The potential of artificial intelligence (AI) to better human life remains a focus of our investment research. I also continue looking for companies and industries that are reaching inflection points—whether pivotal junctures are spurred by technology, China, or other factors.

AI's positive potential is the theme of *The Heart and the Chip: Our Bright Future with Robots*, which I recently read. Author Daniela Rus argues that the best systems will combine the human "heart" with the "chip" of robots.[1] Further, we need to understand machine learning models in order to create robots that "give us superpowers and assist us with all kinds of cognitive and physical tasks, lifting humanity as a whole to a higher standard of living and a more fulfilling existence."[2]

Rus' vision is similar to what Tesla founder Elon Musk foresees in a benign scenario as reported by @elon_docs:

- Work will no longer be needed
- Universal high income
- Humans may give meaning/purpose to AI[3]

These comparable visions remind me of something Steve Jobs said after he was fired from Apple. He called for people not to be bound by the limited vision of others. Instead, he encouraged people to push their limits because an improved life will pop out on the other side.[4]

The concept of human lives greatly improved by AI makes sense to me. To realize that prospect, however, requires a "cross-societal buy-in" on the scale of the U.S. race to the moon or development of the COVID-19 vaccine.[5] That's a collective version of the limit-pushing proposed by Jobs.

According to Rus, this collective effort should pursue 11 qualities for robot-AI systems: 1. Safe, 2. Secure, 3. Assistive, 4. Casual, 5. Generalizable, 6. Explainable, 7. Equitable, 8. Economical, 9. Certified, 10. Sustainable, 11. Impactful.[6] By "assistive," Rus means that, "Ultimately, humans should be in charge of any critical or important decisions involving AI, machine learning, and robotics." Her 11 qualities are among the same qualities that I look for in companies seeking to exploit AI.

At some point, AI will take companies and industries to turning points that require them to adapt or force them to decline. Andy Grove, former CEO of Intel, addresses such strategic inflection points in his book, *Only the Paranoid Survive: How to Exploit the Crisis Points That Challenge Every Company*. Strategic inflection points are caused by changes in a company's competitive environment, including shifts in the power, vigor, and competence of competitors, suppliers, customers, and potential competitors; the possibility that a firm's products or services can be delivered differently; and the force of "businesses from whom customers buy complementary products."[7]

A strategic inflection point results from massive change in one or all of the forces listed above, so that, "the old strategic picture dissolves and gives way to the new."[8] Such inflection points can be "deadly," says Grove, but they also create "opportunities for players who are adept at operating in the new way."[9]

I wonder if the U.S. auto industry is at an inflection point due to China's quest for technological independence. For example, China has a new electric car with Porsche-like styling and a price below $30,000, which threatens the dominance of Tesla.[10] China also sells a tiny electric vehicle for as little as $10,000.[11] Neither is available in the U.S. or in the European Union because of tariffs imposed on the cars. As Steve Westly, Managing Director of the Westly Group and former Tesla board member points out, "[The Chinese] have not had a truly robust auto industry for the last fifty years. It just didn't exist. They don't have any oil. They are dying to reduce their dependence on European and American manufacturers. What they are in essence doing is leap frogging over the entire internal combustion engine background."[12] Given that scenario, how will worldwide auto industries outside China continue to thrive without dramatic changes?

Semiconductors, China's largest import, are another area of concern as China develops its own chips, which is likely to put a significant dent in U.S. semiconductor sales at some point down the road. To accelerate the development of advanced computing chips and memory chips, China has established a new fund. "In Chinese terms, semiconductor is referred to as a neck choking technology," says Winson Ma, adjunct professor of law at NYU School of Law.[13] Ma further states that to solve this "neck choking," China must develop its own semiconductor supply chain in every aspect of the value chain. Similar quests for technological independence are evident in other areas, as China fears that the U.S. could one day impose sanctions similar to those now imposed on Russia.[14]

Even now, financial markets could be pricing in possible outcomes to the U.S. presidential election in November. Michelle Lam, of Societe Generale states, "Investors could be…fast forward looking to [see] if Trump wins the U.S. election at the end of the year, what [that means] for tariffs, the trade policies for China. To some extent, people are pricing in, for the options some pricing effects, some negativity." [sic][15]

U.S. companies have been using the current strength of the U.S. economy to shore up balance sheets. "So, you go to the IG bond market, which is up over 30% year-over-year in volume terms. And that is a big number, that is sixty billion more than this time last year…But I think there is also an effect where companies are trying to issue as much debt as possible before the uncertainty that might come before the end of the year," says Henrik Johnsson, co-head of Investment Bank EMEA at Duetsche Bank.[16]

IG bond issuance is being pulled forward due to uncertainty, as is inventory demand from retailers. Ryan Petersen, Flexport founder & CEO says, "They are starting to pull in goods early and that is part of what is driving this surge. People are worried about the holiday season. They saw what happened during COVID when they didn't have enough inventory. So, anybody that can is trying to get those goods in now, in the event that it is difficult in the peak season, in the holiday season. So, we actually got an early peak ocean freight season."[17]

We are considering the implications of these threats as I review investments for client portfolios.

In our clients' fixed-income portfolios, we are adding duration by laddering in bonds with longer maturities. We see signs of the economy slowing, which will eventually spur the Fed to act. For example, Walmart sales are being hurt by lower-income consumers spending less;[18] rent increases have also slowed.

In equity portfolios, we're adding to positions in companies that have been hurt by higher interest rates. We're also doing tax-loss selling for taxable accounts to apply against gains.

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

Sincerely yours,

Li Chang

[1]Daniela Rus and Gregory Mone, The Heart and the Chip: Our Bright Future with Robots, p. 1.

[2]Daniela Rus and Gregory Mone, The Heart and the Chip: Our Bright Future with Robots, p. 176.

[3]Tweet by @elon_docs, May 23, 2024, https://twitter.com/elon_docs/status/1793732884492386688.

[4]"Steve Jobs Secrets of Life," https://www.youtube.com/watch?v=kYfNvmF0Bqw.

[5]Rus, p. 176.

[6]Rus, p. 178-184

[7]Andrew S. Grove, Only the Paranoid Survive: How to Exploit the Crisis Points That Challenge Every Company, pp. 34-35.

[8]Andrew S. Grove, Only the Paranoid Survive: How to Exploit the Crisis Points That Challenge Every Company, p. 39.

[9]Andrew S. Grove, Only the Paranoid Survive: How to Exploit the Crisis Points That Challenge Every Company, p. 13.

[10]https://www.reuters.com/business/autos-transportation/xiaomi-set-plunge-into-evs-tricky-time-china-autos-2024-03-27/#:~:text=BEIJING%2C%20March%2028%20(Reuters),crowded%20EV%20market%20in%20China.

[11]https://www.pbs.org/newshour/economy/small-well-built-chinese-electric-vehicle-poses-a-big-threat-to-the-u-s-auto-industry

[12]"Focus is the key, Tesla could use more of it,' says former board member Westly, May 23, 2024, https://www.cnbc.com/video/2024/05/23/westly.html?__source=sharebar|twitter&par=sharebar

[13]"China's new chip fund to focus on establishing the total semiconductor supply chain: Analyst," May 28, 2024, https://www.cnbc.com/video/2024/05/29/analyst-discusses-chinas-new-chip-fund.html?__source=sharebar|twitter&par=sharebar

[14]Robin Brooks, Is China financially decoupling?, May 9, 2024, https://www.brookings.edu/articles/is-china-financially-decoupling/

[15]"Society Generale economist discusses Chinese property market," CNBC May 16, 2024, https://www.cnbc.com/video/2024/05/17/societe-generale-economist-discusses-chinese-property-market.html?__source=sharebar|twitter&par=sharebar

[16]"Best market conditions for primary issuance for at least two years:Deutsche Bank," CNBC May 21, 2024, https://www.cnbc.com/video/2024/05/21/deutsche-bank-best-market-conditions-for-primary-issuance-for-at-least-two-years.html?__source=sharebar|twitter&par=sharebar

[17]"Shipping Strain should start to regulate in medium-term, Says Flexport CEO Ryan Petersen," CNBC, May 31, 2024, https://www.cnbc.com/video/2024/05/31/shipping-strain-should-start-to-regulate-in-medium-term-says-flexport-ceo-ryan-peterson.html

[18]"Kimco CEO Conor Flynn: There's a retrenchment occurring at Walmart for the lower-end consumer," CNBC, June 7, 2024, https://www.cnbc.com/video/2024/06/07/kimco-ceo-conor-flynn-theres-a-retrenchment-occurring-at-walmart-for-the-lower-end-consumer.html