Investment Outlook

A monthly round-up of global markets and trends

June 2023

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Investment outlook

Breaking down the enigma of artificial intelligence

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Technology stocks have made a comeback this year after underperforming in 2022. By the end of May, the tech-heavy Nasdaq in the US was up more than 20% as companies delivered solid earnings in the first quarter and investors discounted the end of the Federal Reserve's interest rate tightening cycle.[1] This has given some relief to the interest rate sensitive tech sector.

Arguably, tech valuations have also been driven up by favourable investor sentiment over a new type of artificial intelligence (AI) called generative AI. This follows the rollout of the ChatGPT tool by developer OpenAI (part-owned by Microsoft) in what is the first generative AI to reach mass adoption and could be considered a breakthrough moment. As broadly described by ChatGPT itself, generative AI *"involves creating models that can generate new and original data or content. In other words, it involves training algorithms to generate new content that is similar to existing data, but not identical."* In practical terms, ChatGPT and its Large Language Model (LLM) 'chatbot' peers have a diverse set of use cases, including writing letters, summarising books and producing computer code.

AI is not a new concept. It was first introduced in the 1950s by British mathematician Alan Turing, who is famous for leading a team that cracked German WW2 coded messages from the Enigma machine using statistical techniques. While a lack of computing power inhibited progress then, the vastly increased processing speed available today has driven the staggering rate of ChatGPT adoption. For instance, it took two months to get 100 million users, one of the fastest applications to do so.[2] For reference, it took Uber, a cab-hailing app, five years and 10 months to reach that threshold.[3] The telephone took 75 years.[4]

The surge in AI development over the past few years has been driven by Graphical Processing Units. These are specialised processors with dedicated capacity to handle billions of calculations simultaneously. By analysing language patterns, so-called transformer technology teaches computers how to write in a human way. Moreover, the lifeblood of LLMs has come from the exponential growth of 'big data': there are 8.5 billion searches on Google every day, around one for each person on the planet.[5] These two factors combined have led to the breakthrough in generative AI, which could revolutionise how machines and humans interact.

Generative AI could have a significant impact on productivity. Essentially, by freeing up capacity from time-consuming activities, workers can become more productive. For example, generative AI can set up computer code to run statistical modelling rather than needing expertise and time to write it from scratch. Goldman Sachs, an investment bank, estimates that generative AI adoption could boost annual worker productivity growth by an average of around 2-3% per annum.[6]

A key unknown for investors is how quickly AI adoption feeds through to productivity growth. History shows that new technological innovation can take time. For example, it took over four decades for electricity to really raise manufacturing productivity following Thomas Edison's invention of the carbon filament light bulb in 1879 and the construction of the Edison central generation stations in New York and London in 1881.[7] That's because of the slow pace of replacing still serviceable steam-driven manufacturing with initially costly electricity. AI-led productivity gains could potentially come much faster since it is readily accessible and cheap. Another unknown is how accurate the results produced by AI chatbots are. Improving its efficacy will depend on many factors, including the questions asked and the quality of data they are exposed to.

A potential risk to the global economy is to what extent it affects employment and private consumption growth. Goldman Sachs estimates that by extrapolating the full adoption of generative AI, around two-thirds of occupations could be partially automated. However, it does not necessarily mean that AI implementation leads to mass unemployment. Many workers displaced by automation are likely to find new job opportunities. For example, companies are now hiring "prompt engineers" to provide prompts for LLMs like ChatGPT. Over time, new jobs drive economic growth. As David Autor, an academic at MIT's Department of Economics, notes, an estimated 60% of US jobs in 2018 did not exist in 1940.[8]

Investing in artificial intelligence

Instead of trying to pick winners from the multitude of AI start-ups, we are investing in the more established technology names. Few companies have the scale of data management and processing required to handle the growing volumes of data that are crucial to the successful deployment of AI. These incumbent mega caps are, therefore, likely to maintain their dominant positions for the foreseeable future. They also have the cash to hoover up the winners in the start-up space, as well as the resources to invest in AI research and development. Our analysts focus on companies that have a proven track record of innovation and delivering shareholder value.

We also think it should be more rewarding to invest in the 'picks and shovels' rather than the gold rush. Here, that would be areas such as semiconductors or the hardware that is necessary for AI development. These companies are unlikely to see the same boom-bust dynamics as the companies at the coal face of AI.

AI is changing the world and will continue to do so. It will play a crucial role in many of the themes we expect to define the next decade and beyond. To exploit this, we prefer to invest in companies that have proven experience in deploying new technologies effectively while avoiding those that face an existential threat.

Publication sources:

[1] Refinitiv/Evelyn Partners

[2,3] Generative AI - Part I: Laying Out the Investment Framework, Goldman Sachs, 26 March 2023

[4] The Economic Times, India Times, 5 March 2023

[5] Dark Side of the Moon: AI, Google and Online Travel Disruption, Redburn, May 2023

[6,8] The Potentially Large Effects of Artificial Intelligence on Economic Growth, Goldman Sachs, 26 March 2023

[7] The Dynamo and the Computer: An Historical Perspective on the Modern Productivity Paradox, Paul David, Stanford University, January 1990

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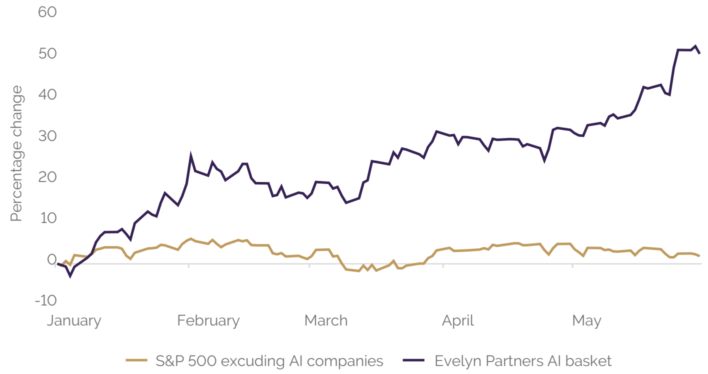
Market highlights

Equities

Recent developments in generative AI have shifted investor sentiment in the favour of AI-related equities. To analyse this, we created a market capitalisation weighted basket of the equities we believe are best positioned to benefit from AI proliferation. The index includes companies from a wide range of industries – from computer chip designers and manufacturers to the companies developing AI-powered chatbots. We found that over the last five months, the Evelyn AI Index has outperformed the rest of the S&P 500 by around 50%. Whether this outperformance continues will depend on whether companies can translate these technological advances into superior company fundamentals.

AI positioned companies have outperformed the rest of the S&P 500 during 2023



Source: Refinitiv Datastream/Evelyn Partners, data as at 31 May 2023
Note: percentage change of total returns in US dollars

Fixed income

The debt ceiling represents a limit on the amount of money the US can borrow. This currently stands at $31.4 trillion, and it was breached in January. Since then, the US Government has been drawing down their cash reserves, with Janet Yellen, Secretary of the Treasury, citing 5 June as the date the US would effectively run out of money. This has led to concerns that the US could default on its debt payments. This risk has been reflected in the bond market, where shorter dated one-month treasury yields reached 5.8% – their highest levels since December 2000. Treasuries that mature at the start of June saw yields spike above 7%. However, on 27 May a preliminary deal was reached between President Biden and Kevin McCarthy, the house speaker, to suspend the debt ceiling until 1 January 2025. This was passed by Congress, removing the risk of default.

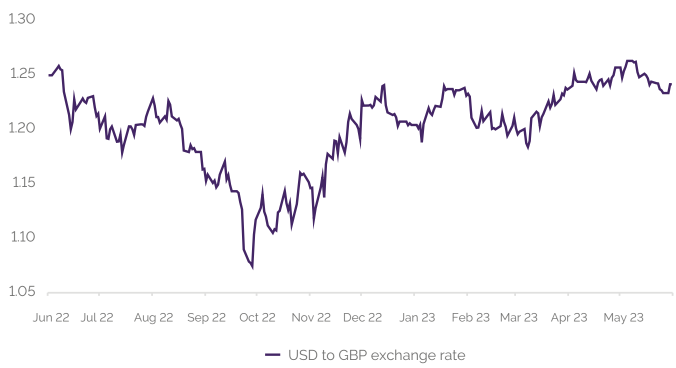
Treasury yields have eased as US default fears recede

Source: Refinitiv Datastream/Evelyn Partners, data as at 31 May 2023

Currencies/Commodities

In May the International Monetary Fund (IMF) once again raised its forecasts for UK growth. It now expects economic growth of 0.4% in 2023 compared to its previous projections of a 0.3% contraction. Further good news could be found in April's retail sales data which showed three-month sales growth was at its highest level since August 2021. This increased optimism about the UK economy's near-term outlook has been reflected in the strength of sterling relative to the US dollar. Sterling rallied to one-year highs in May, briefly touching $1.26, before a stronger-than-expected inflation print prompted sterling to dip. Sticky UK inflation led markets to expect the Bank of England to raise interest rates higher than previously thought to bring inflation under control. This could cause economic growth to slow and dampen the newfound optimism.

Sterling achieved a new one-year high against the US dollar



Source: Refinitiv Datastream/Evelyn Partners, data as at 31 May 2023

Market returns (Total return (%), sterling)	1 month	3 months	1 year	5 year
Equities				
MSCI All-Country World	0.4	1.2	3.1	52.7
MSCI UK	-5.2	-4.5	1.3	17.9
MSCI UK Broad	-5.0	-4.6	-0.1	13.3
MSCI USA	2.1	3.1	4.6	80.0
MSCI Europe ex UK	-4.1	-0.6	9.0	41.4
MSCI Japan	3.3	4.0	6.7	19.5
MSCI Asia Pacific ex Japan	-4.6	-7.5	-5.3	16.1
MSCI Emerging Markets	-0.3	-2.1	-6.5	5.8
Bonds				
iBoxx GBP Gilts	-3.8	-2.8	-16.7	-20.2
iBoxx USD Treasuries	0.2	-0.1	-0.7	10.5
iBoxx GBP Corporate	-2.4	-1.3	-8.4	-5.4
Commodities and trade-weighted currencies				
Oil Brent Crude ($/barrel)	-7.5	-12.4	-40.2	-5.3
Gold ($/ounce)	-1.0	8.0	6.9	51.2
GBP/USD	-1.4	2.4	-1.7	-6.9
GBP/EUR	2.1	1.8	-1.2	2.0
EUR/USD	-3.4	0.5	-0.5	-8.7
USD/JPY	2.6	2.6	8.6	28.6

Market commentary

May was a varied month for equities. The US had a strong month, boosted by the large technology names and other potential AI winners. Japan, aided by a cheap yen, was up 3.3%. In contrast, it was a weak month for UK equities, weighed down by the performance of energy and commodities companies. These companies struggled on news that China's economic recovery appears to be stalling. Overall, this resulted in a modest 0.4% gain on the month for the MSCI All-Country World Index. Gilts had a rocky month, with a stronger-than-expected UK inflation print causing interest rate expectations to move up. Oil continued to slip, with brent crude down 7.5% for the month due to concerns around the demand outlook. Gold ended its winning streak edging down 1% for the month, as positive news about the US debt ceiling resolution prompted investors to reduce exposure to the 'safe haven' asset.

Key macro data	Latest	2023 Consensus forecast	Spot rates	31-May	Yields (%)	31-May
UK GDP (YoY%)	0.21	0.20	GBP/USD	1.24	MSCI UK	4.36
UK CPI Inflation (YoY%)	8.70	6.90	GBP/Euro	1.16	MSCI UK broad	4.22
Bank of England Base	4.50	4.65	Euro/USD	1.07	10 Year Gilt	4.18

The market commentary, values and charts as at 31 May 2023. Total returns in sterling.
Returns are shown on a total return (TR) basis ie including dividends reinvested (unless otherwise stated).
Net return (NR) is total return including dividends reinvested after the deduction of withholding tax.
Source: Refinitiv Datastream/Bloomberg

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