Artificial Intelligence (AI) vs. Artificial Stupidity (AS)

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Moving on and moving out

May was a big "moving" month for the Holperin family. Daughter Arianna found a really cute apartment built into the second story of an older barn on a farm parcel outside of Lodi, Wisconsin. She is 23 now but this is her first move out of Rhinelander and so of course, I had to do the decent thing and help her haul her life's possessions to the new crib. That was on the 6th of May. Four days later mom and dad travelled to New Brunswick, New Jersey (with a larger trailer in tow) to first attend the graduation ceremony of son Max, and then pack up all of his belongings to bring them back to the Midwest. Max is now officially done with his formal education, receiving a Masters of City and Regional Planning degree (M.C.R.P.) from Rutgers. He will be headed to Bloomington, Minnesota to begin his first career job with Walker Consulting (a national firm with 27 locations), specializing in planning and mobility with an emphasis on parking solutions. It's been quite a whirlwind.

Serial Bubbles

"Buy low, sell high." Sounds simple enough, right? This is the one pearl of wisdom that, if observed over a lifetime of investing, could lead to long-term success. "*Buy when others are fearful, sell when others are greedy"* said famed investor Warren Buffett. *"Don't panic. The time to sell is before the crash, not after."* -Sir John Templeton, who also advised, *"Remember, no investment is forever".*

Hindsight is a funny thing. It is obvious now when looking at charts that the growing stock bubble that had fomented for over a decade now crested in 2021 and began to pop in 2022. This wasn't just one investment theme lasting over a decade, but rather, it's been a series of themes and mini-bubbles that eventually morphed into the granddaddy of all stock bubbles. In the end it was a wild-eyed speculative orgy in orders of magnitude above the others and perhaps driven in part by the massive amounts of government handouts and largesse post-pandemic. In the final analysis, scores of individual stocks have soared and then rapidly (and completely) collapsed. How big were the moves? Many that were previously in the $20s and $30s per share (with some even in the $100s per share) can now be bought for under two bucks a share.

Anyone involved in markets for any length might be aware that the first bubbles to pop usually aren't the last to do so. Speculators will speculate, always on the hunt for the next shiny object. Wildly over-priced markets that collapse usually don't occur in isolation, but rather, there's a series of collapses led by the weakest and least liquid of stocks first, followed by the larger and more liquid of names next. The giants are usually the last to fall, thus bookmarking the end of a major half-cycle. The other half-cycle is the subsequent bear market cycle which actually has its origins in the late stages of the prior bull market. As more stock price deflation occurs we will eventually have the evidence that a new half-cycle (bear) is already here, and may intensify going forward. As always, bear markets, just like bull markets before them, are not obvious in the early stages. They are more easily identified in their later stages, as in, "Oh gosh, it looks like we're in a bear market!" But, first things first, in the short run it appears that at this moment the line of least resistance is still "up".

Arianna's New Apartment in Lodi

How They Start

Every bull market is built around a theme. Investment themes at their earliest stages often involve a niche business that at some point captivates the imagination of its promoters. Those on the ground floor race to get out in front of their competitors. More often than not, the general public is almost completely oblivious to the earliest developments that lead to these thematic bullish episodes. Consider those of the recent past. Think of the "Dot-Com" boom of the late 90s. Although online sales started with the advent of web-based search engines, the public participation came several years later, ultimately gorging on nearly any stock with an online sales platform whether or not there were any actual revenues. As an important side note, this early speculative frenzy preceded the development of the highly sophisticated delivery network that would be necessary to get all those goods to their end buyers in reasonable time, a key requirement to the long-term sustainability of the concept. But in the heat of a market mania, that didn't matter. This speculative episode ended in tears when that bubble burst in the crash of 2000-01 and left many late investors holding the bag of deeply devalued shares. Likewise, the 3-D printing mini-bull market that sent many stocks soaring in the 2012-2014 era actually had its origins much sooner, but the fascination with the concept that 3-D printing would revolutionize society had a relatively narrow window of time and resulted in a trading frenzy that saw many stocks melt up, only to collapse once that bubble burst. As was the case above, the late arrivals were once again the bag holders.

Then there was the mother of all bubbles in 2021 when speculators went crazy for many stocks, among them a non-business proposition. Venture capitalists figured out that there was so much speculative money sloshing around that they couldn't wait to get a business started, so instead they formed a shell entity called a "SPAC" a Special Purpose Acquisition Company that they could then worry about how to fill with an operating entity later. The proposition was that the proceeds from the SPAC could eventually be put to work by purchasing another business later, and thus there was no shortage of willing buyers for these empty offerings. No kidding; no business, just the intention of owning a business was the offer. This development just happened to coincide with another bubble event, the "meme" stock craze. All of this "crazy" in 2021 led to an eventual bubble bursting by late in the year and spilling into 2022, resulting in many more new bag holders.

I could give more examples, but hopefully you get the picture. The seed of a novel concept is planted, a limited number of investable opportunities takes root, the early-movers see significant investment gains as their story grows, and soon the bubble blossoms as word gets out and the masses arrive, capital in hand. Too few stocks with too little liquidity facing too high of demand for the available shares is the perfect formula for a roaring bull market. What truly amplifies the bubble is when other stocks get drawn into the mix that aren't core to the concept, but the general public doesn't care **as long as two conditions exist**: a believable story and upward momentum! Many times these thematic episodes become self-fulfilling success stories in and of themselves, but still end badly as valuations simply get way too far ahead of the reality of the underlying business models.

How They End

So how do bubbles end? Saturation? Over-owned? Over-loved? Over-valued? Exhaustion? Perhaps a combination of each of those? I've lived through many and I would submit that the common denominator to all stock market bubbles is that they **end in euphoria.** That is, just as deep bear markets end in panics, enduring bull markets end with just the opposite, a feeding frenzy at the top. There is no bell that rings and there is usually no singular event that can be identified as culprit for a shift of sentiment in the other direction. All of the reasons cited above combine to render topping action, but the ultimate top is not black and white, it is quite gray. As for the speculators, the first ones out are usually the only ones out. Thus, this brings us full circle to our current market conditions.

The Latest Bubble

The days of money-losing unicorn companies leading the stock market to rocket-shot highs from late 2020 through the first quarter of 2022 is well in the rear-view mirror and has been given a proper funeral, but the giants have yet to fall. There still appears to be some fight left in this very mature bull market. As I see it, the battle between the bulls and the bears is centered on the largest of tech companies with a particular focus on semiconductor, software, and tech platform companies. The dominant theme this time is Artificial Intelligence, or "AI". AI has captivated the imagination of speculators in a way that is rarely seen and it appears to still be gaining upward momentum. Scores of thought leaders, CEOs, and other corporate titans have made AI a centerpiece of their investor presentations and public talking points which just feeds even more into the self-reinforcing action mentioned above. The narrative is the trap for vast amounts of investment capital invading this space. AI is now everywhere.

However, there's one small issue that is important to know. It is not uncommon to see a higher number of casual investors come late to the thematic investments, and their late arrival is consistent with past late-stage bull market progressions. These later arrivals are what can feed more capital into the sector via late-stage fund sponsors and new investment product focused on that area that is most in demand. It might be naïve to think this is ground-breaking territory though as AI isn't new and many of the current AI concepts that are the juice behind the capital draws may not be ready for prime time, not that this matters to those who seemingly can't get enough of it. AI is actually decades old and is simply continuing to evolve as it always has, with science finding more and more ways to integrate it into our everyday lives. I've read research reports with financial projections tied to AI and from various new AI applications that could lead to tens of billions of dollars of future sales. I find this somewhat under-whelming when I do basic math and I see that the stock market valuations of the leading AI companies <u>are already measured in trillions!</u> This smacks of previous bubbles that have come and gone, where the fantasies of the future were just too far removed from the realities of the modern day. I understand that the world will be different because of AI, but conceptually many of those changes could still be a decade or more out. What many are calling Artificial Intelligence (AI) today is looking more and more like Artificial Stupidity (AS) to me. It can never be known in advance how far and how high prices can go, but there is more than enough examples of recent history to suggest that we could potentially be much closer to another top than a ground-floor opportunity. I'll step aside and leave the rest of the risk (and potential reward) to others at this seemingly late stage.

"Don't panic. The time to sell is before the crash, not after." This sage advice is easy to read but can be hard to put into practice. *"Remember, no investment is forever"*. In other words, don't love something that can't love you back. They are just stocks. When euphoria is the dominant mood it might be a challenge to be an early seller, but at some point I believe that's the smart choice to make. When I look across the landscape and connect the dots as I see them, it appears to me a lot of euphoria is already here with Artificial Intelligence. Let's not give in to Artificial Stupidity. Perhaps more importantly,

while many investors are busy trying to squeeze the last percentages of gains from this seemingly over-loved theme, there appear to be quite a few very attractive but neglected alternative opportunities out there, many with sound fundamentals, low valuations, and very high yields via dividends. *"Buy low, sell high"*. *"Buy when others are fearful, sell when others are greedy".* If this can work for one of the greatest investors of our time, it may work for us too! There is fear surrounding several market sectors and there is greed associated with others. It isn't hard to figure out which is which. We are always here to help you sort this out by calling (715) 369-1719 or sending an e-mail to either holperind@stifel.com or kipperb@stifel.com.

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Past performance does not guarantee future success and no one can predict the markets with any certainty. Investing involves risk including the potential loss of capital invested. Due to their narrow focus, sector-based investments typically exhibit greater volatility.