## *Summary*

In a light week for economic data, ISM non-manufacturing fell back but continued on a path of expansion. Jobless claims were mixed, with possible continued effects from seasonal adjustments.

Equities gained across the board last week, as sentiment continued in a positive direction. Investment-grade bonds fell back, as yields ticked higher, with foreign bonds seeing gains from a weaker dollar. Commodities were mixed, with crude oil falling back, as production cuts were offset by economic growth concerns.

## *Economic Notes*

(0/-) The **ISM services/non-manufacturing index** for May declined by -1.6 points to a still-positive 50.3, relative to an expected minimal decline to 52.4. However, the gauge is now teetering on the brink of contraction. Business activity fell by a half-point, remaining expansionary, while expansion in closely-watched new orders decelerated by over -3 points to just under 53. Supplier deliveries fell a point further into a mild contraction, while prices paid still rose but decelerated to a lesser expansionary rate of 56. As noted by the ISM, there has been a pullback in the rate of services growth, with falling employment (as firms take a pause to get a better sense of the economy's forward path) and faster delivery times, in light of slowing demand. Some industries have shown consistent conditions with little change and more normalization in activity, while others have seen a bit of weakening, although not dramatic. While services are still running more robustly than manufacturing, keeping overall economic growth positive, this will be an area to watch going forward to see if expansion can be sustained.

(0) **Initial jobless claims** for the Jun. 3 ending week rose by 28k to 261k, well above the 235k forecast, and technically the highest level since Oct. 2021. Continuing claims for the May 27 week, on the other hand, fell by -37k to 1.757 mil., below the 1.802 mil. median forecast. By state, CA, PA, and OH led with the largest increases. However, seasonal factors around the holiday weekend may have played a role, with non-adjusted initial claims rising by only 11k. Jobless claims have been recently hampered by a variety of issues, from seasonal adjustments, and related distortions, to fraudulent claims. For that reason, these might be looked at more with a grain of salt than normal.

## *Question of the Week*

***Will artificial intelligence (AI), ChatGPT, etc. completely change the economy and investment landscape?***

Undoubtedly, the long-term development of artificial intelligence and recent release of several new tools to the public have generated a high degree of excitement in the news and in financial markets. On the positive side, AI appears to offer strong potential for productivity and timesaving enhancements for personal and business uses, for which current tools may have only scratched the surface. There are a variety of research benefits as well. In industry, tools that sift through immense amounts of data, math formulas, or scientific relationships offer obvious time savings versus manual or trial-and-error work.

AI has also raised fears, as rapid technological changes have tended to do historically. On the negative side, concerns that it will take over the world, exterminate humanity (after all, aren't we the cause of all the world's problems?), or simply make most or all jobs redundant over the next few years seem overdone. However, there are likely real consequences that could be somewhat offsetting and may need to be ironed out from a policy and practical standpoint. For instance, having AI author student term papers is just one problem the education system will have to contend with. With so much information immediately at one's fingertips, critical thinking and creativity run the risk of becoming scarcer, and thus, more valuable than ever. A recent comic captured this conundrum well—with an employee asking AI to craft an especially long and detailed e-mail which then

proceeds to go unread by the receiver due to its ridiculous size and overly bland content. (Although no doubt this already happens without the help of AI.)

Despite the recent hype, various forms of AI have been around for quite a while, although the impact has been more subtle. For instance, predictive text on a smartphone, online map directions, or voice commands all use simpler forms. More recent tools have sharply expanded the universe from which information is pulled; a database of 'everything ever published' is almost too large to get one's head around. For instance, instead of asking one's phone simple questions and being provided weather forecasts, sports scores, or website links, newer tools can craft a more accurate bullet-point summary, or a longer essay (or poem!) to answer a question. These AI tools are built on a probabilistic platform, looking at the wisdom of the crowd, so to speak, using math to craft the best 'average' response. So, these aren't 100% accurate at this stage, and answers can appear generic (since they are using averages after all, as opposed to extremes), but could be effective for day-to-day purposes.

Will AI ruin the labor market? Over the centuries, when new technology has been introduced that could threaten jobs, worker responses have run the gamut from amazement, to mild worry, to outright revolt. Depending on the case, the concern has often been valid, particularly as machines were specifically designed to improve output with the same or less input, not to mention bypass the downsides of human labor (sick days, fickle morale, etc.). While this came to the point of workers destroying new inventions multiple times, progress couldn't be unwound once it was unleashed. Eventually, as opposed to human labor as a whole evaporating, workers shifted to different types of jobs—in fact, overall jobs tended to keep expanding along with the growing global population. Many times, these were jobs that hadn't even been imagined prior to the technological changes. However, there has been some transition period of pain as societal adjustment and/or re-training tends to be required, something that's been brought up by U.S. policymakers in recent years but hasn't been overly effective in implementation. Sociologists have attributed modern job-skill deficiencies to being a key cause of weaker labor force participation, even leading to drug use and crime among a portion of the working-age population, particularly as jobs were lost due to automation and/or offshoring over the last few decades in certain regions of the country. Well-known in the emerging world, large groups of the unemployed and frustrated have been catalysts for populist movements on many occasions. In milder forms, pushback against change can morph into anti-business policies, as too much of a focus on capital and not enough on labor and working conditions eventually turns negative. A stretch of the latter 19th and early 20th centuries in the U.S. saw a pushback against the 'robber barons,' leading to progressive labor reforms, unionization, anti-trust legislation, and generally more government oversight over business in general.

Some skeptics of AI translating into an immediate cascade of profits ask: if it becomes available to everyone, is it as valuable? This is in keeping with any change in technology. If the same tool is available to all, while useful, it doesn't provide a relative competitive advantage to one party over another. Economics professor Robert Gordon at Northwestern University, who has described himself as 'the prophet of pessimism,' has been famously skeptical of the benefits modern technological change have brought. He's pointed out that productivity gains at a marginal level today are far less impactful on society than those created during what he calls the 'special century' (roughly 1870-1970). Those included the exponential human experience improvements of indoor plumbing, electricity, telegraph/telephone communications, the internal combustion engine, and air travel, for a few examples. Amusingly, his thesis advisor, Nobel Prize winner Robert Solow, noted in the late 1980's that the computer age 'could be seen everywhere except in the productivity statistics' (although that seemed to improve in the following decade).

Nevertheless, according to some economists, AI has the potential of increasing economic growth rates, largely due to anticipated gains in productivity. While this is difficult to measure at this stage, some estimates point to a possible 1-2% per year rise in productivity growth over the next ten years, with perhaps up to a percent per year improvement in GDP growth. The improved productivity would offset mixed expectations for labor force growth in coming years, largely determined by demographics driven by family formation and immigration policies. At the same time, many expected productivity enhancements from new technologies, such as

smartphones and social media, haven't been fully realized in business output (although they have enhanced social connectivity and entertainment value).

Another fear of widespread AI adoption is its possible misuse, as in the manufacture of misinformation, making it difficult to judge the accuracy or source of output. In fact, some political strategists fear that an important threat of AI is not 'AI vs. humanity,' but rather potential effects of using misinformation to pit people and groups against each other through misinformation campaigns. Clearly, political polarization is already high, and such techniques have been used historically in lower tech ways to generate instability. Determining what content is 'real' and what isn't will be a rising challenge. From a geopolitical standpoint, both the U.S. and China are undoubtedly seeking their own advantages in AI for commercial and defense purposes. Whether this continues down a single path or further diverges into two separate technology platforms (as with 5G wireless communications) remains to be determined.

For investment markets directly, new technology matters in terms of how it can generate revenue and ultimately translate into profits. The implications of newer AI are less clear in this regard. The popularity around technology stocks recently is at least partially due to excitement around AI, as the mega-cap firms are those with the deepest pockets to explore such technology. Some parallels about market exuberance have been drawn to the excitement over the rollout of the internet in the late 1990's. There is certainly potential for a variety of firms in this environment, while it could be the 'picks and shovels' equipment providers in hardware reaping many of the early benefits (explaining much of the positive sentiment around Nvidia). As the technology develops and depending on whether 'tiers' are formed in terms of AI services, it's possible software service companies could find niches here as well, potentially as subscription products. Of course, this carries over to a host of other sectors that could see immense benefits from AI, including military applications/defense systems, law, logistics/transportation, pharmaceuticals, medical devices, and even financial services, among many others. All that said, AI remains a long-term and evolving project with much more unknown than known at this point.

(Author's Note: The preceding was not written by AI.)

***Market Notes***

| **Period ending 6/9/2023** | **1 Week %** | **YTD %** |
|---|---|---|
| DJIA | 0.36 | 3.26 |
| S&P 500 | 0.41 | 12.82 |
| NASDAQ | 0.15 | 27.20 |
| Russell 2000 | 1.92 | 6.63 |
| MSCI-EAFE | 0.64 | 10.46 |
| MSCI-EM | 1.89 | 5.77 |
| Bloomberg U.S. Aggregate | -0.15 | 2.01 |

| **U.S. Treasury Yields** | **3 Mo.** | **2 Yr.** | **5 Yr.** | **10 Yr.** | **30 Yr.** |
|---|---|---|---|---|---|
| 12/31/2022 | 4.42 | 4.41 | 3.99 | 3.88 | 3.97 |
| 6/2/2023 | 5.50 | 4.50 | 3.84 | 3.69 | 3.88 |
| 6/9/2023 | 5.37 | 4.59 | 3.92 | 3.75 | 3.89 |

U.S. stocks earned minor gains last week, with little economic news but enthusiasm over the potential benefits of AI as well as an expected pause by the Fed next week seemingly leading the mildly positive sentiment. By sector, stocks were dominated by gains in consumer discretionary (due to Tesla), utilities, energy, and industrials; laggards included negative returns for technology and consumer staples. In tech, there was some interest in the eagerly anticipated Apple mixed reality headset (with a price tag of up to $3,500). Then again, as with AI, the near-term economic growth benefits don't seem obvious, and price reaction was neutral on net.

With the U.S. debt ceiling suspension now in the rearview mirror, the focus has turned back to economic growth, earnings (with Q2 season starting in a month), inflation, and the Fed's path. Technically, the S&P is now up 20% from its October low, while strategists debate whether this is the beginning of a new bull market, or merely a bear market rally within the prior cycle. Such distinctions are often unclear, and arbitrary definitions probably don't really matter. In addition, the narrow leadership of the rally in tech-related stocks has some investors concerned, although bull markets and other rallies in the past haven't necessarily required broad leadership (at first, at least). In fact, the five largest S&P 500 firms (Apple, Microsoft, Amazon, Alphabet, and Nvidia) now comprise nearly 25% of the index's market cap—with the small group up over 45% year-to-date, and remaining 495 stocks up only 5%. Small caps have also rallied this month, which demonstrates signs of improved breadth, and indicative of investors recognizing their lowest relative valuation vs. large caps in years.

The World Bank, in their Global Economic Prospects document, downgraded global growth by a percent from 3.1% in 2022 to 2.1% this year, with a small recovery to 2.4% in 2024 and 3.0% in 2025. For the U.S. specifically, 2022 growth of 2.1% is being downgraded to 1.1% and 0.8% for 2023 and 2024, with 2.3% expected for 2025.

Foreign stocks were minimally higher in developed markets, as gains in the U.K. and Japan were offset by negative returns in Europe, prior to central bank meetings where rate hikes were again expected. At the same time, the eurozone technically entered recession, as the economy shrank by -0.1% in both Q1-2023 and Q4-2022. Emerging markets were the best performers in the world last week, with gains in Brazil, Mexico, and South Africa in the mid-single digits.

Bonds fell back slightly as interest rates ticked higher across the yield curve, with treasuries outperforming investment-grade corporates. High yield and floating rate bank loans bucked the broader market with gains. Foreign bonds in both developed and emerging markets rose along with a drop in the dollar. Both Canada and Australia hiked rates again last week after a multi-month pause, which seemed to raise awareness of the same possible path for the U.S. Fed.

Commodities featured gains in industrial and precious metals, while energy and agriculture saw declines. Crude oil fell over-2% last week to $70/barrel, offset a bit by a rebound in natural gas. Over the prior weekend, a decision by Saudi Arabia (acting outside of OPEC+) to cut production by 1 mil. barrels/day starting next month resulted in a crude oil price rise of several percent Monday morning. However, continued worries over slower economic growth kept a lid on gains, as did speculation about a renewed U.S.-Iran nuclear deal (which would allow Iran to ramp up production). Wheat and corn prices temporarily rose with the collapse of a dam in Ukraine, but fell back sharply by the end of the week, with little effect in U.S. markets.

Have a good week.

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Sources: FocusPoint Solutions, American Association for Individual Investors (AAII), Associated Press, Barclays Capital, Bloomberg, Citigroup, Deutsche Bank, FactSet, Financial Times, First Trust, Goldman Sachs, Invesco, JPMorgan Asset Management, Marketfield Asset Management, Morgan Stanley, MSCI, Morningstar, Northern Trust, PIMCO, Standard & Poor's, StockCharts.com, The Conference Board, Thomson Reuters, T. Rowe Price, Univ. of Michigan, U.S. Bureau of Economic Analysis, U.S. Federal Reserve, Wall Street Journal, The Washington Post. Index performance is shown as total return, which includes dividends. Performance for the MSCI-EAFE and MSCI-EM indexes is quoted in U.S. Dollar investor terms.

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Notes key: (+) positive/encouraging development, (0) neutral/inconclusive/no net effect, (-) negative/discouraging development.