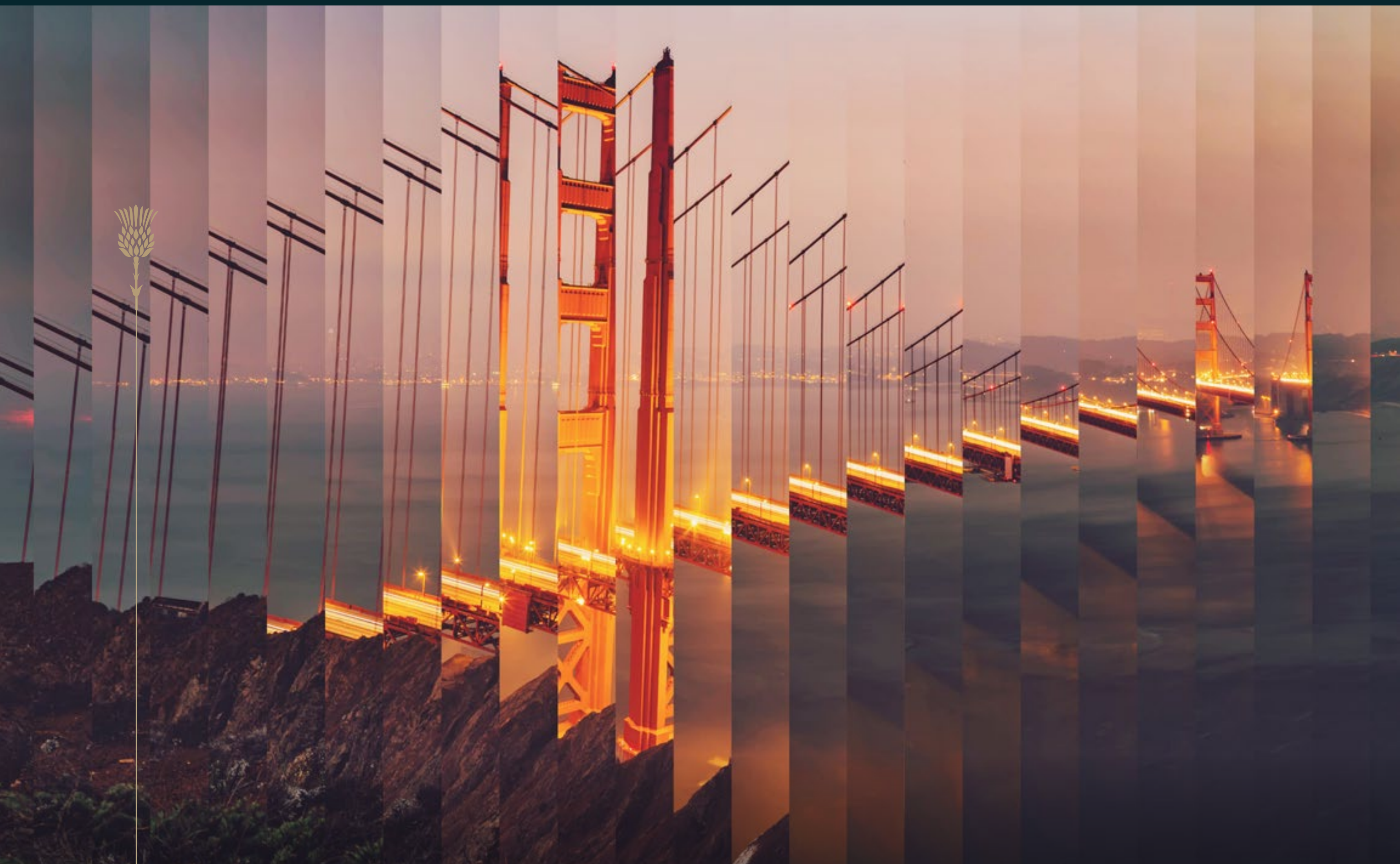
ROCKEFELLER
GLOBAL FAMILY OFFICE

CIO MONTHLY PERSPECTIVE

MAY 2024



Paradigm Shifts

The rise of AI and fall of free trade

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Market Watch

Equity Market Indices[1]	3/31/24 Price	4/30/24 Price	MTD Change	YTD Change
MSCI All Country World	784	757	-3.4%	4.1%
S&P 500	5254	5036	-4.2%	5.6%
MSCI EAFE	2349	2281	-2.9%	2.0%
Russell 2000®[2]	2125	1974	-7.1%	-2.6%
NASDAQ	16379	15658	-4.4%	4.3%
TOPIX	2769	2743	-0.9%	15.9%
KOSPI	2747	2692	-2.0%	1.4%
Emerging Markets	1043	1046	0.3%	2.2%
Fixed Income				
2-Year U.S. Treasury Note	4.62%	5.04%	41	78
10-Year U.S. Treasury Note	4.20%	4.68%	48	80
BBG U.S. Agg Corp Spread	0.90%	0.87%	-3	-12
BBG U.S. HY Corp Spread	2.99%	3.01%	2	-22
Currencies				
Chinese Renminbi (CNY/$)	7.22	7.24	0.3%	2.0%
Brazilian Real (Real)	5.01	5.19	3.6%	6.9%
British Pound ($/GBP)	1.26	1.25	1.0%	1.9%
Euro ($/Euro)	1.08	1.07	1.2%	3.5%
Japanese Yen (Yen/$)	151.35	157.80	4.3%	11.9%
Korean Won (KRW/$)	1347.35	1382.10	2.6%	7.3%
U.S. Dollar Index (DXY)	104.49	106.22	1.7%	4.8%
Commodities				
Gold	2230	2286	2.5%	10.8%
Oil	83.2	81.9	-1.5%	14.3%
Natural Gas, Henry Hub	1.76	1.99	12.9%	-20.8%
Copper (cents/lb)	401	456	13.9%	17.3%
CRB Index	290	291	0.4%	10.5%
Baltic Dry Index	1821	1685	-7.5%	-19.5%

Source: Bloomberg

INTRODUCTION

After several months of euphoria over a seemingly improving macro backdrop and imminent rate cuts, investors had a rude awakening in April.

For the first time in modern history, Iran launched a direct attack on Israel, firing hundreds of drones and missiles in retaliation for Israel's apparent strike on the Iranian consulate in Syria. While ostensibly temporary, this sudden turn of events reminded investors that geopolitical tension can unexpectedly flare up. As military conflicts in the region persist, investors have sent gold, viewed as a safe haven, to new highs.

On the economic front, the Consumer Price Index (CPI) for March came in higher than anticipated. With three consecutive stickier-than-expected CPI reports to start the year, the Fed was compelled to begin backpedaling its three-rate cut guidance for 2024. The market reacted by pushing the 10-year Treasury yield to as high as 4.7%, and the rapid rise in bond yields finally triggered a pullback in equities.

With the policy debate within the Federal Reserve on 2024 rate cuts seemingly having turned from *when* to *if*, the U.S. Dollar Index (DXY) has gained nearly 5% year to date. Since Japan has the widest interest rate differentials with the U.S., the yen had weakened to a 34-year low of 160 yen/dollar before Japan's Ministry of Finance finally intervened. By month end, the yen was still down by roughly 10% versus the dollar year to date. A weak yen has raised the prospect of a sizeable devaluation of the renminbi, as China may elect to use currency to further boost its exports to offset still-soft domestic demand. The continued yen weakness and potential renminbi devaluation could unleash a chain of competitive devaluation to impact fund flows and financial markets. Of course, much will depend on when the Fed starts easing to narrow the interest rate differentials with the rest of the world. To wit, starting in June, the Fed will slow down the pace of reducing its Treasury securities holdings from $60 billion to $25 billion a month – a positive liquidity move for the market.

On the political front, House Speaker Johnson managed to pass the contentious $61 billion aid package for Ukraine with more support from Democrats than his fellow Republicans. He also forced a somewhat reluctant Senate to pass the TikTok divest-or-be-banned bill by attaching it to the critically important foreign aid package. It has started the countdown to a showdown with China on the fate of the popular social media app's existence in the U.S.

In short, while investors were inundated with earnings reports, greater macro surprises were unfolding in the backdrop. We are indeed still living in interesting times.

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A Cinematic Lost & Found

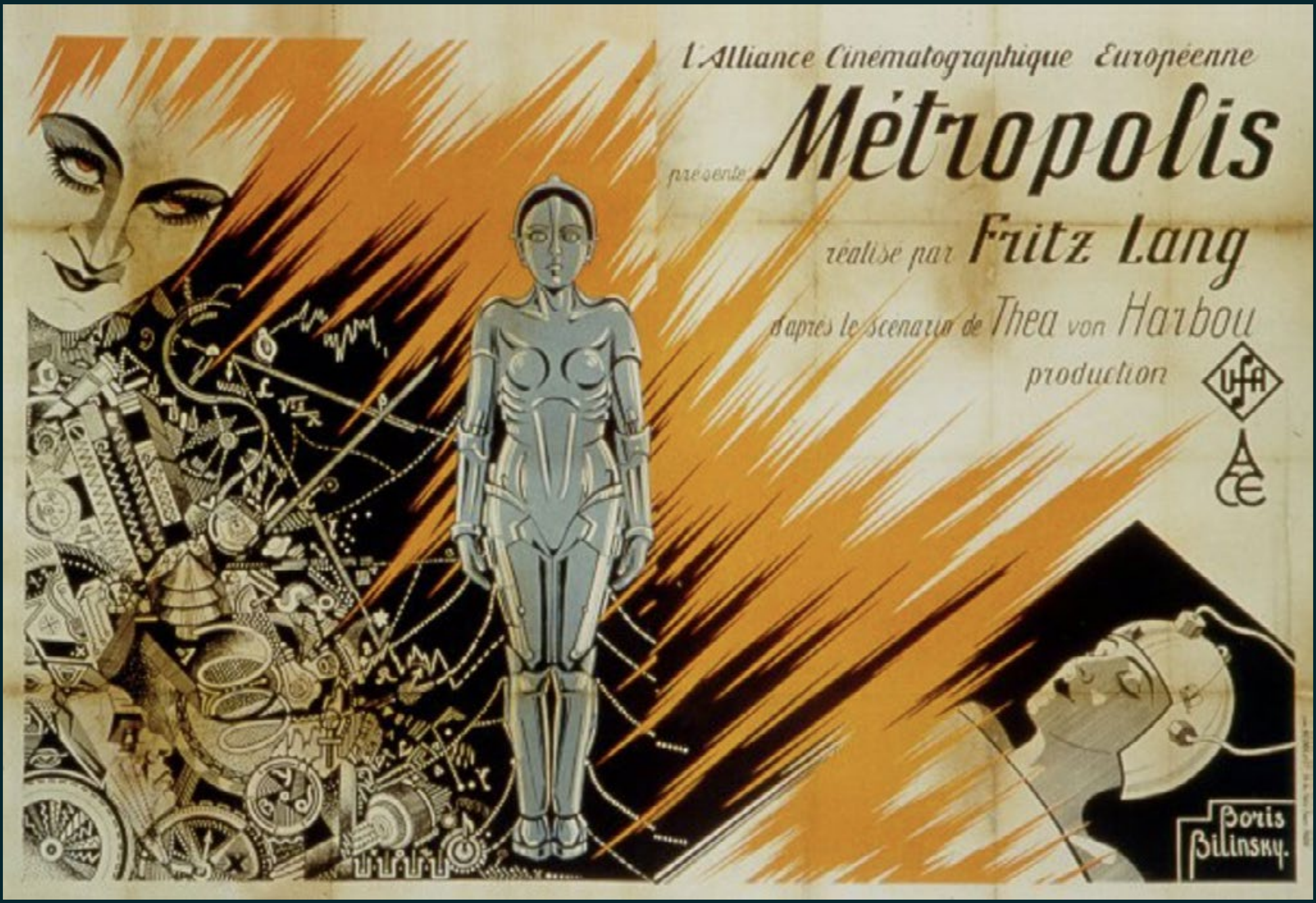
It was early spring 1933 in Berlin, the silent film capital of Europe, where Friedrich “Fritz” Christian Anton Lang, a widely admired filmmaker, had a dreaded sense that the German film industry’s golden era was coming to an end. The 43-year-old director was a pioneer in the German Expressionist movement that featured dramatic lighting and visual distortion to explore themes related to psychological and social issues. However, the newly installed government had intruded on artistic freedom and Lang’s new film, *The Testament of Dr. Mabuse*, was recently banned. Lang was subsequently asked by the new regime to lead the production of their propaganda films, which he found ironic. With his marriage to screenwriter and novelist Thea von Harbou already on the rocks, he no longer felt an attachment to Berlin. They finalized their divorce on April 20, and Lang left Germany for good on July 31, 1933. Three years later, he began a career in Hollywood and made 22 feature films over 20 years. However, under the constraints of Hollywood’s Hays Code – a set of industry guidelines for self-censorship of content from 1934 to 1968 – Lang was never able to replicate the breakthroughs of his earlier film career.

Fritz Lang is best known for his landmark 1927 science fiction film, *Metropolis*, a silent-film era epic that featured elaborate sets and innovative special effects, as well as a plot that still resonates with modernity and technology nearly a century later.

The screenplay for *Metropolis* was adapted from Harbou’s novel of the same title, which was serialized in Frankfurt-based newspaper *Illustriertes Blatt* to promote the film. The futuristic city in the film was inspired by the Art Deco movement and New York City’s skyscrapers, which Lang first visited in 1924.

The plot unfolded in the ultramodern city of *Metropolis* where the elites luxuriated in gleaming skyscrapers while workers toiled with dangerous machines underground to keep the city running. The city was overseen by Joh Fredersen, an authoritarian industrialist unsympathetic to the suffering of the workers. His son Freder, on the other hand, became disillusioned upon witnessing the workers’ harsh lives. Joh was concerned that Freder had fallen in love with Maria, an angelic figure from the underclass who was calling for mediation between the “head and hands” that built Metropolis.

Fredersen was shown a lifelike “machine-man” (robot) created in memory of his late wife and Freder’s mother, Hel, by a genius inventor Rotwang, who had vied for her affection. Fredersen ordered Rotwang to give the robot the likeness of Maria and have it sow distrust between the workers and the real Maria. Rotwang obliged by kidnapping Maria and superimposing her appearance on the robot. However, his instruction to the robot was to destroy Frederson, Freder, and the city.



Poster for the film Metropolis, 1927.

The robo-Maria was effective in winning the hearts of both the elites and workers. She then sowed discord among the former and persuaded the latter to rebel. The apex of the film revolved around the chaos unleashed by robo-Maria and Rotwang, and how the pandemonium was quelled.

Metropolis premiered in Berlin on January 10, 1927, and was met with mixed reception. While the audience and critics marveled at the film's breathtaking visuals, they were less impressed with the melodramatic plot. The film's 153-minute runtime was also a problem as it far exceeded that era's typical 60-to-90-minute length for feature films. *Metropolis* was literally put on the chopping block with its American distributor cutting it down to 107 minutes. It was relatively easy to dramatically re-edit a silent film by changing its intertitles. Lang was so frustrated that he quipped, "Their experts have slashed my best film, Metropolis, so cruelly that I dare not see it while I am in England." Adding insult to injury, the film was further shortened to 91 minutes at the behest of Nazi censors in 1936. With the original reels of the

A CINEMATIC LOST & FOUND

film having been lost during WWII, the heavily re-edited 1936 version wound up as the "official" version for the next seven decades, and audience were left guessing about the original plot and intent.

By the early 1960s, as Lang's career was grinding to a halt, he began to dismiss *Metropolis* as "silly and stupid." His obituaries in 1976 did not even rank *Metropolis* among his top films. However, *Metropolis* gained a cult following in later years among film scholars and enthusiasts. The music video of British rock band Queen's "*Radio Ga Ga*" extensively featured footage and recreated scenes from the film. In 1984, Italian music producer Giorgio Moroder outbid David Bowie for the rights to mix his synth-driven soundtrack with the film. The project featured songs by rock stars such as Pat Benatar, Freddie Mercury, and Bonnie Tyler, and introduced the film to a new audience. *Metropolis*' cult classic status was further enhanced with its release on VHS and DVD.

In early 2008, Fernando Peña, an Argentine film archivist, received a call from his ex-wife, Paula Félix-Didier, who had recently been appointed as the curator at the Museo del Cine (Cinema Museum) in Buenos Aires. Peña had heard a story twenty years earlier that someone had seen the screening of an archived *Metropolis* which ran unusually long. He had long suspected that it was the original, uncut version, but his repeated attempts to gain access to the reels were stymied by bureaucracy. Félix-Didier invited Peña to the museum's archive to look for the film, and they discovered a dusty film canister labeled "Metropolis" – after decades of searching, the original *Metropolis* was finally rediscovered.

It turned out that an Argentine film distributor, Adolfo Wilson, happened to be in Berlin when *Metropolis* premiered in 1927. He liked the film and purchased the rights to distribute it in Argentina. After the theatrical run, the reels went into a private collection that was later donated to the Fondo Nacional de las Artes (National Endowment for the Arts). In 1992, the reels were transferred to the Museo del Cine and left in storage until 2008.

The re-emergence of the original version of *Metropolis* was a seminal event for film buffs worldwide. Many of the questions and puzzles posed by the truncated version were finally answered. After an eighty-three-year hiatus, the original version – now digitally enhanced – had its world "re-premier" at the Berlin Film Festival on February 12, 2010. Today, *Metropolis* is hailed as one of the greatest works of the silent film era, and one can easily view all versions of the film, including colorized and audio-dubbed, on YouTube. I suppose it's only a matter of time before an AI-enhanced version becomes available.

The AI Debate - Open or Closed

The Maschinenmensch in a screenshot from the 1927 film Metropolis.

The film industry has undergone several phases of technological revolution over the last century – the switch from silent films to sound and color in the 1930s, introduction of widescreen format in the 1950s, and growing use of computer-generated imagery (CGI) since the 1970s. In recent decades, rapid advancement in software and computing power has enabled CGI to create increasingly realistic content digitally. Today, in the face of mind-blowingly rapid advances in artificial intelligence, the film industry is suddenly confronted with seismic changes that will dramatically disrupt film making.

On February 15, 2024, OpenAI introduced Sora, a text-to-video tool that creates short videos based on a user's text description, also known as a prompt. The impact was swift and dramatic.

In one instance, after seeing the Sora demo, filmmaker Tyler Perry indefinitely suspended an $800 million studio expansion plan that he has been working on over the last four years, a project that was to add 12 more soundstages to his 330-acre studio in Atlanta.

As a business owner, Perry is seeing tremendous cost savings with AI – a pilot that usually costs up to $35 million to create can be made at a fraction of the price. In an interview with *The Hollywood Reporter*, Perry observed, "I no longer would have to travel to locations. If I wanted to be in the snow in Colorado, it's text. If I wanted to write a scene on the moon, it's text, and this AI can generate it like nothing. If I wanted to have two people in the living room in the mountains, I don't have to build a set in the mountains, I don't have to put a set on my lot. I can sit in an office and do this with a computer, which is shocking to me."

As a fellow actor and filmmaker, however, Perry is concerned about the job prospects of so many people in his industry and lost employment among construction workers and contractors as a result of the cancellation of his studio expansion plan. He said that the only way to deal with the impending disruptions created by AI is to have all interest groups galvanize as one voice "not only in Hollywood and in this industry, but also in Congress."

As if on cue, California senatorial candidate and Congressman Adam Schiff introduced the *Generative AI Copyright Disclosure Act*, which

THE AI DEBATE - OPEN OR CLOSED

would require AI companies to file with the Register of Copyrights all copyrighted works used to train their models. It would apply to both new models and retroactively to prior works. The bill is intended to protect human content creators so they can be compensated or be allowed to enforce their rights against unauthorized use of their works. AI companies have claimed that the use of copyrighted materials for training is an example of fair use, and the proposed act would give an edge to foreign competitors in China and Russia.

This proposed bill is merely an opening salvo of upcoming policy and competitive battles over AI. Among venture capitalists and technology companies, there are debates on whether AI should be made open or closed source and the role of regulation.

Open-source proponents, including leaders at Meta and venture capitalist Marc Andreessen, believe sharing technology will ensure greater transparency, maintain America's influence and leadership over AI development, and prevent companies from monopolizing the huge potential market.

On the other side of the debate, OpenAI and venture capitalist Vinod Khosla, an investor in OpenAI's for-profit business, have been advocating greater government regulation and less sharing of AI technologies. Khosla has long warned of the dangers of AI being used by bad actors and geopolitical foes – imagine AI being turned into a robo-Maria-like entity to tear down society. He has publicly challenged the open-source camp by asking Andreessen if he would have open sourced the Manhattan Project.

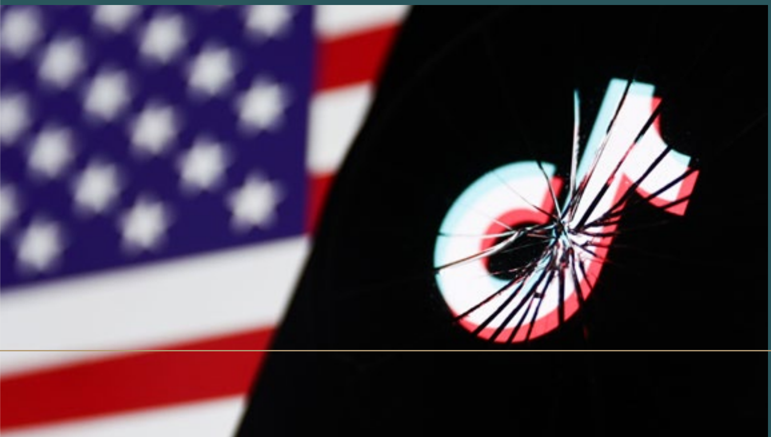
In the fiercely competitive and rapidly evolving world of AI, leading companies' pro-regulation stances are viewed by new entrants as a strategy of regulatory capture – using governmental power to serve private interest – to enable incumbents to protect their turf. First Amendment advocates also cautioned that the drive to regulate AI-generated content is a double-edged sword, as history is rife with examples of governments suppressing information that was objectively factual. With the impressive total solar eclipse still fresh in our memory, one can point to Galileo's heliocentric theory – the sun, not the Earth, being at the center of the solar system – running afoul of the Catholic orthodoxy, which led to his trial and forced recantation in 1633.

In short, while investors are enamored with the AI industry's immense potential opportunities, many companies are confronted with elevated regulatory, competitive, and business model uncertainties. Meta's open-source large language model, or Llama, is already commoditizing parts of the AI ecosystem. It may be one of the reasons why investors have favored the "arms dealers" in the AI race – providers of semiconductor chips, servers, data centers, infrastructure, etc. However, without a defensible revenue model for AI applications, the torrid pace of investment may not be sustainable.

Tick-Tock for TikTok

Speaking of technology companies' growing regulatory risk, back in mid-March, the House of Representatives overwhelmingly voted by a margin of 352 to 65 to give Chinese social media giant ByteDance 180 days to divest its TikTok subsidiary or see it banned in the U.S. The 180-day window would have forced the issue to a head before the November election. With the Senate having shown no urgency in bringing the bill to the floor, the House passed a modified bill on April 20 to give ByteDance up to one year (270 days plus a 90-day extension by the President) to divest TikTok and attached it to the urgent foreign aid package for Ukraine and Israel. This maneuver forced the Senate to vote on TikTok's divestment, and President Biden to subsequently sign it into law.

A day before the House passed the modified bill, China's Cyberspace Administration ordered Apple to remove popular messaging apps – Telegram, Signal, and Meta's WhatsApp and Threads – from its App Store as they were banned by the Chinese government. A few weeks earlier, China's Ministry of Industry and Information Technology (MIIT) ordered the nation's telecom carriers to phase out foreign processors – chips made by Intel and AMD – by 2027. It's clear that the world's two biggest economic powers are actively dismantling the erstwhile "Chimerica" symbiosis.



The TikTok saga has several potential outcomes:

1. ByteDance successfully gets the court to overturn the bill on the grounds of the First Amendment; the company has argued that the ban would "trample the free speech rights" of its 170 million American users and 7 million businesses.

2. ByteDance divests TikTok to a U.S. or non-Chinese foreign entity after failing to have the court overturn the bill.

3. The Chinese government refuses to let ByteDance divest TikTok, resulting in the social media app being shut down in the U.S. This is not unprecedented as India banned TikTok in June 2020 following its border clashes with China. Two hundred million TikTok users in India lost access to it overnight and turned to other social media apps.

For investors, the first outcome would be the status quo. The second may lead to new investment opportunities, though I doubt ByteDance or the Chinese government would let the acquirer gain access to the company's proprietary algorithm, which is the crown jewel of the business. The third potential outcome would be a bonanza for competing social media companies like Meta and X (formerly known as Twitter) as they stand to gain more user traffic and split the billions of dollars in advertising revenue that TikTok is currently amassing.

No More Thank You Notes

The TikTok saga is just one facet of the growing tension between the U.S. and China. Putting aside the mutual distrust on geopolitical issues, the U.S. still has serious concerns about China's export-led mercantilist economic model. Gone are the days when the U.S. welcomed cheaper goods from China, which also provided us with vendor financing by recycling its massive trade surplus to buy U.S. Treasuries. The rapidly evolving economic relationship is reflected in Treasury Secretary Janet Yellen's comments before she departed for her April visit to China. Yellen said, "People like me grew up with the view: If people send you cheap goods, you should send a thank-you note. That's what standard economics basically says." She then added, "I would never ever again say, 'Send a thank-you note.'"

To many Western economists, the global trade imbalance is in part caused by China's subsidies to businesses and exporters at the expense of domestic consumers. Despite China's meteoric growth over the last three decades, household consumption accounts for less than 40% of GDP, way below the global average at roughly 60% and nearly 70% of GDP in the U.S. China's household consumption is depressed as the result of a managed currency – pegging to the greenback despite years of growing trade surplus vs. the U.S. – and policies that kept wages, benefits, and interest on bank deposits artificially low to indirectly subsidize businesses.

The U.S. and its allies are concerned that, instead of pursuing policies aimed at lifting household consumption to bolster economic growth, Chinese policymakers appear to be doubling down on export-oriented industries, especially in strategically important sectors such as electric vehicles (EV), batteries, wind and solar projects, etc.

To Western observers, the "proof" of China's predatory export policy is the country's overcapacity in strategic industries. According to the China Photovoltaic Industry Association, at the end of 2023, the country's annual production capacity for solar modules was 861 gigawatts, more than double the global installed base of 390 gigawatts. The oversupply has driven solar panel prices down by more than 40% in 2023, making Chinese panels more than 60% cheaper than those made in the U.S. In the lithium-ion battery sector, China's production in 2023 alone matched global demand. Western policymakers are now worried that China will pursue a similar strategy in electric vehicles, which has already propelled China to be the world's largest auto exporter in the world.

China has dismissed the West's concerns about EV overcapacity as groundless. *The People's Daily* pointed out that in 2023, only 12% of electrical vehicles produced in China were exported. However, what the paper failed to acknowledge is China's immense scale and impact on the rest of the world. As the world's biggest car manufacturer by a wide margin – 30 million units in 2023 – each percentage point increase in China's production has a far greater impact than percentage changes in other countries. For example, a 10% increase in China's auto production will add 3 million new units, which equates to roughly 70% of what neighboring South Korea had produced in 2023.

To be fair, China's competitors also need to acknowledge that some leading Chinese EV companies are extremely innovative and well-run. The contrast between two of the world's leading smartphone makers, Apple and China's Xiaomi, is illustrative of China's competitiveness in entering new markets.

In February 2024, Apple shut down its secretive Project Titan, a $10 billion, decade-long effort to create an autonomous driving electric vehicle. A month later, Xiaomi, China's largest smartphone maker, showcased its much-anticipated sporty electric car with Porsche-like styling, priced below Tesla's Model 3.

Founded in 2010, Xiaomi is best known for affordable smartphones and a variety of appliances such as rice cookers and air purifiers. In March 2021, Xiaomi's founder and CEO, Lei Jun, announced "the final major entrepreneurial project" of his life – a $10 billion investment over the next decade to build out its smart electric vehicle business. Three years and $1.4 billion later, Xiaomi's SU7 (Speed Ultra 7) electric vehicle was showcased with full connectivity to the company's smartphones and other devices running on its proprietary operating system.

The EV industry's competitive dynamics are best summed up by Elon Musk, who has played a key role in jumpstarting China's EV industry with the establishment of Tesla's Shanghai factory in 2020. "Frankly, I think," Musk cautioned earlier this year, "if there are not trade barriers established, they will pretty much demolish most other companies in the world."

Lei Jun, Chairman and CEO of Chinese electronics company Xiaomi, presents the new electric car Xiaomi SU7 model at a launch event in Beijing on March 28, 2024.

Goodbye, Free Trade

While the U.S. and China were arguing over trade practices during and after Secretary Yellen's visit to China, Europeans were venting their grievances against both countries. At a policy conference in Belgium in mid-April, Mario Draghi, the highly respected former president of the European Central Bank (ECB), warned that the U.S. and China "are no longer playing by the rules, and are actively pursuing policies to enhance their competitive positions." Draghi, who is leading an effort to draft a report on Europe's competitiveness for the European Commission, singled out the U.S. for attracting high-value domestic manufacturing while using protectionism to shut out competitors. He also accused China of undercutting Europe by "attempting to capture and internalize all parts of the supply chain in green and advanced technologies," which has led to "significant overcapacity in multiple sectors."

It is no secret that elements of the Inflation Reduction Act can be construed as unfair subsidies in favor of American businesses. India has fretted that Uncle Sam's generous subsidies – tens of billions of dollars – to incentivize highly profitable semiconductor companies to build new fabs in the U.S. violate World Trade Organization (WTO) provisions. India has since come up with a chipmaking incentive plan that has the government bearing half of the cost of approved projects. China has filed a complaint with the WTO over the U.S. requirement that subsidies to EV purchases exclude those vehicles with batteries made in China. The Inflation Reduction Act's green subsidies have also forced the European Union to consider big "green deal" subsidy programs as a countermeasure.

The unspoken reality is that free trade, which has never existed in its purest form, has become a relic of a bygone era. In a world beset by geopolitical rivalry, military conflicts, and incompatible values, fairness in trade practices is an ideal that most countries cannot afford. The changing landscape is summed up by Mario Draghi's observation on Europe's trade policies: "Our response has been constrained because our organization, decision-making, and financing are designed for the world of yesterday – pre-COVID, pre-Ukraine, pre-conflagration in the Middle East, pre- the return of great-power rivalry."

Qianwan container terminal of Qingdao Port in Qingzhou, China, on April 30, 2024

Looking ahead, I expect more protectionist policies to be adopted by major economies. Smaller countries, unfortunately, may be at the mercy of major economic powers and will need to join trading blocs based on shared interests and values, as well as security concerns. Businesses, especially smaller companies with sizeable export exposure, will likely find it more challenging to navigate the evolving policy paradigm, trade barriers, and geopolitical realignment. These trends are inherently more inflationary, as protectionism tends to increase inefficiency, duplication of skills, and productive capacity.

A Mixed Macro Backdrop

From the nadir of last autumn's stock market correction on October 27, 2023, to the S&P 500 Index's all-time-high on March 28, 2024, the Index had rallied 27.6%. However, the market's 2024 EPS expectation for the Index has declined from 246 per share last October to 242 per share halfway into the current earnings reporting season. In other words, the Index's price appreciation was all due to valuation expansion.

During the first half of that impressive market rally, investors rationalized the valuation expansion by pointing to a Goldilocks environment – rapidly falling interest rates and inflation, still healthy economic expansion, and imminent monetary easing by the Fed. However, these drivers have all reversed in April: inflation was recognized as stickier-than-expected after the release of the March CPI report; the Fed began to backpedal on the timing and scale of rate cuts; and the 10-year Treasury yield decisively surged above 4.5% and traded as high as 4.7%. It did not help that geopolitical tension in the Middle East flared up again, and 1Q24 corporate earnings results were rather mixed.

The less friendly macro backdrop triggered an overdue equity pullback: the S&P 500 and NASDAQ 100 Indices have experienced drawdowns of 5% and 7% respectively so far in 2024, and the once red-hot semiconductor index has declined by as much as 17% from its peak. These are rather run-of-the-mill pullbacks as stocks

A MIXED MACRO BACKDROP

are not supposed to go up in straight lines. However, with the 10-year Treasury yield hovering around 4.65%, the S&P 500 Index's current-year price-to-earnings ratio of 21 times is still on the expensive side. If one assumes a reasonable equity risk premium in the range of 75 bps to 150 bps over the 10-year Treasury yield, the Index's "fair" P/E range would be roughly 16.3x to 18.5x, substantially below the current level. That said, the Index does not have to settle in the "fair" range and can remain elevated for an extended period of time if the liquidity backdrop remains favorable.

The consensus view among market technicians is that the S&P 500 Index has fairly strong support in the 4,700 to 4,800 range. The market's liquidity backdrop has also started to improve after the tax filing season drained some liquidity. The question is whether the rebound would break to new all-time highs given the elevated valuations.

For investors who make tactical asset allocation changes based on the business and market cycles, it's been difficult to gauge if we are currently in the early, mid, or latter part of a business cycle. The tsunami of fiscal stimulus since the spring of 2020 has distorted traditional market signals and cycle analyses. Indeed, economic data have been somewhat schizophrenic of late – e.g., the conflicting data from the establishment and household surveys on the strength of the job market, and weak restaurant performance vs. strong travel demand – that one can cherry-pick data supporting either a recessionary or resilient outlook. This mixed macro backdrop has also resulted in rapidly shifting monetary policy expectations.

The market has slashed the expected number of Fed funds rate cuts in 2024 from nearly seven in early January to less than two. However, if the unemployment rate rises to and stays above 4% for a couple of months, the Fed will likely pivot back to start easing imminently.

The recent surge in Treasury yields has made the risk/reward of extending fixed income duration more attractive. Once the Fed starts to taper the pace of quantitative tightening, the Fed will be buying more Treasuries each month to limit the runoffs in its securities holdings. There is also the risk that the U.S. economy weakens materially in 2025, after the "sugar high" from the unprecedented fiscal stimulus wears off. Given the recent stickiness in inflation, a mild recession may still be a prerequisite for taming inflation cyclically. On a secular basis, the inflation outlook will depend on the push and pull between the disinflationary AI advancement and inflationary protectionism. The latter probably has a stronger impact in the next few years as it will likely take some time for AI to materially transform various industries.

Lastly, I find it interesting that the New York Stock Exchange (NYSE) has floated the idea of 24-hour stock trading, which would mirror the round-the-clock, uninterrupted trading of cryptocurrencies. Such a move would be great for day traders who are itching to make a bet any time, any place. However, for those who invest for the long run, is round-the-clock trading necessary? There is a big difference between trading and investing – the latter probably would not mind if the stocks they invest for the long run only trade a few times a year.

The move to 24-hour stock trading would change many existing practices such as companies announcing earnings results and potentially market-moving news after the market is closed. For sell-side analysts, instead of issuing post-earnings analyses and rating changes by the following morning, as is the current practice, they would have to rush out their reports. Wall Street would also need to rearchitect the current settlement process.

Speaking of the settlement process, the industry is about to implement the "T+1" settlement process starting on May 28, 2024. This shortened settlement cycle is mandated by regulators including the Securities & Exchange Commission (SEC) and Financial Industry Regulatory Authority (FINRA).

Currently, it takes two business days after a trade is transacted, or "T+2", to settle the trade – transferring the securities to the buyer's account and cash to the seller's account. "T+1" will have the settlement done in one business day after the trade date. To most investors, "T+1" will not change anything other than having faster access to funds and securities. Please let your advisors know if you have any questions.

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