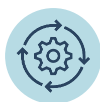
Quarterly Insights

How AI Could Impact the Economy and Investing

By Jared Kizer, CFA

Forecasting what the future holds is always a difficult task. Nevertheless, many clients are curious to hear our perspective on artificial intelligence (AI). How is it likely to impact the economy? And in turn, how might it impact investing?

Regarding the economy, four outcomes are likely:



Increased Task Automation

Improved Long-Term Growth

New Job Possibilities

Regulatory Pressures

- First, we will see, and are already seeing, task automation across a large range of industries, including financial services, health care and retail. The extent of this automation will grow substantially over time in unexpected ways, encompassing tasks that initially seemed impossible to automate and impacting industries that may not have been obvious in advance. So, while more automation is easy to predict, the exact forms that this will take will almost certainly surprise in many instances.
- Second, the automation outcomes should broadly be positive for long-term economic growth, which we all should root for given the global aging population dynamics and government debt burdens. While there are different forecasts, Goldman Sachs projects that AI will start to boost U.S. GDP by 1.5% annually over the next 10 years.[1]
- Third, because of automation we will see new job possibilities unfold, but as with any new technology, some jobs and companies will be far more negatively impacted than others.
- Finally, AI will likely face significant legal, political and regulatory pressure that, as with automation, will take unexpected turns and forms. In general, the primary risk is that the regulatory burden greatly compromises the economic benefits that would have otherwise accrued.

From an investment standpoint, three points come to mind:

- First, a safe assumption is that markets are already pricing in all the above points. This is not to say, of course, that markets will be able to perfectly price in what actually occurs, but a reasonable assumption is nevertheless that none of us can predict outcomes better than markets themselves.
- Second, broad diversification across stocks, industries and countries will help mitigate the risks of automation. As with any new technology, a multitude of companies that seem to be great investments today may have large portions of their business models rendered obsolete by AI.
- Finally, connected with the first point, a sensible supposition is that the public companies most likely to benefit from AI either directly or indirectly are already priced at high valuations. This will likely lead to lower — not higher — realized returns when compared to the broad market.

If you have questions about your portfolio and its potential exposure to developments in AI, speak with your financial advisor.

[1] Goldman Sachs Research. AI may start to boost US GDP in 2027. Nov. 7, 2023.

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Selecting Individual Stocks? 4 Questions to Consider

By Daniel Campbell, CFA

Picking stocks, or trying to choose the companies that will outperform the broader market, has been an ambition of investors for years. And even the professional fund managers struggle to pick the winners from year to year.[1] For those inclined to try, consider this framework first. Although the questions may be simple, they provide tremendous insight into designing a stock portfolio and what to expect from its performance.

1. What to buy

The first question to consider is what do you want to buy. Although you can find numerous pages in financial textbooks and even more eye-catching headlines dedicated to this topic, making a decision can be complicated.

That's because we must make a distinction between a company and its stock price. Every company's price is determined first by the current value on its financial statements. For this, we can look at the company's assets minus liabilities, also called book value or shareholder's equity. If that was all that drove the stock price, prices would be relatively stable.

But stock prices tend to be anything but stable. Rather, prices not only depend on the company's cash flows and earnings today, but also those we expect the company to generate. The more earnings or cash flow someone predicts or the more confident someone is in those cash flows, the higher price they'll pay for the stock. Put simply, stock prices are driven by the stories we hear about a company – and how believable we find them.

2. When to buy

We have two simple ways to make money in the stock market: We can buy low and sell high. Or we can buy high and sell higher.

When we buy based on the stories we hear about companies – whether how great they are or will be – we run the risk of buying high to sell higher. Prices already reflect the optimism from those stories. Good stories dominate headlines, which, as much as we may try to resist, will influence our expectations for a company.

The other approach would be to try to buy low and sell high. To do this, we could try to find the best deal available today. Figuring out a "good" price for a company can be challenging, but research shows we can get close by comparing the price to the company's financial statements. For example, we can look at the price compared to the book value, earnings or cash flows. Historically, focusing on the less expensive companies has been a better recipe for long-term performance than buying something at a premium and hoping to sell it for more down the road.

3. How much to buy

Once you have a list of companies trading at competitive prices, you will need to figure out how much of your portfolio to allocate to each. Being intentional about how much we choose to invest in each company, and how that amount compares to the broader stock market, can have a big impact on returns.

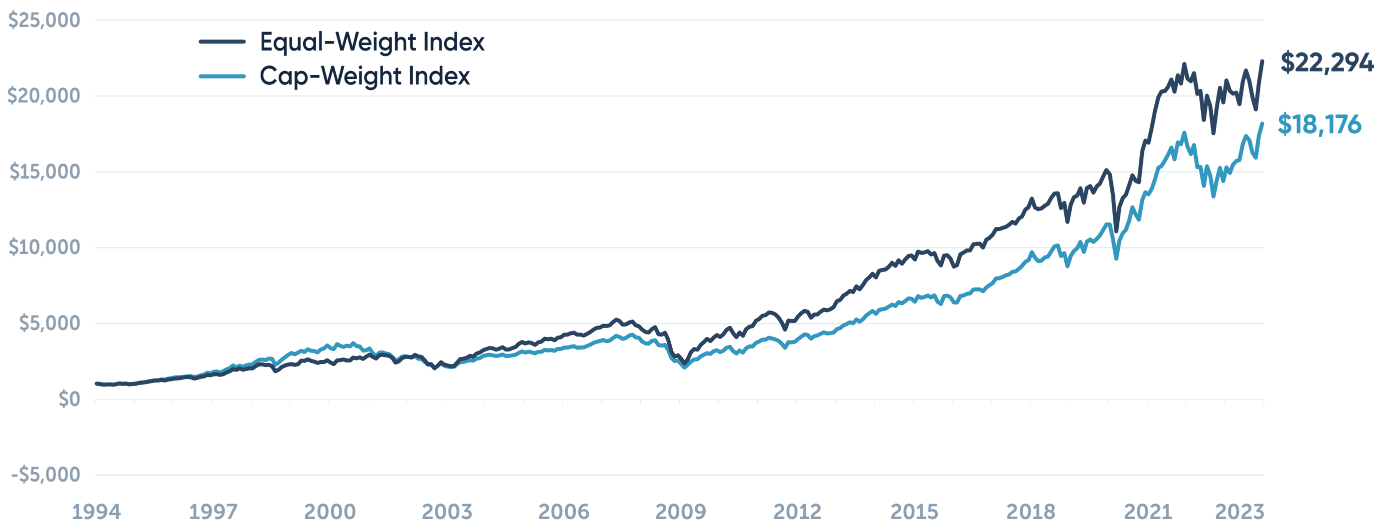
The graphic illustrates how. Both lines represent indexes invested in S&P 500 companies. The light blue line represents the S&P 500 index weighted by market capitalization, meaning that larger companies get a larger allocation.[2] The dark blue line represents the performance of the index if each company was weighted equally (so that the index invests approximately 0.2% in each company).

[1] S&P Dow Jones Indices LLC, S&P Indices Versus Active Funds (SPIVA®) U.S. Scorecard. Mid-Year 2023.

[2] Market capitalization is simply the number of shares outstanding times the price per share, which is also known as the market value. A market-capitalization index will invest in companies in proportion to their market value, so that larger companies receive a relatively larger investment.

Same Holdings. Different Weights.

Hypothetical Growth of $1,000 over the last 30 years



Source: LSEG. For illustrative purposes only. Reflects returns from January 1994 through December 2023. Cap-Weight Index represented by the S&P 500 Index; Equal-Weight Index represented by the S&P 500 Equal Weight Index. Returns include the reinvestment of dividends. Indexes reflect unmanaged baskets of securities and are not available for investment. The S&P 500® Equal Weight Index (EWI) is the equal-weight version of the widely-used S&P 500 index. The index includes the same constituents as the capitalization weighted S&P 500, but each company in the S&P 500 EWI is allocated a fixed weight or approximately 0.2% of the index total at each quarterly rebalance.

Hypothetically, an investor that opted for equal weights of these stocks would have had much better performance over the 30-year period than those that allocated more to the larger companies. This underlines a key point: Your performance is dictated not only by what you own, but also how much you choose to own of each company.

4. When to sell

The final question to answer is when to sell. Often overlooked, even by professionals, answering this question in advance forces us to be more thoughtful in our decisions, which is good because history shows us very few companies are worth holding forever.

An article published in the Journal of Finance in 2019 looked at all companies in the Russell 3000, an index that represents the totality of the U.S. stock market. From January 1987 through December 2017, a hypothetical $1,000 investment would have grown to nearly $22,000 by the end of the period. Not too bad.

However, when the authors looked at the companies within the index, they found that the bulk of the index returns came from just 7% of companies, and 47% of the stocks would have been unprofitable investments. Even more startling, 30% of the stocks lost more than half their value and never recovered. Imagine if you were holding mostly those stocks – would you have known when to sell? Markets typically recover from downturns. But the same can't be said for an individual company or its stock.

Bringing it together

Building a portfolio of individual stocks is tough. Although these four questions are simple, answering them is challenging. Rather than attempt to build a portfolio of single stocks hoping for outsized returns, the simpler and more dependable approach is to own a little bit of every company. If you want to try for better returns, you can emphasize less expensive and profitable companies. This is easier to do through mutual funds and exchanged-traded funds. Then, instead of spending all that time trying to find the best stocks, you can enjoy the life you have worked hard to build.

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Stock Risk in Your Portfolio: Is the Price Right?

By Alex Kluesner, CFA

Imagine that you are a TV game show participant and are given four options to claim your prize. Which would you choose from the following?

A: $20,000 in cash

B: 50% chance at winning $100,000

C: 25% chance at winning $200,000

D: 5% chance at winning $2,000,000

For those wanting a guaranteed prize, $20,000 cash on the spot may be tempting. The remaining options provide a larger prize but at lower odds. Is there a correct answer?

From a mathematical standpoint, there is. Underlying the solution is a statistical term called the probability-adjusted return, which means that we can multiply each prize by the percentage chance of winning it to arrive at its expected value:

A: $20,000

B: $100,000 X 50% = $50,000

C: $200,000 X 25% = $50,000

D: $2,000,000 X 5% = $100,000

Option D has the highest expected value of $100,000. So, if you're OK with giving up the guaranteed prize for a chance at winning multiples more, then why not risk it? After all, it's a game show, and you're not risking your own money.

What's the lesson for investors?

This thought experiment might better prepare you for a game show, but it also sheds light on how human behavior affects our level of risk-taking as investors. To that end, imagine that the dollar values represent how much your portfolio is worth when you decide to retire. (To make this more realistic, multiply each dollar amount by 10 but keep the percentage chances the same.) The mathematically correct answer, option D, doesn't change, but what's at stake is completely different. Introducing risk and chance of loss into your ability to retire will likely cause you to ignore the mathematically "correct" choice.

How your assets are allocated plays a major role in your retirement portfolio's ability to grow. Traditionally, our portfolios comprise a mix of publicly traded stocks and bonds. You can think of option A, the guaranteed payout, as a portfolio of short-to-intermediate term, high-quality U.S. government bonds. These are commonly viewed as one of the safest investments one can buy at a promised rate of return when held to maturity. The remaining options are expected to be worth considerably more but introduce the risk of loss or falling short of your goal. You can think of these options as a portfolio containing both bonds and stocks, with option D having the highest allocation to stocks, which are inherently riskier due to their uncertain cash flows.

Your decision is now much less straightforward. If you want your portfolio to grow more, you need to be willing to take additional risk. Everyone has different goals that dictate different levels of risk-taking. For example, if you have saved a comfortable amount and your goal is to maintain your savings through retirement, you might only need to take on enough risk so you can be fairly certain of the outcome. For others, your goals might require so much risk that you may be better off revising your goals to be more attainable.

Ultimately, the right decision for you may be the one that allows you to sleep well and stay invested.

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