's World**

While thinking about AI and getting it right is crucial (and fascinating/fun), we are still in a world where we have to make it through the next few weeks and months doing mundane things like buying, selling, and issuing bonds.

**We get the full array of data on the employment front – JOLTS, ADP, and NFP this week.**

I cannot find anyone who seems to have good stories on hiring. Yes, relatively low paying/basic jobs are abundant. AI cannot mow a lawn, deliver food to a table, etc., so jobs there seem plentiful. But more senior positions? Most of what I'm hearing is that hiring is on hold. Companies want to see how things pan out in the economy before committing to hiring. If anything, the doubt about the economy has given them the ability to reduce their workforce where they see fit.

Maybe we will get the usual:

- Surprisingly good jobs numbers.
- Detailed analysis highlighting why the headline data is misleading, how electronic job advertising overstates jobs available, and that abysmal survey response rates are concerning/likely causing misstatements in the data.

It seems that has been the scenario every month for at least a year. Maybe (hopefully) this time will be different, but I fear that we will all be left scratching our heads on Friday morning trying to figure out where all the jobs are coming from.

**The consumers** keep on spending, but they are utilizing a lot of their potential resources to do so. Can this continue?

**The Fed** is being pushed towards another 25 bp hike, but markets don't care (which is positive).

**Look for one last wave of IG new issuance ahead of a slow summer and for the HY issuers to start filling the void.**

**Bottom Line**

I'm trying to decide if the next surge resulting from this AI craze will propel the broad markets and the laggards higher. That is quite possibly the biggest shift in thinking that I've had in at least a month (the S&P 500, for all of the headlines, is up 0.9% this month, and "only" 0.3% last week).

**On this Memorial Day**, please honor and remember all of those who made the ultimate sacrifice in service to the United States of America.

If you missed Wednesday's [Around the World](#) it is an excellent read as it focuses on Russia/Ukraine, China/Pakistan, Israel/Gaza, and Turkey.

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