

Market Commentary Third Quarter 2023

Over the course of 2023, many people have been astonished by the emerging potential of artificial intelligence (AI). After all, one year ago, few regular folks had heard of using AI technology to write articles, play chess, create art, or diagnose an illness. Nor had they foreseen the explosive, AI-related stock price gains.

Swedish-born philosopher Nick Bostrom's *Superintelligence: Paths, Dangers, Strategies*, a *New York Times* bestseller, suggests new pathways that AI might take—directions we will keep in mind as we search for new investment opportunities. According to Bostrom, director of Oxford University's Future of Humanity Institute, superintelligence is “any intellect that greatly exceeds the cognitive performance of humans in virtually all domains of interest.” Superintelligence represents a huge potential gain in intellectual power.

Bostrom points out that there is potentially a decisive advantage for an early developer of superintelligence. “If the frontrunner is an AI system, it could have attributes that make it easier for it to expand its capabilities while reducing the rate of diffusion,”¹ making it difficult for laggards to catch up. His analysis is consistent with what I said about AI in last quarter's letter: There will be fewer big winners, and those winners will be bigger. Superintelligence may lead to positive

outcomes that human beings cannot visualize. I was fascinated by the concept of “coherent extrapolated volition,” a term developed by AI researcher and theorist Eliezer Yudkowsky in reference to “friendly AI” development:

...our coherent extrapolated volition is our wish if we knew more, thought faster, were more the people we wish we were, had grown up farther together; where the extrapolation converges rather than diverges, where our wishes cohere rather than interfere; extrapolated as we wish that extrapolated, interpreted as we wish that interpreted.²

The result of programming AI to carry out coherent extrapolated volition might be much better than what humans can individually or collectively imagine. In other words, as Bostrom says, it would mean that the AI would “Do whatever we would have most reason to ask the AI to do.”³

As I consider where to invest, I also think about where the economy is heading because that affects which investments will thrive. With that in mind, I read *Keeping at It: The Quest for Sound Money and Good Government* by Paul Volcker, chairman of the Federal Reserve, 1979 –1987. Volcker joined the Fed with a “mission to salvage an economy nearing the end of its inflationary rope.”⁴

I'm interested in the parallels between how the Fed dealt with high inflation at that time and the Fed's stance now. Of course, Volcker experienced more extreme inflation—an annual rate of almost 15%⁵ when he took office—and responded in kind, raising the fed funds rate as high as 20% from a rate of 10% when he became Fed chair.⁶ He also curbed the growth of the overall money supply, which reduces inflation by requiring banks to hold more reserves.⁷

Many in the business community weren't happy with the high interest rates under Chairman Volcker. When Volcker was about to address the National Association of Home Builders, he was told, "What are you doing here? The home builders will kill you."⁸ However, Volcker's message prompted a standing ovation: "Stick with us. Inflation and interest rates will come down. There are a lot of homes to be built." And both inflation and interest rates declined as predicted.

I believe that we're at a similar turning point for U.S. inflation and interest rates. The Fed kept rates steady at its September 2023 meeting.

While many are talking about interest rates being "higher for longer," I disagree. Nonetheless, oil prices are a wild card that could slow the arrival of an interest rate decline. Since January 2022, the U.S. has boosted its daily oil production by about 1 million barrels, but OPEC has cut its supply by about 2 million barrels per day.⁹ As a result, demand for oil

is higher by about 2 million barrels a day because China ended its zero-COVID policies.¹⁰ Global demand exceeds supply, so oil is increasing inflation.

Speaking of China, the country's post-COVID economic growth has disappointed many observers, including Hui Shan, Goldman Sachs' chief China economist, who revised her Chinese gross domestic product forecast down from 6% in March to 5.4% in a July podcast.¹¹ However, this decline is understandable, given the changes in China's priorities in recent years. China now emphasizes stabilizing and deleveraging its economy to become more self-reliant. This focus on security comes at the expense of growth, as Hui pointed out in her podcast. Accordingly, China won't mindlessly repeat its old pattern of economic slowdowns followed by major stimulus.

Against this backdrop, portfolios are well-positioned for when interest rates eventually drop. I haven't made many adjustments to portfolios, but I continue to reinvest portfolio dividends in existing positions with attractive valuations and prospects.

As always, thank you for the trust you have placed in me and in 7Summit Advisors. We work hard to earn that trust each day.

Sincerely yours,

Li Chang

¹Bostrom p. 96.

²Bostrom, p. 259.

³Bostrom, p. 270.

⁴Volcker, p. 104.

⁵Volcker, p. 105.

⁶<https://www.npr.org/2022/09/29/1125462240/inflation-1970s-volcker-nixon-carter-interest-rates-fed>

⁷Volcker, pp. 105, 108.

⁸Volcker, p. 114.

⁹<https://twitter.com/KobeissiLetter/status/1706707357185483072>.

¹⁰<https://www.reuters.com/business/energy/saudi-arabia-extends-voluntary-oil-output-cut-1-mln-bpd-end-2023-2023-09-05/#:~:text=Saudi%20Arabia%20will%20extend%20its,citing%20an%20energy%20ministry%20official>.

¹¹<https://podcasts.apple.com/us/podcast/goldman-sachs-exchanges/id948913991?i=1000621845806>.