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CIO Insights: AI Brings New Rewards and Risks

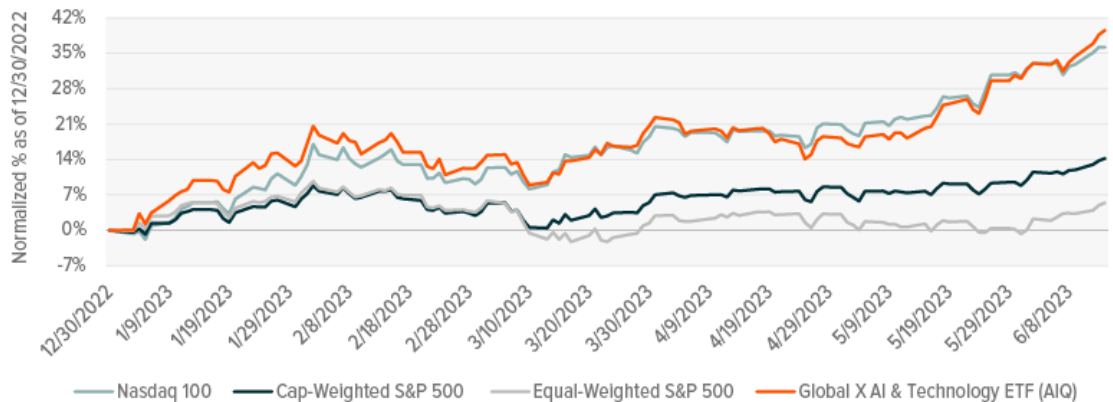
*Editor's Note: **Conversational Alpha® (CA)** is a vehicle we use for deeper and more relatable discussions about portfolio construction. In that sense, it represents both a journey and a destination. This report is a periodic look at journeys and destinations that investors may want to consider.*

How long did it take ChatGPT to hit 100 million users? About two months, a brisk pace well ahead of the adoption rates of other disruptive tech platforms like TikTok, Instagram, and Netflix. To find that bit of trivia, I read **Generative AI, Explained**. What I did not do was ask ChatGPT. Why? ChatGPT can't answer that question. For now, ChatGPT's knowledge cutoff is September 2021.

Current generative artificial intelligence (AI) systems have their limitations and they are fallible, capable of producing incorrect and misleading information. But it's clear that their early impact is already far-reaching and set to become even more so with global spending on AI forecast to more than double and top \$300 billion by 2026.¹ AI's influence is certainly evident in market performance this year. A substantial portion of the S&P 500's year-to-date return can be attributed to five well known stocks, with a big part of their gains credited to their involvement in AI. It's another reason why AI's omnipresence feels all-consuming in 2023, a feeling that is likely to continue.

BIFURCATED MARKET LED BY ARTIFICIAL INTELLIGENCE (AI)

Source: Bloomberg data as of June 16, 2023



My early experimentations with ChatGPT are positive, whether brainstorming and outlining ideas, summarizing content, or making sure that I cross 't's and dot 'i's in reports like these. As AI systems evolve and become more powerful for more people, they are likely to dramatically reshape economies and transform the way businesses operate. We can't fully know all the ways



that they will yet, but as the situation develops, there will be plenty of new considerations for investors to digest.

Conversation Starters

- **Big players have dominated the AI story, but smaller companies show their might.**
- **Tech is often disruptive because of its practicality, and AI is no exception.**
- **AI risks are likely, but so are solutions.**
- **To Wrap It Up: Portfolio considerations.**
- **Moving On... Let's Chart: The Treasury General Account needs cash.**

Small Tech Can Help Drive AI Integration Trends

The generative AI platforms hitting the market at this stage are incomplete, which makes this period something of a test phase for individual users and businesses alike. The platforms are in a constant state of development. Spend some time experimenting with them, and you can see how quickly they improve.

To understand the longer-term integration path, Microsoft's partnership with OpenAI, the developer of ChatGPT, may offer something of a preview. Microsoft incorporated ChatGPT for Word, Excel, and Bing, which are, respectively, functional applications for content creation, data visualization and analysis, and web search. That is, Microsoft introduced the technology to existing software that can provide a foundation for broad adoption in everyday use.

An interesting aspect of AI's development at this stage is that smaller players, like OpenAI, can be just as disruptive, if not more so, with their solutions as the bigger players. The AI race among Big Tech is on, which may lead to more partnerships and integrations like Microsoft and OpenAI's. Also, as firms begin to understand how to package AI into new products, it could be a shot in the arm for the [IPO market](#), which has been slow so far this year.²

AI Can Transform Industries with New Practicality

Segments plagued by bottlenecks are ripe for AI infusion. Healthcare stands out to me with its vast amounts of data, including electronic medical records and imaging data, that providers must analyze. With the help of AI, these datasets could be turned into new diagnostic tools, predict patient outcomes, and improve the overall patient care experience. From a customer service standpoint, generative AI's ability to answer questions in a timely manner could be a welcome change in healthcare.

Education is another likely growth opportunity, as AI could bring personalized and alternative education opportunities. Generative AI's ability to respond to complex inquiries can essentially make it a dedicated tutor. It can also help teachers and school administrators develop and manage curriculums, which will need to adapt to prepare students for an AI-infused labor market.³

Legal service is another field filled with bottlenecks that generative AI could alleviate. Its research, writing, and summary capabilities at speed could help law firms increase their productivity and lower costs for clients while increasing the odds of favorable results. AI is even



finding its way into courtrooms, helping to create sentencing reports and, in one case, rendering a verdict.⁴

AI's Risk Profile Is TBD

Innovation begets innovation, and the AI revolution bears similarities to previous technological advancements, where an initial application paves the way for more complex and innovative ones. Consider the progression from the personal computer to the internet and cloud computing. If we learned anything from the trajectories of these technologies, we know that their evolutions ebbed and flowed. I expect the same sort of trajectory for AI, though likely expedited by comparison.

Innovation also begets new risks as applications become more complex and their adoption more widespread. With AI, the risks are thought to be many. Workers face a drastically different labor market. According to one estimate, 300 million jobs are at stake worldwide.⁵ Businesses must be mindful of the regulatory environments in which they operate and navigate the potential legal and financial pitfalls. According to a recent report, 73% percent of senior IT leaders have concerns about AI generating biased results, and 79% have concerns about security risks.⁶

Alphabet and Google CEO Sundar Pichai said recently, AI affects “every product of every company.” The implementation process won’t always be smooth. About his own company’s efforts with public testing of Bard underway, he said succinctly, “things will go wrong.”⁷ There is much to be done to implement AI safely, effectively, even morally. But when AI’s risk profile becomes more transparent, so will the solutions, which could present significant growth opportunities for investors.

To Wrap It Up: Portfolio Considerations

In my view, investors must have exposure to companies capable of implementing and monetizing AI for long-term portfolio performance. This late cycle period and the upcoming cycle are poised to be transformative as companies adapt to new market conditions in the post-COVID environment of elevated inflation, higher interest rates, deglobalization, and the push for clean energy. Companies need to invest in productivity, and AI offers compelling enhancements.

Exposure to companies that use AI technologies effectively can bring new growth potential to portfolios, particularly with AI likely to reshape market leadership in various industries, ranging from tech giants to manufacturing. The application of AI and the implications of its application, for example, the critical need for cybersecurity solutions, is but one example of the myriad intersections that AI creates.

Let's Chart: T-Bill Issuance on the Other Side of the Debt Ceiling Standoff

The good news is that lawmakers raised the debt ceiling in the nick of time. The not-so good news is that the extraordinary measures used to fund the government during the standoff ran down the U.S. Treasury’s coffers to near record lows. As I [previously wrote](#), now the Treasury needs to build them back up with T-bill issuance, and quickly. A net \$1.4 trillion in bill supply is expected between now and year-end, with \$1 trillion by the end of August.⁸

The Fed will likely proceed cautiously as the surge in T-bill issuance could equate to a money market rate hike, maybe even two. This is unlikely to fray markets, but modest volatility is



possible. Historically, equities do not respond well in the short term when debt ceiling-related T-Bill issuance reduces market liquidity.

DEPLETED TREASURY GENERAL ACCOUNT (TGA)

Refilling TGA will lead to a surge in new issuance

Source: Federal Reserve Bank of St. Louis, as of June 5, 2023



Footnotes

- ¹ IDC, Worldwide Spending on AI-Centric Systems Will Pass \$300 Billion by 2023, September 12, 2022
- ² Bloomberg, AI Excitement Seen Jumpstarting Sleepy IPO Market – Just Not Yet, May 30, 2023
- ³ US Department of Education, US DOE Shares Insights and Recommendations for AI, May 24, 2023
- ⁴ Yahoo! Finance, AI Could Become a Game-Changer for Courts Around the World, February 8, 2023
- ⁵ CNBC, Goldman Sachs Says Generative AI Could Impact 300 Million Jobs, May 28, 2023
- ⁶ Harvard Business Review, Managing the Risks of Generative AI, June 6, 2023
- ⁷ CNBC, Google CEO Sundar Pichai Warns Society to Brace for Impact of AI Acceleration, April 17, 2023
- ⁸ Bank of America, Bill Supply Surge FAQ, May 25, 2023

Definitions

S&P 500 Total Return Index: The index includes 500 leading U.S. companies and captures approximately 80% coverage of available market capitalization.

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