

# TOP 10

## Investor Questions

As the second half of 2024 begins, investors face questions about the key forces shaping the future of financial markets. This year, we continue our custom of using the third-quarter edition of Strategy Insights to answer the top 10, most frequently asked investor questions. From uncertain monetary policy to inflation concerns and the frenzy around artificial intelligence (AI), there are no shortage of questions as it relates to the potential implications for investors.

With global equity markets sitting at or near all-time highs, we believe now is an opportune time to take stock of key market drivers — both the headwinds that may create challenges and those forces that could propel markets higher from here.

Some of the most notable developments we are monitoring include the:

- path of monetary policy;
- business cycle outlook;
- narrow market leadership;
- widening fiscal deficits; and
- demand for AI.

Looking ahead, we believe recent market performance may be difficult to repeat without additional catalysts to maintain positive momentum. Overall, however, we remain confident in expectations for continued global growth.

The 10 questions we address in this publication are wide-ranging, which speaks volumes about the complexity of issues investors are tackling this year. We hope you find this useful, timely and insightful.



**This year’s top 10 investor questions point to the unique nature of market drivers and challenges investors face.”**

**Daniel J. Brady**  
Managing Director, Investment Strategy

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## 2024 by the numbers\*

**805.13**

MSCI ALL  
COUNTRY  
WORLD INDEX  
REACHES  
ALL-TIME HIGH

**31**

NUMBER OF  
NEW ALL-TIME  
HIGHS FOR  
THE S&P 500®

**495**

NUMBER OF  
DAYS THE  
YIELD CURVE  
HAS BEEN  
INVERTED

**\$7,304B**

FED  
BALANCE  
SHEET  
ASSETS

**126.7%**

BANK OF JAPAN  
BALANCE  
SHEET AS A  
PERCENTAGE  
OF JAPAN'S GDP

**28  
Months**

STREAK OF  
UNEMPLOYMENT  
RATE BELOW 4%

**1**

NUMBER OF TIMES  
THE EUROPEAN  
CENTRAL BANK  
HAS CUT  
INTEREST RATES  
BEFORE THE FED

**\$59.4B**

AGGREGATE  
BITCOIN  
EXCHANGE-  
TRADED FUND  
FLOWS

**4.72% of  
15.46% YTD**

S&P 500  
RETURN  
CONTRIBUTION  
FROM NVIDIA  
CORP.

\*As of 6/25/2024

Indices are unmanaged, not available for direct investment, and not subject to management fees, transaction costs or other types of expenses that an account may incur.

# 1. What is the outlook for U.S. inflation?

In March 2021, the U.S. Consumer Price Index (CPI) crossed above the Federal Reserve’s (Fed’s) 2% target and has not fallen below 3% since. The pandemic created lasting, structural forces, including tight labor market conditions and elevated wage growth, that continue to support higher inflation.

As we begin the second half of 2024, economic data continue to suggest the path to the Fed’s 2% target remains uncertain. As of May 31, headline inflation was 3.3%; while a marked improvement from the 2022 peak of 9.1%, core inflation (excluding energy and food prices) remains high, at 3.4%, supporting our view that several key inflation components are sticky (**Figure 1**).

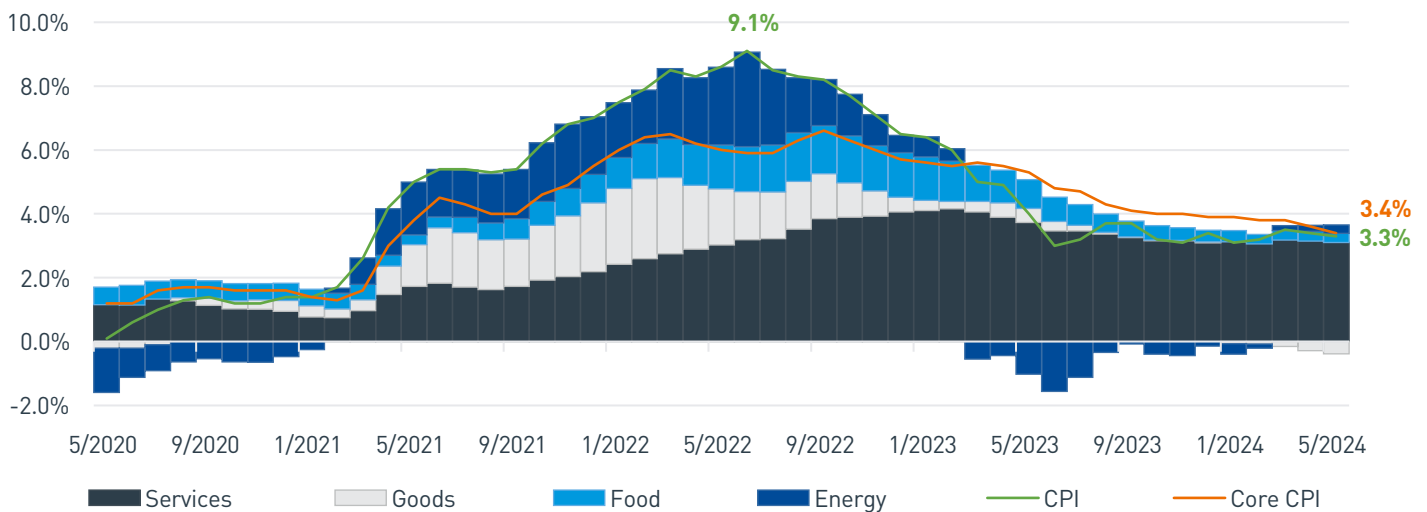
Recently, two of the most significant inflation drivers have been housing and automobiles. The housing

market has been experiencing rising prices due to low inventory, even while 30-year mortgage rates are near the highest level in 20 years. Similarly, the automobile industry continues to be impacted by supply chain bottlenecks while demand for new vehicles remains robust, resulting in rising automobile insurance prices. As Fed policy has little direct impact on either housing or automobile, it may take longer for pricing in these two inflation-sensitive industries to normalize.

Given our expectation for continued elevated inflation, we maintain a preference toward quality exposures within our asset allocation positioning. We believe companies with pricing power, higher margins and lower leverage can better defend market share and grow earnings, even in these later innings of the business cycle. As such, we maintain a domestic overweight, with a tilt toward larger-capitalization stocks. Within fixed income allocations, we continue to find core fixed income attractive given current mid-single-digit yields, especially relative to below-investment-grade credit, which has greater risk exposure.

**Figure 1. Components of U.S. CPI**

Strong service economy drives sticky inflation



As of 5/31/2024. Source: Bloomberg L.P.

## 2. What is the future path of U.S. monetary policy and the implications for markets?

Since the global pandemic, the Fed has dominated much of the market narrative, a dynamic we do not expect to fade until policy easing begins. In our view, questions about when the Fed will begin cutting rates and by how much are far less important than the fact that the Fed plans to ease policy at all. At this time, we believe the Fed's goal is to bring its policy rate as close to neutral as possible, without causing inflation to reaccelerate. Given its dual mandate of promoting maximum employment and stable prices, the Fed must walk a policy tightrope. We believe this delicate balance has led to the Fed's willingness to stay "on pause" for such a long time.

If we were to segment monetary policy into four phases, an investor might be able to draw conclusions based on where the Fed is in the policy continuum (**Figure 2**). These monetary policy regimes can provide insight into how markets are likely to behave. For example, broadly speaking, stocks have historically performed better against an easy

monetary policy backdrop. We believe current Fed policy resides between Phases II and III, which has historically been associated with weakening earnings growth, rising valuation multiples, and solid equity market performance.

Since late 2023, when the Fed began to adjust its forward guidance to signal it was considering easing policy, investors have been uncertain of when rate cuts would begin. In our view, equity markets have experienced a boost simply from this guidance, despite the absence of actual rate cuts, as investors anticipate positive performance resulting from easing policy. That said, when the Fed enacts rate cuts, investors have historically tended to view it negatively as cuts typically coincide with cracks in the economy.

At a current range of 5.25-5.50%, the fed funds target rate range is approximately 100 basis points above the theoretical "neutral" 10-year Treasury yield of approximately 4.5%, at which point policy is considered neither tight nor easy (**Figure 3, page 5**). We expect when the Fed eventually cuts rates, the pace will err on the side of caution so as not to over-ease policy and accidentally reverse the progress toward lowering inflation that it has worked so hard to achieve.

### Figure 2. Monetary Policy Phases

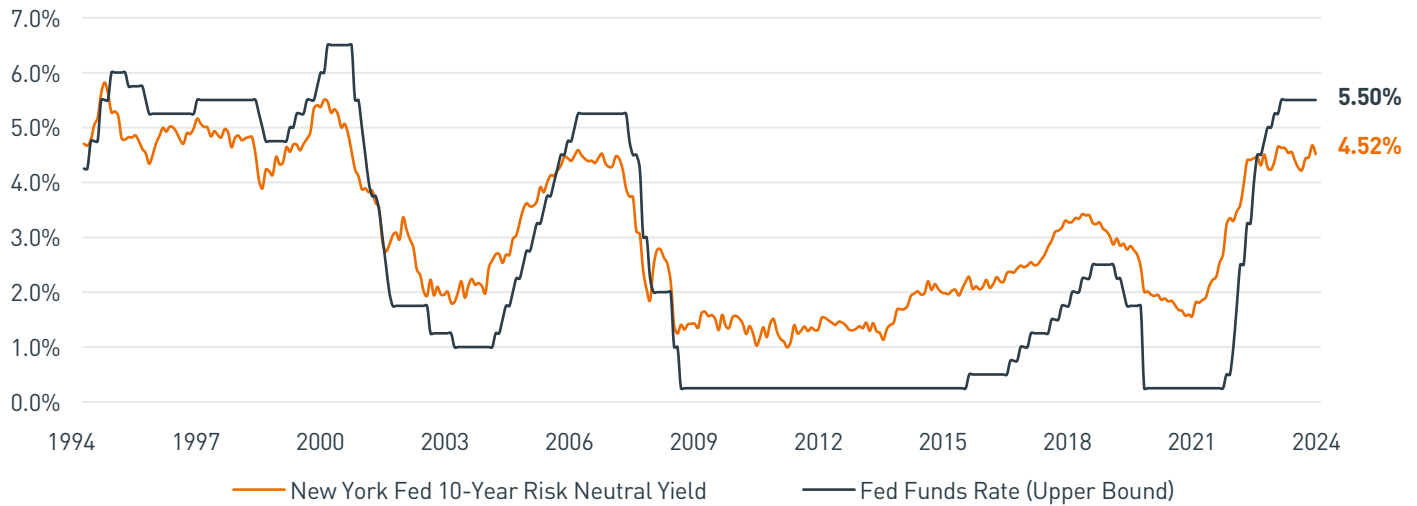
Forward guidance helps shift policy from phase to phase



As of: 5/31/2024. Source: PNC

### Figure 3. “Neutral” Policy Interest Rate

The Fed has ample room to ease policy



As of 5/31/2024. Source: Bloomberg L.P.

## 3. What can economic and market indicators tell us about the 2024 U.S. presidential election?

While politics do not drive markets in the long run, we believe the 2024 U.S. presidential and congressional elections may impact short-term market volatility as we approach November.

When it comes to the relationship between markets and elections, there is no clear predictor. After all, we can only examine outcomes through a historical lens with the benefit of hindsight, and every election is influenced by unique factors. What we can offer is a look at how certain data have correlated with various outcomes over time. For example, since the 1920s, every presidential election that was not preceded by a recession in the previous two years has resulted

in the reelection of the incumbent candidate. While this relationship is noteworthy, correlation is far from causation.

From an economic perspective, real disposable income has been positively correlated with presidential elections, with higher income growth favoring the incumbent candidate. According to the Bureau of Economic Analysis, over the last 20 years, year-over-year growth in real disposable income per capita has averaged about 1.5%. Against that context, the most recent reading of 1.7% is just above average. Nonfarm payrolls — specifically the jobs number, not the unemployment rate — and real GDP growth also appear to be correlated with election outcomes. Like real disposable income, when the measures convey a favorable economic environment, they tend to be positive for the incumbent. Both measures have remained resilient well into the Fed’s tightening cycle; however, the April payroll report was the lowest in over a year, and first quarter GDP growth was the weakest since early 2022.

One market-based relationship that appears to have a strong association with presidential elections is the S&P 500 return for the three months leading up to the election. According to Strategas Research Partners, going back to 1928, if the S&P 500 posted a positive price return in the three months before the election, the incumbent party remained in the White House (**Figure 4**). If the index posted a negative return, the incumbent lost the election. There are four occasions over the study period when this relationship did not hold: 1956, 1968, 1980 and 2020.

While there are a multitude of factors that investors can use to try to ascertain the outcome of the election, with so many permutations, a definitive conclusion from any one measure is dubious. Furthermore, the 2024 election marks the first time Millennial voters will outnumber Baby boomers, which could render conclusions from past data less reliable. Given the current economic environment is defined by the highest interest rates in 15 years and an extended period of elevated inflation, we believe these factors could also have a greater influence on voter sentiment than in prior cycles.

**Figure 4. S&P 500 Price Return for the Three Months Prior to the Election**

S&P 500 performance has historically served as a harbinger of election results

Election Year	Price Return (%)	Incumbent Party Won/Lost
1928	14.91	Won
1932	(2.56)	Lost
1936	7.92	Won
1940	8.56	Won
1944	2.29	Won
1948	5.36	Won
1952	(3.26)	Lost
1956	(2.58)	Won
1960	(0.74)	Lost
1964	2.63	Won
1968	6.45	Lost
1972	6.91	Won
1976	(0.09)	Lost
1980	6.73	Lost
1984	4.80	Won
1988	1.91	Won
1992	(1.22)	Lost
1996	8.17	Won
2000	(3.21)	Lost
2004	2.16	Won
2008	(19.48)	Lost
2012	2.45	Won
2016	(1.90)	Lost
2020	2.26	Lost

Source: Strategas Research Partners, PNC

## 4. Is the U.S. consumer as strong as we think?

Since the onset of elevated inflation and the “higher-for-longer” interest rate backdrop, rising prices have negatively impacted consumer purchasing power and household balance sheets. While consumers have increasingly used debt and savings to finance expenses, consumer spending continues to grow, rather than slow.

Excess savings from pandemic-era fiscal stimulus has nearly been spent, and as of April 2024, savings as a percentage of disposable personal income has fallen to 3.6%. In May, year-over-year nominal consumer income growth of 4.5% was outpaced by nominal year-over-year consumer spending growth of 5.3% (**Figure 5**). The continuation of these trends would likely deteriorate consumers’ financial health.

From a leverage perspective, total U.S. household debt has risen to an all-time high of \$17.7 trillion as of the first quarter of 2024; however, wage and income growth have kept pace. Loan delinquency rates have risen but vary dramatically by the type of debt. For example, mortgage delinquency rates of 90 days or longer are essentially at pre-pandemic

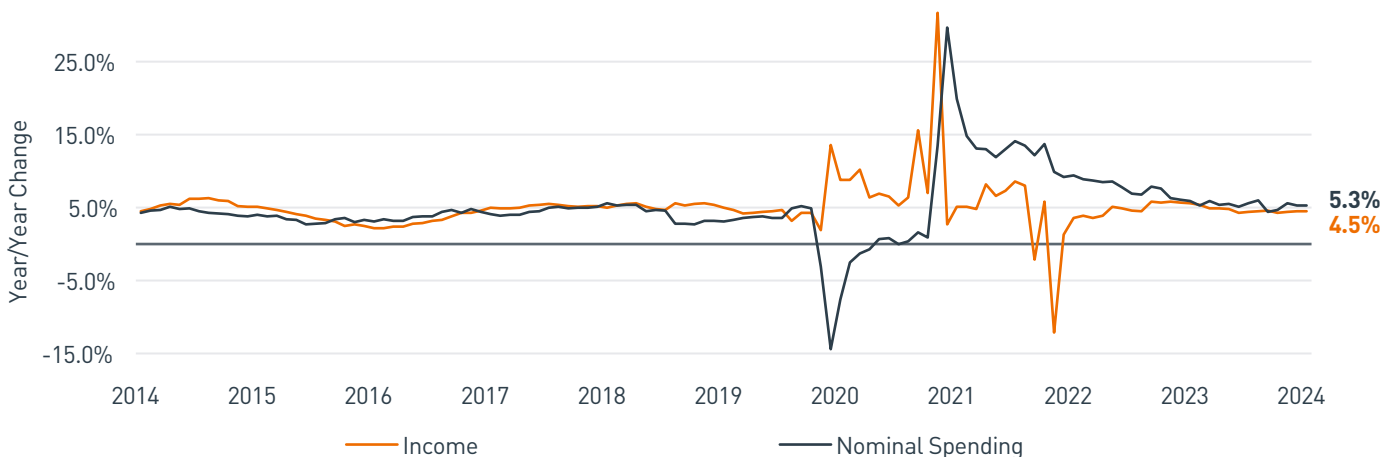
levels, with a 10-year average of just 1.09%. However, 90-plus-day delinquency rates for auto loans and credit cards have reached the highest levels in over a decade.

A recent study<sup>1</sup> by the Federal Reserve Bank of St. Louis shows a growing bifurcation among credit card delinquencies, as higher net worth individuals have significantly lower defaults relative to lower net worth individuals. As interest rates remain higher for longer, we believe the spread in delinquency rates between high- and low-net-worth individuals will continue to broaden. This is due to the tendency for lower net worth individuals to rely more on borrowed funds, ultimately putting them at an increased risk of default relative to higher net worth individuals.

Despite the liquidity and debt challenges facing consumers, we believe labor market strength continues to underpin resilient consumer financial health. Labor market strength indicators include the 4% unemployment rate, healthy initial jobless claims data and a labor force participation rate that remains close to pre-pandemic levels. Additionally, total job openings are above pre-pandemic levels at approximately 8.1 million available jobs. Therefore, we believe a steady flow of income from the strong labor market should continue to buoy consumer health.

### Figure 5. Consumer Financial Health

Consumer balance sheets remain challenged amid the inflationary and low-savings-rate environment



As of 5/31/2024. Source: Bloomberg L.P.

<sup>1</sup> *The Broad, Continuing Rise in Credit Card Delinquency* (stlouisfed.org).



## 5. Is the high concentration in earnings and index performance concerning?

As domestic large-cap equity performance climbed higher in May, the price ratio of the S&P 500 relative to its Equal Weight index reached the highest level since 2009 (**Figure 6**). This rising market concentration has drawn significant attention, particularly as many of the stocks leading the market also have above-average valuations. Furthermore, given mega-cap tech is leading the pack, some are drawing comparisons with the late-1990s dot-com or 1960s “Nifty Fifty” eras as investors ponder whether valuations are reaching unsustainable levels.

Despite the fanfare around the perils of market concentration in the media, we believe much of the hype is unfounded, and rather, reflects the dynamics of the current business cycle environment.

Market concentration occurs with relative frequency and is not unique to the current environment, nor is it approaching extreme levels relative to history. There remains a significant gap between current levels and those of the dot-com era. Additionally, we would not expect approximately one third of S&P 500 stocks to have outperformed the overall index through the end of May, as was the case, if market concentration was at troublesome levels.

The concentrated market narrative extends beyond performance, as earnings growth has also been narrowly led. While the concentrated group of stocks leading the market have high valuations, we believe these valuations are supported by fundamentals. This subset of companies continues to deliver outsized earnings growth, free cash flow and profit margin expansion amid a challenging macroeconomic environment. The same holds true for companies that have not fared as well; we believe their valuations reflect their underlying fundamentals. For example, both the Russell 2000 and MSCI Europe indices, both of which have underperformed the S&P 500, had just two sectors

**Figure 6. Price Ratio of the S&P 500 Relative to its Equal Weight Index**

Narrow earnings growth is leading to narrow market leadership



As of 5/31/2024. Source: Bloomberg L.P.

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deliver positive earnings growth in 2023, and earnings revisions for 2024 have already been cut in half for both indices since the start of the year.

In our view, the divergence between the companies thriving and those that are not reflects the macro environment, characterized by elevated inflation and high interest rates across the globe. This phenomenon is particularly pronounced in developed markets where economies rely heavily on consumers and services. For a small subset of leading companies in innovative industries, macro conditions are less of a headwind, and therefore their earnings keep growing while those of their peers slow, ultimately widening the performance differential.

While concentration may persist for some time, as we see no immediate change to current market drivers (that is, high inflation and interest rates), the underlying stocks comprising the concentrated leadership can certainly change. Thus, we recommend maintaining a diversified portfolio across asset classes and geographies, with a focus on exposures to quality stocks. Overall, we view the market's narrow leadership as emblematic of the current phase of the business cycle.

## 6. What's going on in private markets?

Throughout 2023, high interest rates and tightening bank lending standards created a challenging environment for merger and acquisition (M&A) activity. Although the number of completed deals did not fall as low as it had in 2020, it declined 25% compared to 2022. That said, the aggregate deal value fell by 67% — the largest drop on record (**Figure 7, page 10**). We attribute 2023's particularly poor year for M&A to two primary causes: (1) the Fed was in rate-hiking mode and, (2) expectations for a U.S. recession were rising. Both factors impacted company valuations through a higher cost of capital and lower earnings, respectively.

To date in 2024, M&A activity has been weak, both in terms of deal count and value, amid the slowing global economic growth backdrop. Additionally, given the highly uncertain timing of Fed rate cuts, we expect deal activity to remain challenged. Even when the Fed decides to cut rates, we do not expect a material change in financing costs. Meager M&A activity thus far in 2024 has been largely attributed to aggressive expectations for Fed rate cuts that investors priced in toward the beginning of the year, which have since fallen, from seven rate cuts to one.

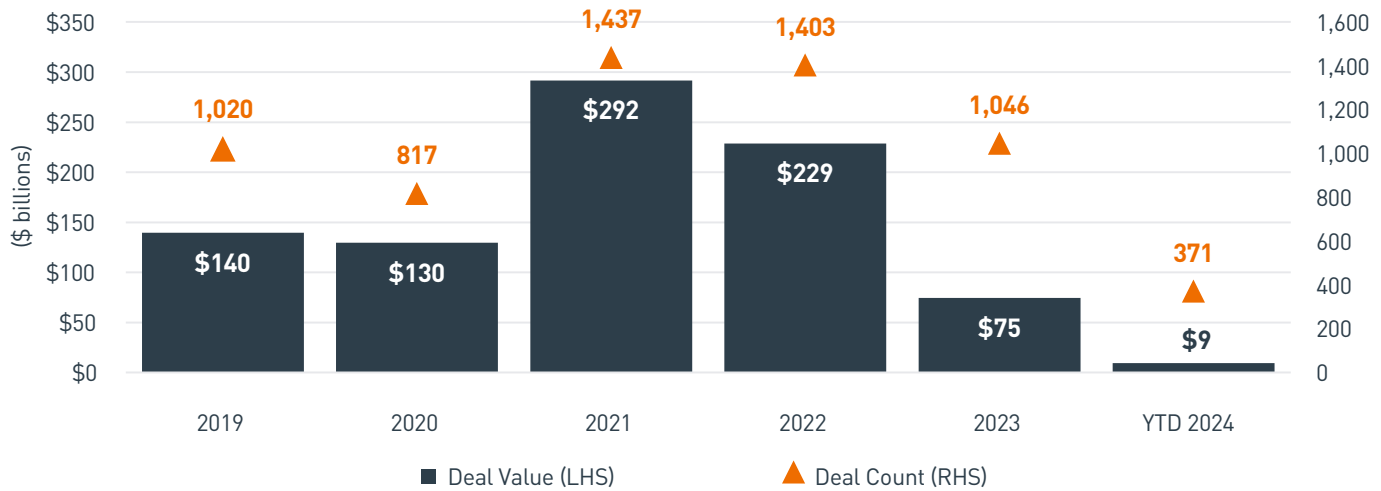
The initial public offering (IPO) market also remains quite slow, which may be surprising considering equity markets are near all-time highs. However, recent market concentration and high equity valuations are likely causing would-be IPO candidates to wait for a more attractive entry point. Additionally, fewer IPOs may indicate private companies are more inclined to be acquired by a larger firm rather than going public, given the costs required. There has been a notable decline in the number of publicly traded firms, a trend we do not anticipate will reverse course any time soon.

While the M&A and IPO markets remain subdued, one area of private markets that has seen significant growth is private credit. A relatively newer asset class, private credit typically comprises below-investment-grade direct lending, mezzanine and distressed debt. While private debt remains a smaller portion of the private investment market, it has grown substantially in recent years. In particular, growth over the past 12-18 months has coincided with a sharp tightening of credit standards in reaction to the banking industry issues in early 2023. The meteoric rise of private credit has raised concerns about problematic credit quality. However, in our view, it is too soon to declare widespread issues as a credit cycle downturn has not yet materialized.

There are a few important distinctions between private credit and traditional lending markets for investors to consider. First, there are far fewer private market lenders, which could narrow potential

## Figure 7. M&A Activity

Deal flow has slowed as equity valuations have rapidly rebounded



As of 5/31/2024. Source: Bloomberg L.P.

loan losses, as fewer counterparties create less potential for widespread contagion risks. In contrast with the traditional syndicate loan market among banks, private credit lenders typically both originate and hold the loans on their books. In our view, this practice is an added incentive for private lenders to maintain strict risk controls, ultimately creating the potential for improved recovery values in the event of default. In short, while the growth in private credit is significant, the data does not yet suggest valuations are becoming rich or that risk management controls are any less stringent than in traditional lending markets.

## 7. What phase of the business cycle are we in?

Given the number of variables impacting the macroeconomic landscape, business cycle analysis is the most complex component of our investment process. Determining the phase of the business cycle is a critical factor in making asset allocation decisions because it provides a framework for

which investment styles, factors or other drivers could potentially influence markets in the near term. We believe the current business cycle is in a slowing expansion phase based on several data points we monitor, including:

- slowing economic and earnings growth;
- rising wages;
- tightening credit standards and falling business optimism; and
- weakening consumer confidence.

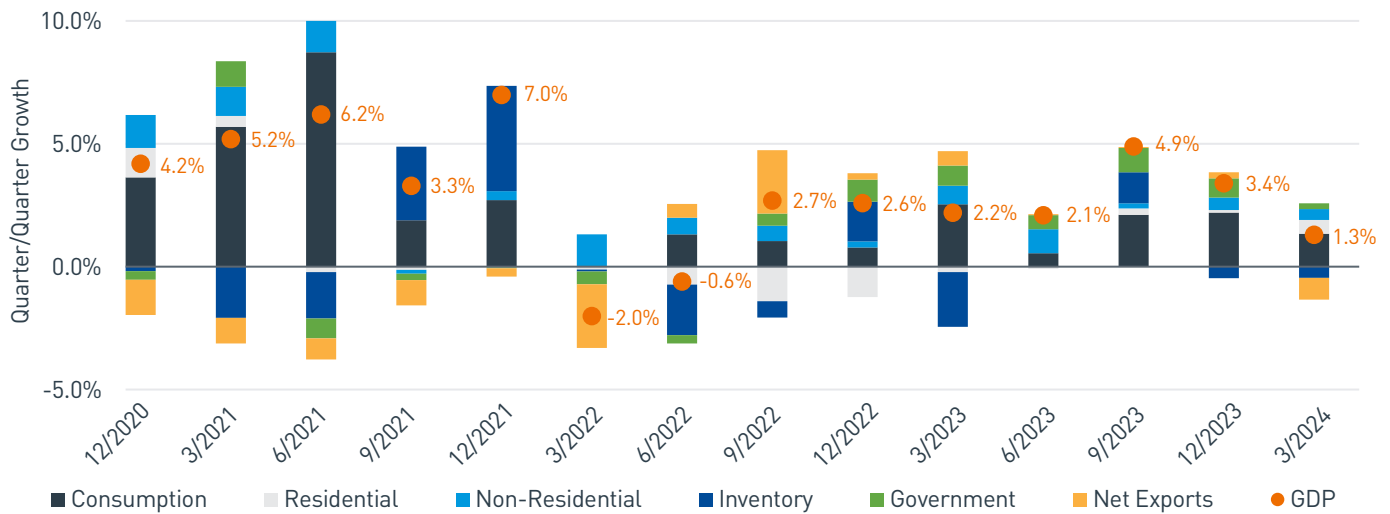
There is a lack of consensus on the phase of the cycle, largely due to the widening divergence between strong U.S. consumer activity and subdued manufacturing activity. For example, inflation-adjusted average hourly earnings growth has been positive since May 2023, and the ISM<sup>®</sup> Services New Orders Index has been in expansion territory since January 2023. Yet, industrial production, a proxy for manufacturing activity, has delivered negative year-over-year growth for six of the past nine months.

More recently, economic and inflation data have started to moderate; potentially paving the way for the Fed to ease monetary policy. First quarter U.S. GDP fell to a 1.3% annualized rate as personal consumption softened (**Figure 8**). The labor market is also showing signs of cooling, with the unemployment rate ticking up to 4.0%, the highest level since January 2022. Sticky inflation remains a concern for the path of the business cycle; however, recent readings, such as the April headline CPI of 3.3%, have been a welcome sign that inflation is not meaningfully reaccelerating.

As inflation remains well above the Fed’s 2% target, its path forward and the Fed’s policy actions will influence the trajectory of economic and earnings growth. Financial markets are now pricing in “tighter-for-longer” monetary policy, which we believe will extend the slowing expansion phase of the business cycle. Slowing economic growth remains a net-positive for global earning growth; every major asset class is expected to deliver positive earnings growth in both 2024 and 2025. In our view, continued positive economic growth and a reacceleration of broad-based earnings growth are key to elongating this business cycle.

**Figure 8. Components of GDP**

Personal consumption remains the driver of the U.S. economy



As of 5/31/2024. Source: Bloomberg, L.P.

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## 8. Do the federal debt and deficit matter?

Over recent decades, the U.S. has accumulated a federal deficit that is now on par with levels typically seen during recessions or major military conflicts. Federal debt levels have also increased substantially. We expect these issues to soon return to the fore, given the presidential election in November and expiration of the debt limit suspension, set for January 2025.

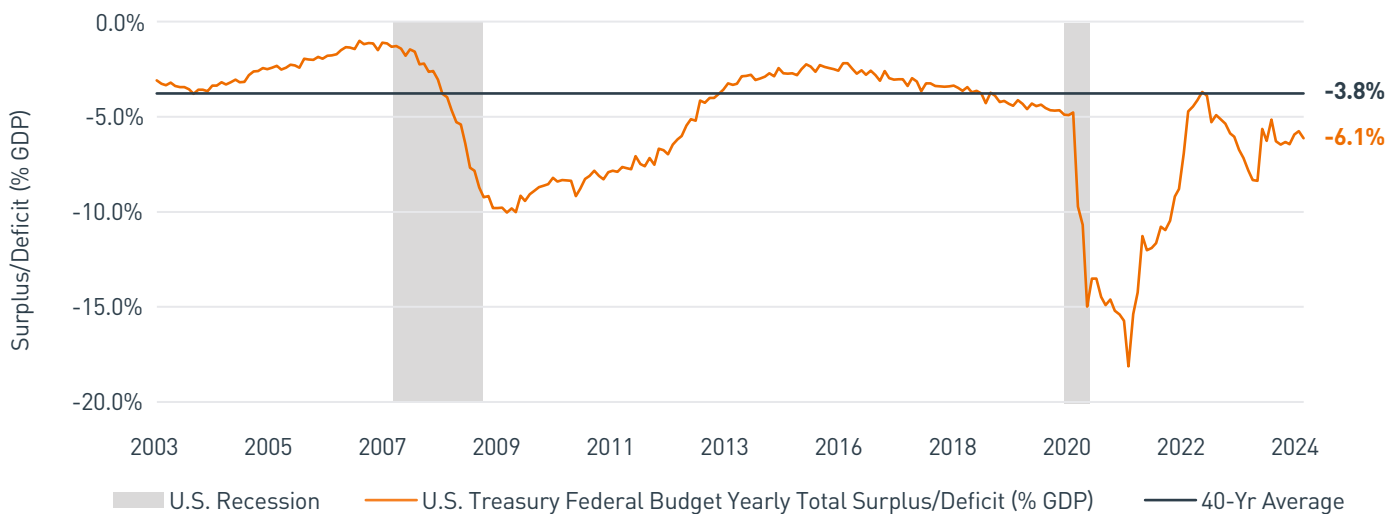
According to the Congressional Budget Office (CBO), the deficit is expected to grow from an equivalent of 5.6% of GDP in 2024, to 6.1% in 2034, and federal debt levels are expected to climb from 99% of GDP to 116% over that same period. There are many reasons behind the sizeable balances, but the effects of government intervention during the global financial crisis and COVID-19 pandemic have exacerbated their growth trajectory (**Figure 9**).

For most of the last 15 years, the federal government was able to help fund itself by issuing debt at ultra-low interest rates. Now, with the post-pandemic surge in inflation and the commensurate monetary policy responses by the Fed, the government's ongoing ability to service its debt at higher interest rates is in question (**Figure 10, page 13**). In our view, the anticipated increase in interest expense further compounds the debt service issue and reflects the negative deficit trajectory going forward.

While the U.S. deficit outlook has its challenges, we believe it is important for investors to consider it on a relative basis. In our view, the U.S. is relatively better situated to service and honor its debt obligations than other countries. This is summed up by the country's near-AAA credit rating, which reflects its global economic supremacy; prevalence of the U.S. dollar as a global trading, financing and reserve currency power; deep capital markets; consistent innovation and attraction of talent and investment flows toward its dynamic economy.

**Figure 9. U.S. Federal Deficit**

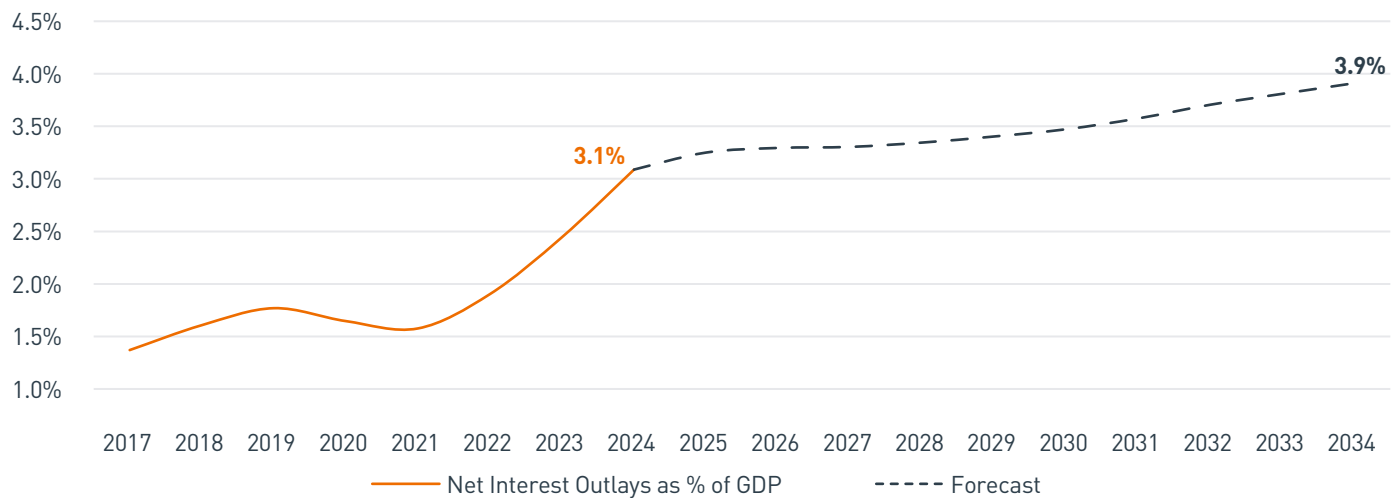
In the short run, wide fiscal deficits remain supportive for the U.S. economy



As of 5/31/2024. Source: Bloomberg L.P.

**Figure 10. CBO U.S. Projected Net Interest Outlays as % of GDP**

Interest outlays are expected to dramatically increase should rates remain elevated



As of 5/31/2024. Source: Bloomberg L.P.

In the near term, financing the U.S.'s high levels of debt at a high cost will likely lead to additional volatility in Treasury markets. It may also keep upward pressure on yields, given a large part of its investor base — that is, retail and mutual fund investors — is more price sensitive.

As the Fed gains comfort that inflation is moving sustainably toward its 2% long-term target, monetary policy is expected to soften. Policy easing through fed funds rate cuts and/or tapering of the Fed's balance sheet runoff program should help improve the supply/demand equilibrium of U.S. Treasury securities. As we approach both Election Day in November and the January 2025 debt ceiling expiration, we expect increased volatility related to concerns about fiscal debt and the deficit, and expect these concerns to prompt further engagement toward seeking resolution.

## 9. Is it time for fixed income investors to lengthen duration?

While we maintain a positive outlook for equities, fixed income markets remain challenged. The Bloomberg U.S. Aggregate Index has been in a drawdown since late 2020, its longest pullback on record. Consensus expects the Fed to begin cutting rates later in 2024, and even end its balance sheet reduction program this year. As such, many investors naturally presume interest rates have peaked for the cycle and therefore ought to be searching for opportunities to extend duration in portfolios.

Additionally, investors may be tempted to extend duration given similarities to the inflationary economic backdrop of the late 1970s, early 1980s or even late 1990s. However, we believe the current period is uniquely characterized by both an outsized

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Fed balance sheet of more than \$7 trillion and the longest consecutive streak of an inverted yield curve on record.

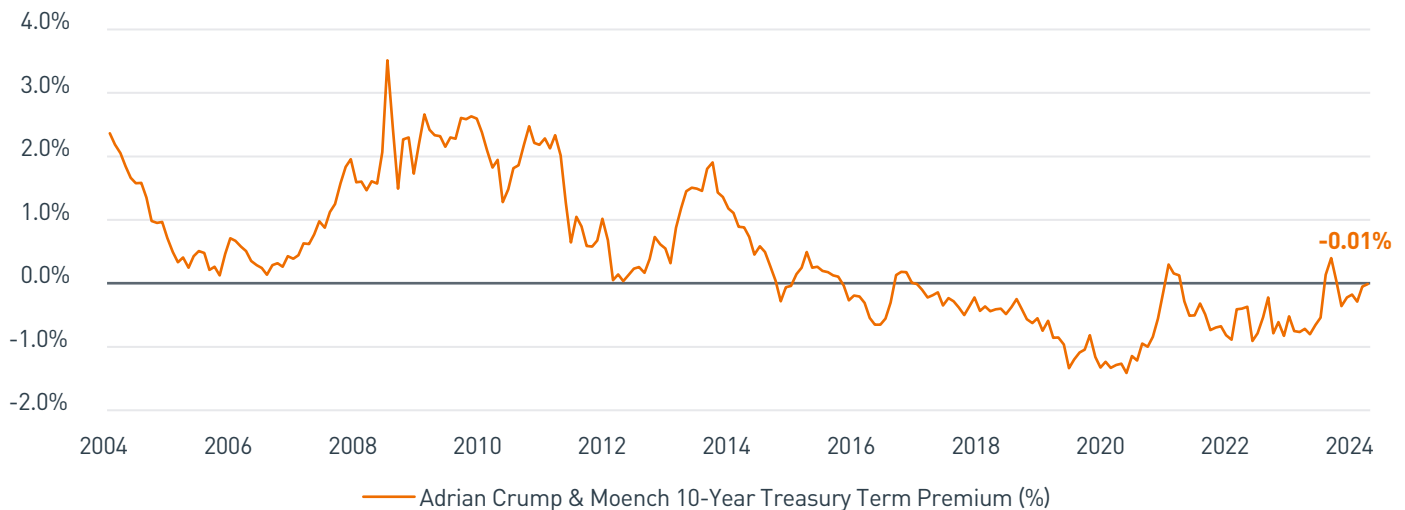
The current structure of the yield curve impacts the term premium, or theoretical expectation investors have for holding longer-maturity bonds. Besides brief periods in early 2021 and late 2023, the term premium has been consistently negative for nearly 10 years (**Figure 11**). In the prior business cycle, consensus widely argued the term premium was negative due to aggressive monetary policy easing with a prolonged period of near-zero policy rates. That view has since been challenged as interest rates are near the highest level in 15 years, and yet, the term premium remains negative. We believe there are other forces at play beyond the fed funds rate, namely elevated inflation, as well as the expectation for continued elevated inflation in the near term as breakeven yields, or the market's expected inflation

level over a certain time horizon, have remained above 2% for nearly four years (**Figure 12, page 15**).

Given current inflation levels are accompanied by solid economic growth and a tight labor market, making it unique relative to prior business cycles, we caution against portfolio decisions rooted in comparisons to the past. Therefore, we recommend investors consider that long-term economic and inflationary trends may persist and consequently influence fixed income allocations. We expect long-term factors, such as elevated global government debt burdens, the impact of aging demographics on labor markets and other structural forces that prop up inflation, to continue exerting upward pressure on interest rates. In our view, this is an especially important time to consider the role of active management in fixed income, as credit analysis and the ability to selectively tilt away from broad index exposures are likely to be particularly valuable.

### Figure 11. The U.S. Treasury Term Premium

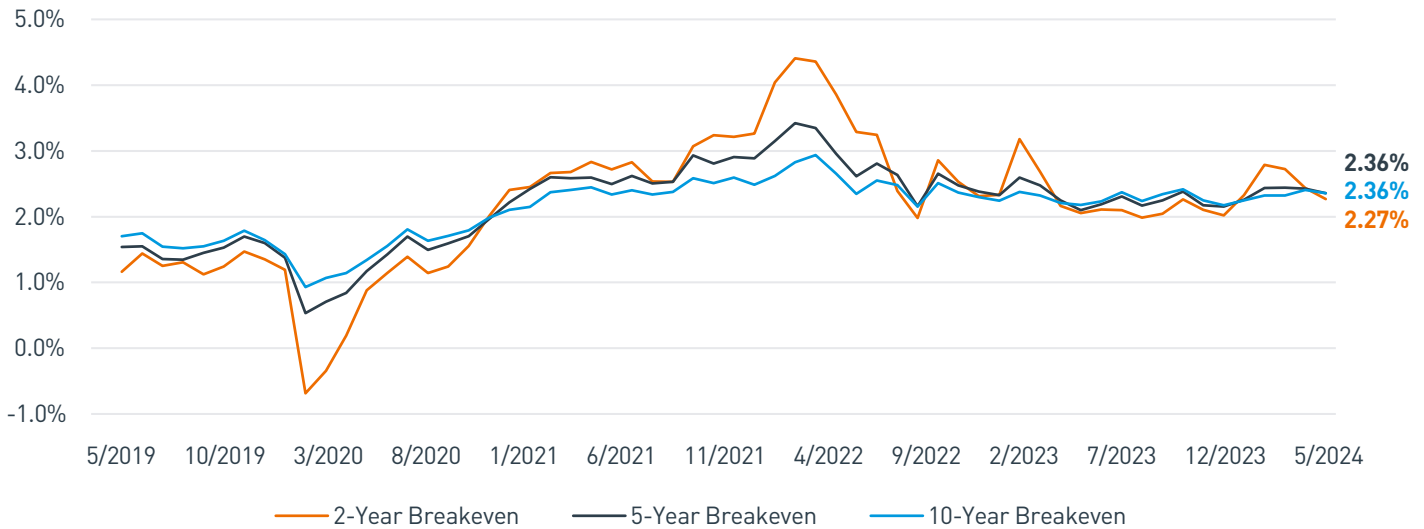
A negative term premium complicates the opportunity to extend duration



As of 5/31/2024. Source: Bloomberg L.P.

**Figure 12. Breakeven Yields Are Still Trending Above 2%**

Fixed income investors remain skeptical of when inflation will reach the Fed's 2% target



As of 5/31/2024. Source: Bloomberg L.P.

## 10. AI: all hype or the next big thing?

Since the launch of OpenAI's ChatGPT tool in November 2022, AI-buzz has dominated financial markets, with AI-related stocks like NVIDIA Corp. rising nearly 250% on an annualized basis since that time. Unsurprisingly, investors constantly ask if the AI buzz is just another passing fad, or if there is staying power to match the extraordinary earnings growth among the companies supporting the AI buildout.

In that sense, we believe the change AI potentially heralds is quite real. Some have compared its potential to the impact of the steam engine, or the printing press. That said, the pace of AI adoption has been extremely fast and with low visibility. Additionally, demand is growing at an unprecedented pace, and several of the components needed to support adoption, such as graphics processing unit

chips that operate AI infrastructure, are in short supply.

Although it is plausible that AI will have a material impact on labor productivity and the job market, the technology is too new to make broad, precise predictions, in our view. However, there has been a more tangible impact at the industry-specific level. Semiconductors have been a clear initial winner, as well as other areas within the Information Technology sector, such as hardware, software and specialty REITs that focus on data centers and cloud computing storage.

At this stage, we caution against extrapolating these early successes to other sectors, such as Consumer Discretionary or Utilities, as we believe sustainable second-order effects of AI demand will take time to manifest in company fundamentals. Another challenge for investors seeking portfolio exposure to AI beyond the group of mega-cap tech stocks leading

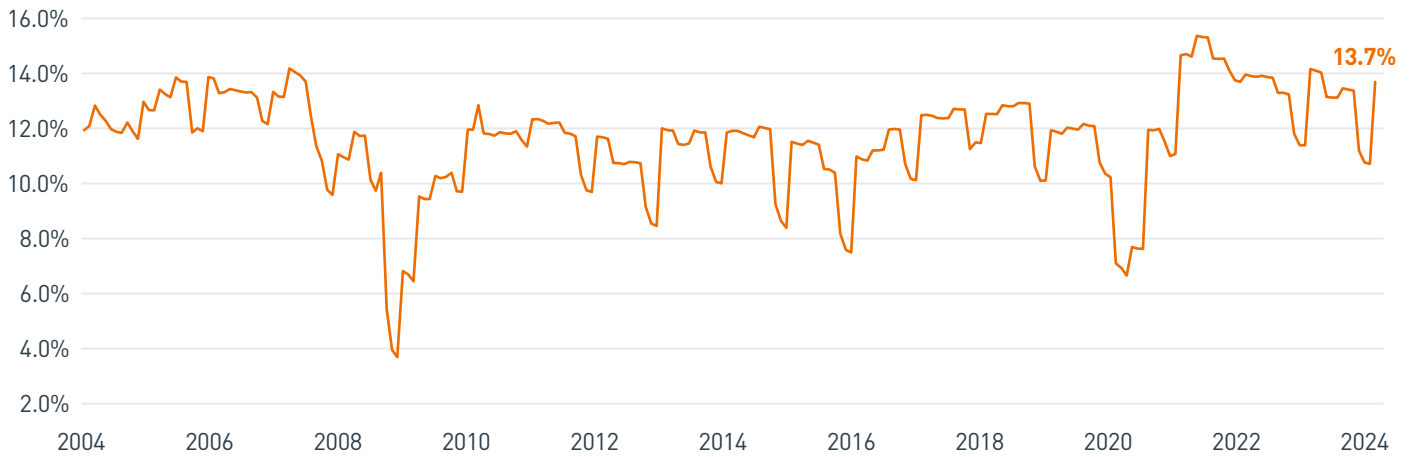


the charge, is that “AI” may not explicitly show up as a line item on a company’s financial statements. That said, investors would potentially notice enhanced revenue growth and profit margin expansion that suggest the latest innovative technology might very well be leveraged across the firm (**Figure 13**). In our view, the ability for firms to adapt to the use of AI may protect those margins from falling to prior cycle averages and support further extension of the current business cycle.

We also believe AI growth is going to function as a long-term tailwind for private equity and venture capital markets. Overall, we believe the present environment is an exciting time for innovation. While companies like NVIDIA Corp. are currently at the center of the AI buzz, we believe AI is not specific to one industry, and will have a broad-reaching impact across many companies.

**Figure 13. MSCI ACWI Operating Margin**

Improved operating margins may prove to be a key beneficiary of AI adoption



As of 5/31/2024. Source: Bloomberg L.P.

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