ROCKEFELLER
GLOBAL FAMILY OFFICE

CIO MONTHLY PERSPECTIVE

AUGUST 2023

The Regulatory Golden Rule

Whoever has the gold makes the rules

Market Watch

Equity Market Indices[1]	6/30/23 Price	7/31/23 Price	MTD Change	YTD Change
MSCI All Country World	683	707	3.6%	16.8%
S&P 500	4450	4589	3.1%	19.5%
MSCI EAFE	2132	2199	3.2%	13.1%
Russell 2000®2	1889	2003	6.1%	13.7%
NASDAQ	13788	14346	4.0%	37.1%
TOPIX	2289	2323	1.5%	22.8%
KOSPI	2564	2633	2.7%	17.7%
Emerging Markets	989	1047	5.8%	9.5%
Fixed Income				
2-Year U.S. Treasury Note	4.90%	4.88%	-2	45
10-Year U.S. Treasury Note	3.84%	3.96%	12	9
BBG U.S. Agg Corp Spread	1.23%	1.15%	-8	-15
BBG U.S. HY Corp Spread	3.90%	3.71%	-19	-98
Currencies				
Chinese Renminbi (CNY/$)	7.25	7.14	-1.5%	3.5%
Brazilian Real (Real)	4.79	4.73	-1.2%	-10.5%
British Pound ($/GBP)	1.27	1.28	-1.0%	-5.9%
Euro ($/Euro)	1.09	1.10	-0.8%	-2.7%
Japanese Yen (Yen/$)	144.31	142.29	-1.4%	8.5%
Korean Won (KRW/$)	1317.75	1274.55	-3.3%	0.7%
U.S. Dollar Index (DXY)	102.91	101.88	-1.0%	-1.6%
Commodities				
Gold	1919	1965	2.4%	7.7%
Oil	70.6	81.8	15.8%	1.9%
Natural Gas, Henry Hub	2.80	2.63	-5.9%	-41.1%
Copper (cents/lb)	374	401	7.1%	5.2%
CRB Index	262	282	7.7%	1.6%
Baltic Dry Index	1091	1110	1.7%	-26.7%

Source: Bloomberg

INTRODUCTION

Summer of 2023 has so far featured the most intense heat waves in modern history, with July 4 being the hottest day on record, according to various climate-tracking organizations. Meanwhile, stock markets around the globe have also been sizzling hot, with the return of Goldilocks in the U.S. and artificial intelligence (AI) being the dominant market-moving narratives. The “advance” estimate of second quarter real GDP (gross domestic product) growth came in at 2.4% annualized, much better than the market’s 1.8% forecast. Investors were also heartened by softer-than-expected inflation data, with the latest Consumer Price Index (CPI) reading dipping down to 3%. This Goldilocks combination has prompted the Fed to upgrade its assessment of U.S. economic growth from “modest” to “moderate,” and Chair Powell indicated that his staff is no longer forecasting a recession. However, as insurance against inflation flaring up again, the Fed raised the Fed funds rate by 0.25% to a range of 5.25% to 5.50% at the July FOMC (Federal Open Market Committee) meeting and signaled that future decisions will be data dependent.

Ironically, the S&P 500 Index’s year-to-date (YTD) price appreciation was practically all realized after the collapse of Silicon Valley Bank – the Index was up a mere 0.6% YTD at the March 10 close. While many had feared that the banking crisis would result in a credit crunch that could eventually push the economy into recession, the consensus today is that the crisis was merely a hiccup; the common refrain among regulators is that the U.S. banking system is “sound and resilient.” That said, there appears to be a slow-motion credit squeeze that will gradually weigh on growth. Aggregate credit offered by U.S. commercial banks has been shrinking sequentially. On a year-over-year basis, the aggregate bank credit growth rate has fallen from 5% in early March to roughly flat by late July. In a credit-driven economy, this contraction will pressure growth, albeit with a delay.

While I believe it is premature to dismiss the risk of recession, the market’s collective psyche wants to embrace positive narratives and move higher (please see my recent report *The Relentless Grind Higher* regarding the catalysts for the rally). Momentum begets more momentum, even though various sentiment indicators have moved into “extreme greed” territory. While these sentiment indicators may not be ideal market timing tools, they have often coincided with interim market tops in the past. In short, I would tread carefully in the face of frothy sentiment and still uncertain fundamentals.

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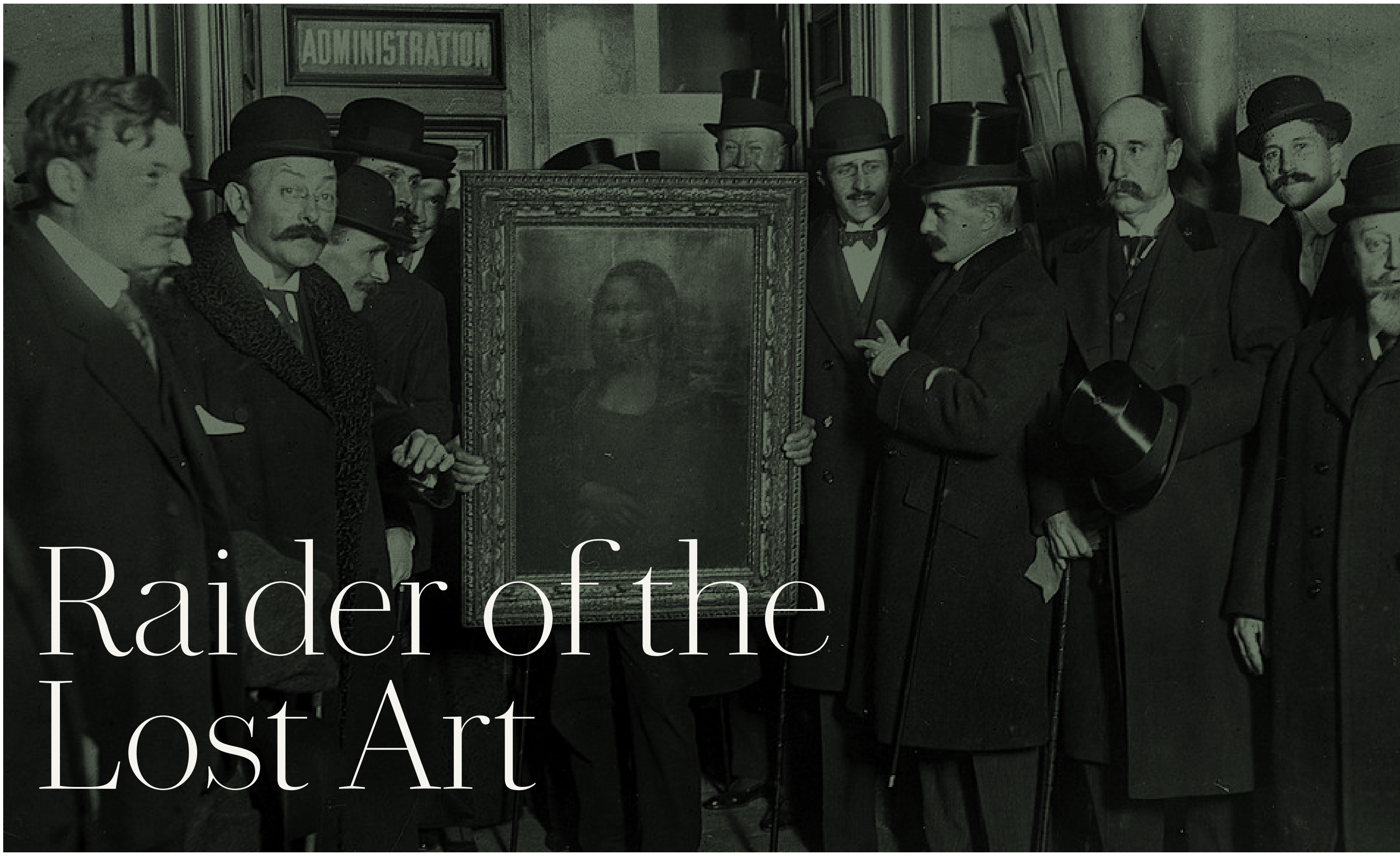
Raider of the Lost Art



People gather around the Mona Lisa painting on January 4, 1914 in Paris France, after it was stolen from the Louvre museum by Vincenzo Peruggia in 1911.

On the morning of Tuesday, August 22, 1911, Louis Béroud entered the Louvre Museum's iconic Salon Carré, a gallery showcasing Renaissance-era paintings, to sketch a masterpiece by Leonardo da Vinci. To his surprise, *La Joconde* (aka the *Mona Lisa*), the centerpiece of his work titled *Mona Lisa au Louvre*, was conspicuously missing – there were four iron hooks hanging off the wall where the painting was normally displayed. Béroud asked the guard about the painting's whereabouts, and the retired army officer said it was probably with photographers who were tasked with cataloging the museum's entire collection. When Béroud returned a few hours later, he was frustrated that the painting was still missing and prodded the guard to find out when it would be returned. Panic set in when the guard learned that none of the photographers had seen the painting that day. The acting director of the Louvre ordered a frantic search to no avail. After the police showed up in the afternoon, the museum was shut down and cordoned off.

The theft of the Mona Lisa made newspaper headlines across the Western world, with photos of the enigmatic smile prominently featured on the front pages. A New York Times headline read, "60 Detectives Seek Stolen 'Mona Lisa,' French Public Indignant." The police distributed thousands of leaflets featuring the painting and offered a reward of 40,000 francs. Some speculated that the theft was commissioned by a greedy American robber baron. When the Louvre reopened after a weeklong search and interrogation, visitors queued up, with novelist Franz Kafka among them, just to see the empty space on the wall where the portrait used to hang.

By early September, there appeared to be a break in the case as police zeroed in on two foreigners as suspects – Guillaume Apollinaire and Pablo Picasso, two bohemian characters in the Parisian art circle. Apollinaire was a renowned poet and art critic of Polish descent. He had coined the term "Cubism" and was a big proponent of avant-garde movements. His friend Picasso, then 30 years of age, had relocated from Spain to Paris seven years earlier and was already a leading figure in modern art.

Privately, Apollinaire and Picasso were worried that they could be implicated because of their association with Honoré Joseph Géry-Piéret, Apollinaire's former secretary who had a history of stealing from the Louvre. Picasso had even purchased two stolen Iberian statuettes from Géry-Piéret that served as inspiration and models for Picasso's controversial but revolutionary cubist painting, *Les Demoiselles d'Avignon*, in 1907. Apollinaire also owned a stolen statuette prominently displayed on his mantelpiece.

Fearful of being implicated for the theft, they contemplated fleeing the country but settled on a plan to eliminate any incriminating evidence by dumping their stolen statues into the Seine. Late one night, they left their homes toward the river with the statues hidden in a suitcase, but their mutual conscience and love of art stopped them from destroying the ancient artifacts. Apollinaire then arranged for an intermediary to return the statuettes to the museum. However, when interrogated by the police, the intermediary broke his vow of silence and ratted Apollinaire out.

The police apprehended Apollinaire and Picasso and searched their apartments. The press were only too happy to sensationalize the possibility that radical foreign artists were behind the theft. During interrogation, the two hapless men turned hysterical, weeping and begging for mercy. However, the police were only able to get them to confess to knowingly purchasing stolen statues, and they were released a few days later. As months dragged on and turned into years, the case turned cold, and many had given up hope of ever finding the Mona Lisa.

During the autumn of 1913, Italian art dealer Alfredo Geri placed an ad in several newspapers stating that he was "a buyer at good prices of art objects of every sort." In November, he received a letter signed by a "Leonardo" who claimed to be in possession of the missing Mona Lisa. The return address was a post office box in Paris. Intrigued, Geri expressed his interest in pursuing a deal. The exchange of letters resulted in "Leonardo" agreeing to bring the painting to Geri.

On December 10, a short mustachioed Italian man under the alias Leonardo Vincenzo showed up at Geri's office. He said he had stolen the Mona Lisa two years ago with the noble intention of returning it to Italy as he believed the painting was plundered by Napoleon's army. He demanded that the portrait be displayed at the Uffizi Gallery in Florence, and to be paid 500,000 Lira for his service. The following day, Geri and Giovanni Poggi, the director of the Uffizi Gallery, showed up at Vincenzo's hotel to examine the artwork. Vincenzo opened a wooden trunk, removed his belongings, and pulled out a false bottom; there laid the 30-by-21-inch oil-on-wood-panel painting wrapped in red silk. Poggi examined it and confirmed that it was the real deal based on the Louvre's catalog number on the back, which would not be known to forgers. The three men brought the painting to Uffizi, and Poggi and Geri somehow convinced Vincenzo to leave the painting in the gallery for further authentication while preparing the reward money. The unsuspecting Vincenzo cheerfully returned to his hotel room, only to be apprehended by police acting on Poggi's tip. The greatest art heist thus ended with a whimper.

RAIDER OF THE LOST ART

It turned out that “Leonardo Vincenzo” was born Vincenzo Peruggia in Italy on October 8, 1881, 17 days before Picasso. He had also migrated to Paris as an aspiring artist but wound up working as a housepainter. Having worked at the Louvre for a few months as a handyman, he was familiar with the museum’s lax security. On the morning of Monday, August 21, 1911, he entered the museum’s employee entrance wearing a white smock that made him indistinguishable from other workers. Since the museum was closed to visitors on Mondays, Vincenzo simply walked up to the Mona Lisa, the smallest painting in the room, lifted it off the iron hooks, and carried it to a service staircase. There he removed the protective case and walked out of the museum with the painting wrapped in his white smock. He then kept the Mona Lisa in the wooden trunk in his Paris apartment for more than two years before seeing and responding to Geri’s ad.

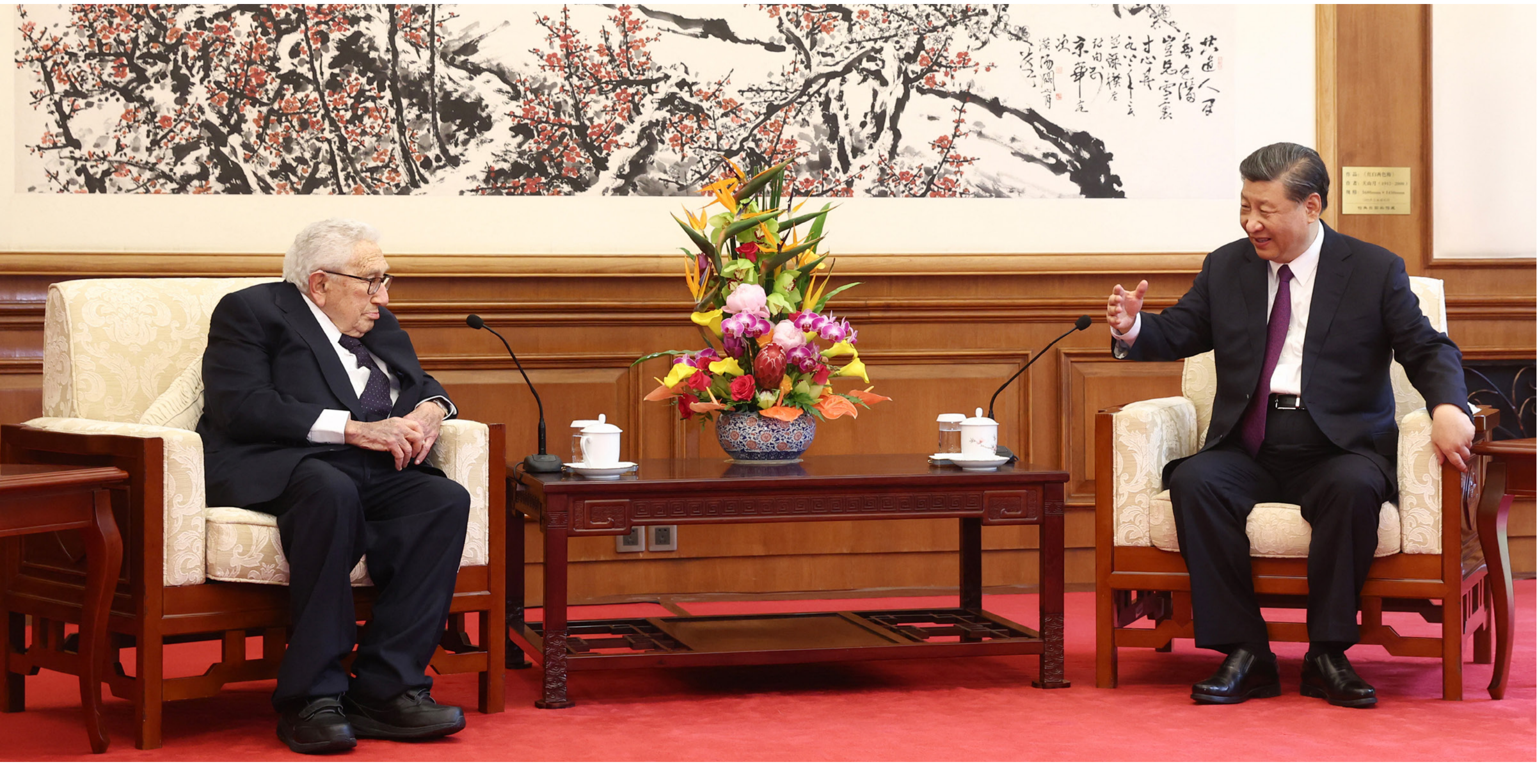
Peruggia was hailed as a national hero by many Italians and wound up serving only seven months in jail for committing the greatest art heist of the century. Back in Paris, Apollinaire and Picasso’s names were finally cleared, but the latter was haunted by the experience. Decades later, Picasso would lament that he still felt ashamed for buckling under pressure during the intense interrogation in 1911 – he told the judge that he did not know Apollinaire and would never forget his friend’s facial expression upon hearing this cowardly dissociation.

After several weeks of exhibition in Italy, La Joconde was escorted back to the Louvre with much fanfare on January 4, 1914. More than 100,000 visitors lined up to see the painting during the first two days after her return to the Salon Carré. Peruggia’s brazen heist had unwittingly catapulted the Mona Lisa into ubiquity and made it the most recognizable and valuable artwork in the world.

A Short-form Video Controversy

On January 7, 2023, a TikTok user named @narvanator posted a 10-second video showing police cars, sirens blaring, racing past the Arc de Triomphe. The video featured the caption, “POV: your [*sic*] in Paris when the Mona Lisa has been stolen.” Two days later, he followed up with an 18-second video claiming to have visited the Louvre and spoken with the staff to confirm that the painting was gone. The videos went viral around the world, sending millions of viewers into a tizzy. A few weeks later in China, WeChat and Douyin (the Chinese version of TikTok) users started circulating fake news that Henry Kissinger, the architect of Nixon’s triangular diplomacy that paved the way for China’s meteoric rise on the global stage, passed away at age 99. The fake news was so widespread that several of my own friends in China reached out to me for confirmation.

In the last few weeks, Kissinger has once again been trending on WeChat and Douyin. Chinese netizens were impressed that the centenarian had just flown to Beijing to meet with Chairman Xi, and legions of armchair foreign policy experts were pontificating on the significance of this visit. The ability for anyone to post on social media and the potential for them to go viral have disrupted the media industry for years. However, the meteoric rise of TikTok, owned by Chinese internet company ByteDance, has raised the alarm among Western regulators. Sensitive user data from the app, such as browsing history, preferences, and biometric identifiers, can potentially be passed on to the Chinese government.



China's President Xi Jinping (R) speaks with former US secretary of state Henry Kissinger during a meeting in Beijing on July 20, 2023

According to the recently published Digital News Report from the Reuters Institute for the Study of Journalism, TikTok is the fastest growing major social media app globally, especially among younger users – it reaches 44% of 18 to 24-year-olds, and 20% of that age cohort uses it for news. What makes TikTok especially addictive is its powerful personalized content feed, which has an uncanny ability to serve up just the right content based on each user's interests and preferences. It's something every social media platform does, but the app has created a more effective algorithm which works on both ends – figuring out what keeps a user engaged with an artificial intelligence-based recommendation engine and mining a huge database of content with a methodology nicknamed "gravedigger" to curate personalized videos.

With TikTok possessing intimate knowledge of its users' preferences, biases, and beliefs, experts believe that the company can use this treasure trove of data to develop psychogenic profiles of its users and implement its sophisticated algorithm to mold public opinion.

At a Congressional hearing last March, TikTok's CEO, Shou Zi Chew, a Harvard-educated Singaporean, tried to assure Americans that the company's $1.5 billion "Project Texas" will ensure that all U.S. data is secured in U.S.-based data centers run by Oracle. Lawmakers were unconvinced, citing Chinese national security laws that can compel Chinese companies, such as ByteDance, to hand over data requested by the Chinese government. Chew's credibility took a hit a few weeks later when a Forbes investigation found that the company has stored sensitive information of the app's biggest American and European content creators, such as social security numbers and tax forms, in China.

During the Congressional hearings on TikTok in the first quarter of this year, there was much support behind an idea first proposed by the Trump Administration in 2020 – banning TikTok from

THE TIKTOK CONTROVERSY

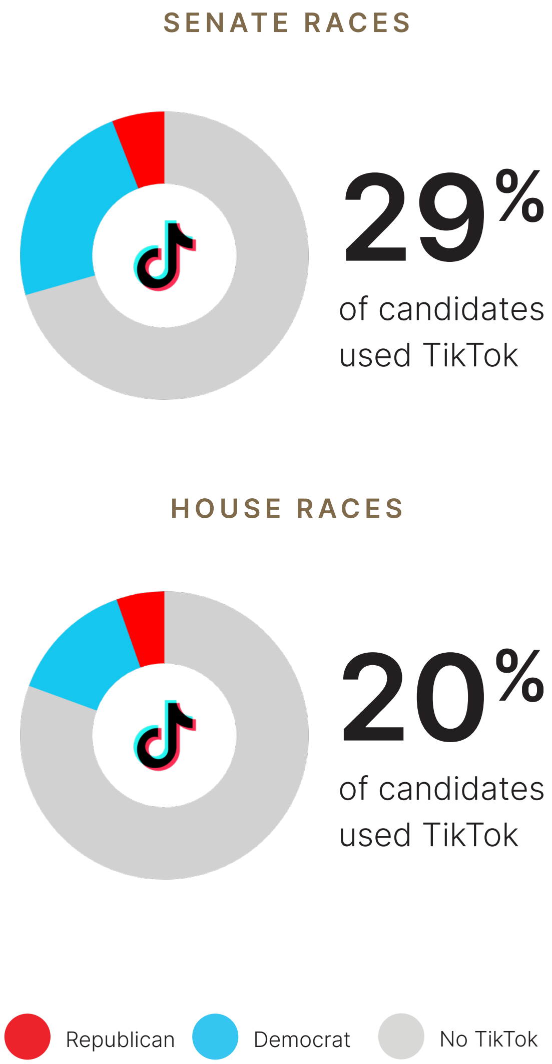
operating in the U.S. or forcing ByteDance to sell it to an American company. However, as the debt ceiling debate subsequently sucked the oxygen out of the legislative agenda, Washington's anti-TikTok movement began to lose steam, and the company seized the opportunity to lobby aggressively against what some consider to be a broad expansion of government power.

Blocking access to TikTok will be legally challenged by free speech groups and is difficult to enforce as the Internet does not offer a single choke point. A forced sale may be the "easier" solution, but the Chinese government will likely play hardball. There is also a political issue with young voters – lawmakers do not want to risk upsetting TikTok's 150 million American users. Some politicians in the 2024 election season may face an awkward position of campaigning against TikTok while campaigning on TikTok.

According to the bi-partisan transatlantic national security advocacy group, the Alliance for Securing Democracy, during 2022's midterm elections, 20 of the 68 Senate candidates had TikTok accounts – 16 Democrats and 4 Republicans. In the House races, 165 of 799 candidates – 112 Democrats and 43 Republicans – had a presence on the platform. These numbers are likely to increase by the 2024 general election, especially among Democratic candidates who count on support from younger voters. With TikTok not accepting political advertising, politicians will need to court influencers and mobilize their supporters to create positive content on the platform about their campaigns.

This balancing act is summed up by one congressional member who told the media in March, "I'm sensitive to the ban and recognize some of the security implications. But there is no more robust and expeditious way to reach young people in the United States of America than TikTok."

2022 MIDTERM ELECTIONS



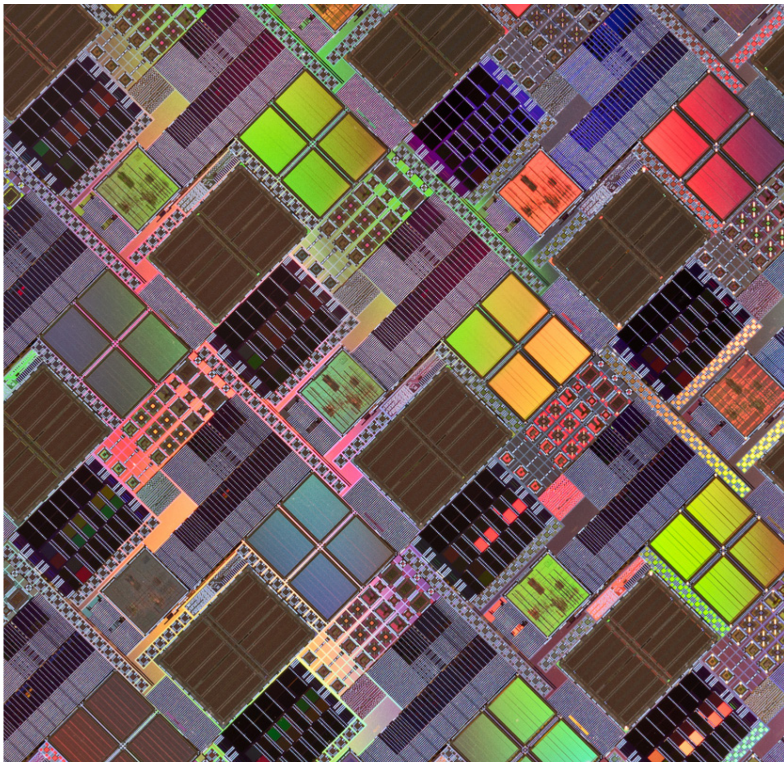
Source: Alliance for Securing Democracy

The Export Control Cat & Mouse Game

TikTok's superior algorithm is one example of the tremendous progress that China has made in technology. According to the Australian Strategic Policy Institute, which launched a "Critical Technology Tracker" in March 2023 to monitor the relative competitiveness in high-impact research among countries, China leads the world in 37 out of 44 technologies. For some technologies, China has the world's top ten research institutions and generates nine times more high-impact research papers than the second-ranked country, which is often the U.S.

After several decades of enabling China's technological advancements with technology transfer, investments, and talent development, our elites have belatedly realized that the "disciple" is no longer willing to play by the "shifu's" rules. Many on Wall Street and in Corporate America were initially critical of the Trump Administration's "trade war" and tighter export controls against China, and some were expecting the Biden Administration to dial down the tension. To their and China's surprise, the Biden Administration went even further than its predecessor and has been prodding our allies to go along with our containment policies.

A key pillar of the U.S. strategy in the technology race is to limit China's access to the most cutting-edge semiconductor technologies since microchips are the brains that control everything electronic. There is the saying that software will eat the world, but what good is software if there is no hardware to run on? In the



race between China and the U.S. for AI supremacy, which is vital to not only economic but also national security interests, U.S. policymakers believe that China's progress will be stunted if they cannot access innovative processors to develop sophisticated AI systems that can be weaponized.

The Commerce Department's Bureau of Industry and Security (BIS) is tasked with regulating the export of sensitive goods and technologies. In 2022, the BIS informed Nvidia that it would need to obtain the agency's approval to export the company's flagship A100 and H100 chips to China. These chips are

THE EXPORT CONTROL CAT & MOUSE GAME

designed for high-performance, data-intensive applications such as neural network training and astrophysics.

The export restriction has created a cat-and-mouse game between the regulator and the regulated. To circumvent the export control, U.S. semiconductor companies would simply design watered-down versions of their leading-edge AI chips for China. For example, Nvidia worked around the export restriction on the A100 by offering the A800 processor that merely operates at a lower connection speed (400 gigabytes per second vs. the A100's 600 gigabytes per second). Intel just held an event in Beijing to introduce its made-for-China AI chip, Gaudi2, with support from major Chinese AI server providers. In reaction to these moves, the BIS is expected to further tighten export restrictions.

These chess moves have spawned a thriving microchip black market as well as preemptive purchases by Chinese technology companies. It is reported that in early 2023, TikTok's parent company ordered more than $1 billion worth of Nvidia's high-end processors, or roughly 100,000 units, in order to front run further BIS restrictions. Other Chinese tech leaders such as Alibaba and Baidu have also been aggressive in ordering and hoarding these valuable commodities.

Nvidia investors have certainly been happy with the explosive order growth from China. ByteDance's alleged $1 billion order alone amounts to 4% of Nvidia's trailing 12-month revenues. Taken together, these orders from China played a key role in powering Nvidia's market cap to above $1 trillion. However, upon reflecting on the potentially dystopian uses of these powerful processors – draconian surveillance, bioengineering, or lethally autonomous weapons – one may wonder if it's morally right for U.S. semiconductor companies to circumvent the spirit of our export controls.

China will manage to remain competitive with the U.S. even with these "watered-down" processors; it just means that computing tasks will take 10% to 30% longer to complete. As such, what have these export restrictions accomplished? If the U.S. government's goal is to prevent our most formidable strategic competitor from leveraging AI to outcompete us, perhaps alternative measures are needed. However, it is hard to separate commercial uses of these advanced processors from military applications. As for impact investors, are they willing to pressure U.S. semiconductor companies to voluntarily refrain from selling even "watered-down" processors to China?

I suppose no investors or corporate executives are willing to take such a big hit, a move equivalent to committing business suicide. This dilemma sadly reminds me of a quote attributed to Vladimir Lenin, "The Capitalists will sell us the rope with which we will hang them."

The Regulatory Golden Rule

When Picasso settled in Paris for good in 1904, France was one of the most immigrant-friendly countries in Europe. Industrialization increased demand for labor, skilled and unskilled, and immigrants from Southern European countries such as Portugal, Spain, and Italy filled this need. After WWII, France once again faced labor shortages as able-bodied people were needed for construction jobs to rebuild the country. However, with the rest of Europe also in need of labor for reconstruction, France had to recruit labor from its former North African colonies. As the post-war reconstruction boom slowed by the 1960s, public support for immigration started to wane. By the 1970s, rising unemployment started to expose social and cultural integration issues which have persisted to this day.

On June 27, 2023, a 17-year-old French citizen of Moroccan and Algerian descent was fatally shot by police in a suburb of Paris. In the words of President Macron, the "inexplicable and inexcusable" killing triggered protests and riots across the country. It was estimated that 200 businesses were thoroughly looted, 300 banks were destroyed, and 25 supermarkets were burned to the ground.

As French authorities tried to get the situation under control, social media was unsurprisingly made a scapegoat. President Macron and various politicians blamed TikTok and Snapchat for enabling its youth to post controversial content to organize and encourage rioting and violence. Macron even threatened to cut off access to social media if things escalated further. While social media indeed has numerous issues, cutting off access to it seems rather anti-democratic.

THE REGULATORY GOLDEN RULE

In the U.K., the controversial Online Safety Bill, which is supposedly designed to make the Internet safer by cracking down on illegal content, has run into stiff opposition from free speech advocates as the government would be empowered to conduct routine monitoring of private communications. Apple, Meta, and various tech companies warned that they may pull their messaging and social media apps out of the country since the proposed law would allow the U.K. government to become the de facto global arbiter of what level of private data security and encryption are permissible. Meredith Whittaker, the President of the Signal Foundation, an American non-profit open-source privacy technology organization, warned that the law could lead to U.K. residents having to download spyware that checks if their messages are permissible to be sent. Conducting censorship at each user's device rather than in the cloud is ingeniously Orwellian and would make North Korea and other totalitarian regimes green with envy.

At the heart of the issue is that existing regulatory and legal frameworks cannot keep pace with the rapidity of technological advancement, which can be highly disruptive and unsettling. The concentration of power – economic, social, and technological – among a handful of transnational corporations has bred public anxiety and mistrust. Various interest groups also have widely disparate expectations on how these leading companies should behave. With AI potentially enabling Big Tech companies to disrupt even more industries and businesses, including their own, the call for regulation will only grow stronger, but there is no consensus on how these fast-evolving industries and companies should be regulated.

Here in the U.S., Big Tech has been criticized by both sides of the political aisle, with one side complaining about censorship and the other asking for more. Both sides agree that U.S. Big Tech companies pose the same threats that TikTok does, with the difference being who owns the data. The Biden Administration has a love-hate relationship with these companies. It has been so active in getting social media companies to suppress undesirable messages and netizens that a federal judge has issued an injunction barring the Department of Health and Human Services and the FBI from reaching out to them "for the purpose of urging, encouraging, pressuring, or inducing in any manner the removal, deletion, suppression, or reduction of content containing protected free speech."

On the other hand, the Federal Trade Commission (FTC), under the leadership of Chairwoman Lina Khan, has been aggressive in filing antitrust lawsuits in an attempt to stymie Big Tech's vast power and influence. However, two recent legal setbacks for the FTC – failing to stop Meta from acquiring a virtual reality startup and losing the high-profile case against Microsoft's takeover of video game giant Activision Blizzard – have raised doubts on the government's ability to clip the wings of Big Tech.

The FTC's legal setbacks and deep division between the blue and red parties means that, at least in the near term, Big Tech will continue to enjoy the Golden Rule in the U.S. – whoever has the gold makes the rules. However, regulatory risks remain elevated in Europe where governing bureaucracies often resort to protectionist measures to make up for their deficiency in competitiveness.

Borrowed Prosperity

Hanging in the Louvre Museum behind layers of bulletproof glass, the Mona Lisa now graciously greets American tourists who flock in for their obligatory selfies with her. The revenge travel wave is bringing more Americans to Europe this summer than ever, according to global travel data provider Official Airline Guide, which expects the number of flights between the U.S. and Western Europe to hit new record highs during this period.

Leisure travel is important to Gen Z and Millennials, 84% of whom would rather take a dream vacation than purchase a new luxury item, according to American Express Travel's 2023 Global Travel Trends Report. Unlike their parents and grandparents, these cohorts view travel as a budget priority rather than something discretionary. It may be partially inspired by the desire to keep up with the Joneses on social media.

Spending on leisure and travel has been partially facilitated by more than three years of student debt forbearance, which has benefited roughly 27 million borrowers. The bad news is that most of them will have to resume their monthly payments starting in the fourth quarter. This comes at a time when credit card and auto loan delinquency rates among 18 to 29-year-olds have been rising rapidly despite the strong job market.

Another potential headwind is that spending from the excess savings built up between 2020 and 2021, which has been boosting the economy to the tune of tens of billions of dollars a month, will eventually be exhausted. Some suspect this could happen by late 2023 or early 2024.

Businesses may have started to worry about the potential drags on consumer spending. According to Chris Williamson, Chief Business Economist at S&P Global Market Intelligence, the firm's July business activity surveys showed that business optimism about the year-ahead outlook has deteriorated sharply to the lowest level seen so far in 2023. Despite the cautious tone from various surveys, the U.S. economy has proven to be more resilient than expected. One of the drivers has been Washington's aggressive deficit-financed spending. At the end of June, nine months into the current fiscal year, federal outlays were 10% above the comparable period's spending in FY2022, and the deficit for these nine months has hit $1.4 trillion, which exceeded FY2022's full year deficit ($1.38 trillion) and the White House's $1.18 trillion projection for the entirety of FY2023.

With no debt ceiling to constrain spending until January 2025, the aggressive fiscal spending will likely continue in 2024, a general election year. Washington's pro-cyclical fiscal policy has diminished the odds of recession, though it is also complicating the Fed's price stability mandate. Aggressive fiscal spending lessens the impact of monetary tightening and risks rekindling inflation. The Fed has indicated that it intends to keep rates higher for longer, but it will feel the heat from politicians who prefer an easing bias in an election year.

BORROWED PROSPERITY

For investors, the absence of a pronounced business cycle creates a trickier environment to navigate. A recession, however painful to those negatively impacted, is the tough medicine required to cure the economy of elevated inflation and restructure zombie companies in order to set the stage for several years of expansion. On the other hand, the continuation of the current muddle-through environment, supported by increasingly costly deficit spending, will keep both inflation and recession risks alive. Equities will likely be range-bound and dominated by sector rotation. The yield curve may become less inverted with longer-dated bond yields climbing somewhat higher and shorter-term rates staying elevated. Higher bond yields will in turn weigh on borrowers, resulting in even more bankruptcies.

In the final analysis, the overriding investment question comes down to whether this time is different thanks to the unusually strong fiscal largess. In a world where the proverbial free lunch does not exist, Uncle Sam's fiscal largess is becoming more expensive – interest outlays are approaching $1 trillion this year and the surging debt service burden could precipitate a potentially vicious cycle down the road. While Fitch's downgrade of the U.S. credit rating from AAA to AA+ is widely criticized, its rationales – erosion of governance, rising deficits and debt-to-GDP in the years ahead – are hard to argue against.

The salvation will need to be a material rise in productivity, courtesy of the AI revolution, and government subsidized projects yielding real dividends. I am more optimistic about the former than latter, as anything involving the government runs the risk of being bogged down by red tape.

As someone who has seen many promises of "this time is different" being dashed, my base case remains a recession in the not-too-distant future, though this view is clearly challenged by the evolving consensus and still resilient job market. Given my cautious view and the run up in major equity indices – all driven by valuation expansion rather than solid growth in earnings expectations – I would deploy capital opportunistically on general market or company-specific pullbacks, as nothing moves in a straight line, even in a trending market. With the benefit of hindsight, I regret not having heeded Warren Buffet's "be greedy when others are fearful" advice. On the other hand, the Oracle of Omaha also said, "Be fearful when others are greedy."

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