ARTIFICIAL INTELLIGENCE
AND THE GREAT DIGITAL TENORS

After the pandemic, the digitalisation companies seemed to have lost their lustre. People, it was thought, now that they could freely leave their homes, preferred to go to the shops for their purchases, recovering those social relationships they had been forced to give up. The growth prospects of online commerce stocks, such as Amazon, would be diminished. The need for new computers and peripherals would have lost the urgency of those who had become accustomed to considering their lives essentially in front of a screen. Sales of Apple's computers and iPads were clearly going to slow down. By spending less time surfing, search engine advertising would also have been less effective, trivialising the strength of titles such as Alphabet. The resurgence of direct social relationships would also have dwarfed the strength of Facebook, so much so that the founder, Mark Zuckerberg, decided to give it a new mission by calling it Meta.

These expectations, depressing in themselves, have been loaded with another burden: that of inflation. The pandemic, the war in Ukraine, the downsizing of globalisation, the retirement of many baby boomers, have lit the fuse of price increases. The central banks, after some hesitation, decided for stability even at the cost of driving economies into recession. The United States, the financial world's driving force through the dollar, raised interest rates from zero to over 5% in just a few months. The first to suffer the consequences were the digitalisation stocks whose values discounted profits calculated with almost non-existent rates projected into the future. By decreasing future profits because they were adjusted to financial costs between 3.5% and 5%, share prices were inevitably bound to correct. This phenomenon clearly has consequences for the economy. Many companies, waiting to understand the new environment, therefore decided to put a brake on the new spending trend that was pushing them to move their data to the clouds of Microsoft, Amazon or companies such as Salesforce, which have established themselves in recent years.

Added to this is another aspect that should not be underestimated. Old investors, thanks to their experience, are great connoisseurs of markets, but they did not grow up with technology and often do not understand it. Even the performance of Warren Buffett's Berkshire is an expression of this misunderstanding: they peaked in the 1980s, weakened in the 1990s and have underperformed since 2017. It was only when the Oracle of Omaha decided to buy Apple heavily that his holding company's shares shone again. Buffett chose to intervene in the world's most capitalised company because it has a market he understands, based on the sale of mobile phones that drive other digital development opportunities. It is a context that, in some respects, appears mature and therefore predictable according to the old canons of the investor looking for the intrinsic value of the company. It is, in a way, the modern variation of the consumer good. Unlike other technology companies, Apple is relatively unambitious when it comes to attacking new markets: it spends one third as much on research, relative to sales, as Alphabet, Microsoft and Meta do. Over the past decade, the company has acted like an old capital allocator, using cash flow to buy its shares on the open market.

Buffett, strong in his reasoning, does not easily give up the stock. The case is different for many other Wall Street professionals who have had to bow to the trend without really believing in it. These interpret the signs of crisis as a confirmation of their deepest convictions: the new economy is a victim of its own investments and Moore's law (which sees digitisation growing according to a geometric progression) has arithmetic limits.

Well, Apple, from the pandemic lows of March 2021, 116 usd, now stands at 175 usd, close to the absolute highs of 182 usd; Amazon from 147 usd has fallen to 120 usd, but with a mighty recovery from 80 usd; Alphabet from 102 usd is now at 124 usd; Microsoft from 227 usd is now at 332 usd; Meta, from 225 usd is back almost at the same level, but after seeing a low below 90 usd in November 2022. Each of these companies has its own dynamic in the face of the events of the past troubled three years. But all of them, in different ways, continue to surprise with their ability to adapt to change through

heavy investment and ability to increase shareholder value.

Their valuations measured by stellar multiples, when compared to those of companies in the old economy, easily confuse the classic investor who underestimates the size of the profit margins of those who digitise the world: it is not impossible to see software companies reporting margins of 90%. There is one accounting aspect that especially annoys the old investor. Research and development expenses, which characterise companies in the new economy, are counted in the year, contributing to lower profits. By contrast, those for tangible assets such as property, plant and equipment (predominant in the old economy) can be depreciated over many years. If research and development expenses are reclassified over time, the multiples of digital companies also 'normalise'. [1]

Through such an exercise, fears that a bubble has been produced in the securities of the new digitisation based on Artificial Intelligence (AI) in recent weeks can be partly allayed. Ever since Microsoft included the specific function, ChatGPT, in its search engine, the stock has started to rally on the stock exchange, dragging all those companies in the digital world involved in this new phase of proactive digitisation development. Hence not only Alphabet and Meta, which have been investing in this field for some time, but also semiconductor companies, such as NVIDIA, which has gained +180% since the beginning of the year. Any company that has managed to make the term AI appear among its competencies has been lucky in the stock market. In some respects, this is reminiscent of the early 2000s, when all a company had to do was indicate that it was doing something via the internet to see its valuations explode. At that time, the dot.com bubble developed, and when it burst, it had disastrous consequences for stock exchanges and economies. At the time, the speed with which the internet would change the way we live and work was overestimated. The technology was there, but it would take years for people and companies to integrate it into their daily lives.

[1] Adam Seessel, *Where the Money Is, Value Investing In The Digital Age*, Avid Reader Press, New York, 2022, 254 p.

What the indices are discounting on AI is completely different from the experience of 23 years ago. Stock markets dream fast and think slow. The current dream is that AI will be almost immediately integrated into the real economy. And this is also technically possible because Microsoft, Alphabet and Amazon, which account for almost a fifth of the capitalisation of the S&P, have the tools for this new technological leap. Moreover, people and companies are already digitised: today's mobile phone runs on 5G and is in everyone's hands. Adding to the new digital vision of the future is the economic one: inflation, which appears persistent, will be defeated by AI, which will be inherently deflationary. Productivity is set to increase rapidly and technology will easily replace baby boomers.

If this is the underlying thought that has driven the rises, especially the Nasdaq (+24% since the beginning of the year), the time for reflection will soon come. Big discussions about the social role of AI and the dangers it implies for privacy, jobs and whatnot, will drive profit-taking. An initial adjustment phase is likely to take place over the summer. Rates will not be able to fall as fast as the markets seem to think, because the phenomena that caused inflation to resume are still present. AI, as fast as it can be implemented, still needs a complex transformation phase.

Should we therefore prepare for a stock market crash? Probably not. We will not go beyond a correction because we will see a sectoral rotation. There are two other sectors that will move the markets in the coming years: decarbonisation, which is intrinsically linked to digitalisation, and the old economy based on gas and oil. However much we prepare for a green future, electricity production itself is still dependent on coal, oil and gas. Considering these aspects, it is possible to imagine a sideways trend in the stock markets in the coming months. Tactical profit-taking in digitisation companies will alternately be in the green or CO2-producing sector. However, this scenario can only occur in a soft landing context. But to have a piloted slowdown in the economy, capable of bringing down inflation without destroying growth, it is necessary for markets to continue to have liquidity. Two converging factors could change this scenario. The agreement on raising the debt ceiling in the United States, if it happens as it seems, implies

new Treasury issues that will, in effect, remove liquidity from the markets. The Federal Reserve and the European Central Bank are also preparing Quantitative Tightening (QT): they want to sell some of the bonds they have accumulated on their balance sheets on the open market. This would further reduce the liquidity available to the markets. Fiscal expansion policies, however, can help manage a difficult balance that still has to deal with complex geopolitics and the Russia/Ukraine, but also China/US challenge. The variables are therefore multiple and complex. And although the S&P has risen 8% since the beginning of the year, without big tech it would be negative. Will AI help unravel the skein? It is hard to know, but the big tenors, Microsoft, Alphabet, Amazon, Apple and company may they will not stay on the sidelines.

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