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Keep On Chargin'

October 12, 2023

Dear Friends,

I recently finished quarterly meetings with the Wall Street crowd and there isn't much to report you haven't already heard. Everyone is worried about commercial real estate; recession forecasts have been pushed off until after mid-2024, and there is more talk of a soft landing. The tone is that the economy has been quite resilient, and this resiliency is what's keeping interest rates elevated.

And speaking of resilient, even though credit card balances are rising, until now US consumers have been rolling with the punches. According to my friend, Peter Hamburger of JP Morgan, the US consumer is a lot less leveraged than they were before the Great Recession, giving them more room to spend. One tidbit of information I picked up: even if we don't count the UAW strike, 2023 has seen the highest level of strike activity in about 20 years. That's worthy of attention. To me it says inflation, higher interest rates and student loan repayments restarting are beginning to squeeze people, leaving them with less money than they need every month. Let's hope the US consumer can "keep on chargin'." Personally, I think we are closer to a recession than people on Wall St believe.

Friends and contacts in different industries also report a lot of strength. A civil engineer friend and client tells me there is not only a lot of government funded work but also a lot of private sector projects as well, so much so that he's had to refuse work. Real estate in the more affluent areas is also in pretty good shape. That said, real estate probably won't catch a break on interest rates until late 2024-2025.

In my previous letter, sent in mid-July, I mentioned how we were due for a 3%-5% pullback in the markets. Well, the pullback

arrived right on time, and per my math the S&P is down close to 7% from its July peak as of this writing. Deeper than I thought. Now, the markets should get a bounce that hopefully turns into something more. My concern? That we don't get a bounce, or it's just a bounce and nothing but.

Recently, many of you are asking if and how we are investing in Artificial Intelligence (AI). It is relatively new technology and the 2nd and 3rd quarter saw AI related stocks do well. If it's like the early days of the internet, we are going to start seeing a lot of new and existing tech companies pop up and compete over its development and uses. In the early 2000's, if a company had a ".com" after its name, it was a hot stock. Today, many of those companies are gone, absorbed by another tech company or simply out of business. In hindsight, it's easy to see how a company like Amazon survived and thrived. However, in the early 2000's, I remember saying to myself, "Amazon sells books; the more books they sell, the more money they lose, and how will they compete with Borders Books?" We know how that story ends, but my point is that picking the internet winners was very difficult at the time. It was a similar story to that of the auto industry in the early 20th century. In the early 1900's, there were dozens of U.S. automakers. Today, there are three - four if we count Tesla. It would have been difficult a hundred years ago to figure out Ford, GM, and Chrysler (now called Stellantis) would have been the three survivors.

I recall from middle school history the stories of the California Gold Rush. It wasn't the miners that made the money, it was the suppliers like Mr. Levi and Mr. Strauss that made fortunes. The enclosed article makes a similar point; perhaps the prudent course of action is to look at the infrastructure that will be needed around AI to help it succeed. In much the same way that the pick and shovel suppliers made money during the Gold Rush, or how warehouses became an integral part of Amazon's growth and success. I'll let you be the judge. I hope you enjoy it.

Sincerely,

Antone Mercurio CFP®

Joe Zidle: A Real-World Investment in the Age of AI

By Joe Zidle June 23, 2023

AI's foundation is data and the infrastructure required to use it, which is one reason that leads me to believe that this isn't a bubble.

Bubble speculation is something of a sport in Wall Street circles. After all, to be first in identifying any form of excess can be wildly profitable. Being the next Jeremy Grantham, often acknowledged for predicting the 1999 tech bubble, or Michael Burry, he of the housing bubble prophecy in 2007 that earned him recognition in books and film, has significant appeal. But their accurate predictions are clear exceptions in bubble speculation history. So, when I see more and more reports questioning whether there's a generative AI bubble, I view them with a skeptical eye.

When analyzing a sector for potential excess in the market, we have to look at its foundation, deeper than recent performance and hype. AI's foundation is data and the infrastructure required to use it, which is one reason that leads me to believe that this isn't a bubble. It's a developing long-term growth opportunity across a potentially transformative technology value chain.

It's early days of AI's growth story At Blackstone, we recently assembled a network of chief technology officers to discuss, among other topics, AI's impact and its potential. A common observation from these CTOs is that many companies are in the research phase with AI and have yet to fully exploit its capabilities for productivity.

I believe these discussions leave little doubt that generative AI will bring about monumental transformations, but it will do so in ways that we cannot yet fully understand.

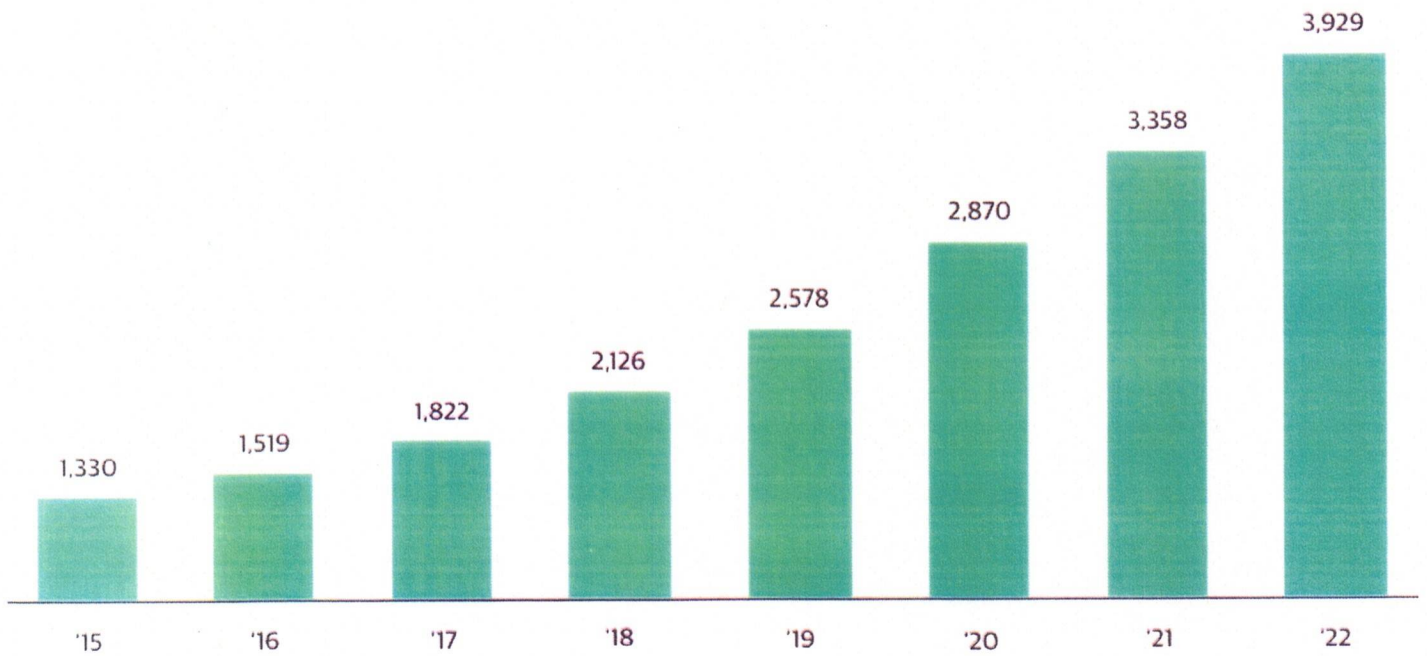
Yes, AI-related stocks have surged significantly this year. But as Deutsche Bank Research Strategist Jim Reid humorously noted in his "Flippant Friday" post, if this were the trajectory of AI stocks with only 50% public awareness, where will these stocks land when the entire population becomes aware of AI?

Where we are currently is the beginning of businesses and the wider economy integrating AI. With as many, if not more, questions than answers currently, what we can do is look to identify the dynamics that figure to be integral to AI's implementation and growth trajectory.

More data means more storage needed In some respects, generative AI reminds me of the earliest days of e-commerce growth. It was clear that Amazon would fundamentally disrupt the retail industry, and that sent investors hunting for the infrastructure that would enable its success. Not so obvious initially was that warehouses would be integral to Amazon's rise. To fulfill its promise, Amazon needed last-mile distribution, which required a massive amount of warehouse capacity near population centers. Urban in-fill warehouses were transformed.

Today, we can look at AI and data centers the same way. Generative AI models rely on robust data processing capabilities and extensive storage capacities, which should drive demand for physical data centers that can handle the intensive computational requirements of generative AI applications. Also, data centers enable distributed training and inference, efficiently coordinating operations across multiple machines or multiple other data centers. The demand for data centers has increased dramatically in recent years with storage and computing requirements shifting to the cloud. According to CBRE estimates shown in Figure 1, data center inventory has nearly tripled since 2015.¹

Figure 1: Data Center Primary Market Total Inventory (MW)




Source: CBRE Research, CBRE Data Center Solutions, H2 2022

This data center growth really should come as no surprise considering the sheer mass of data that the world now produces each day. Figure 2 shows some mind-blowing examples, like that more than 230 million emails and 16 million texts are sent every minute of every day. Each minute also yields 5.9 million Google searches, 1.7 million pieces of content shared on Facebook, and 347,000 Tweets shared on Twitter.

Figure 2: Amount of Data Generated Each Minute of the Day

Google

 **5.9M**
searches

Facebook

 **1.7M**
pieces of
content shared

Snapchat

 **2.43M**
messages sent

Tinder

 **1.1M**
swipes

Streaming

 **1M**
hours viewed


Doordash

 **\$76.4k**
orders placed

Crypto

 **\$90.2M**
crypto currency
purchases

Event

 **\$12.9k**
online event
purchases

Instagram

 **66k**
photos shared

Twitter

 **347.2k**
tweets shared

Youtube

 **1.1M**
uploads


Zoom

 **194.6k**
hours spent
in meetings

Amazon

 **\$443k**
money spent

Venmo

 **\$437.6k**
money transferred

Email

 **231.4M**
messages sent

Texts

 **16M**
messages sent

Source: Domo, data compiled by Goldman Sachs Global Investment Research

Opportunities in generative AI's physical presence Now add AI to the mix. It's natural to think of AI as an esoteric, abstract concept; a form of software that lives in the ether. In reality, real world data centers anchor AI, just as they do data storage and cloud-based applications that run on physical servers. The physical needs of AI will diverge in certain ways from existing applications and could lead to the development of data centers tailored for the new technology. Meta, for example, recently [shared details](#) on its own plans to redesign data centers projects to support its AI development.

Data demand multiplier The same impetus drives the many competing forces racing to develop both narrow and broad generative AI models. All of them heavily rely on substantial computational power, robust data processing capabilities, and extensive storage capacities. All of them are expected to drive increasing demand for data centers that are foundational to handling those intensive requirements to power generative AI applications. Moreover, data centers enable distributed training and inference, efficiently coordinating operations across multiple machines or data centers.

We may not fully understand the costs and benefits of generative AI, but I believe that it is here to stay and that it will bring a surge of investment into the field. While the tech companies battle over the development potential and applications, from my perspective, data centers seem well-positioned to thrive in the present and future of an AI-driven world.

With data and analysis by Taylor Becker.

1. https://www.blackstone.com/~/media/2131927-if-impact-data-center-markets/2pkgd4/678830010?h=CrO99zrkzHmPGIGuwl7qjVpEKDF5UHwqc4ae_3ht80u

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