ONE HERITAGE
CAPITAL MANAGEMENT
SINGAPORE

1H Strategy Snapshot

AI: BUBBLE OR BEGINNING?

February 2024

Global Equities	Price	YTD	1M	1-Year
MSCI World	3,323	4.8%	3.7%	22.4%
S&P500	5,070	6.3%	4.6%	27.7%
Nasdaq	15,948	6.2%	5.2%	39.2%
Dow Jones Industrial	38,949	3.3%	2.1%	19.3%
STOXX Europe 600	495	3.3%	1.8%	7.3%
FTSE 100	7,625	-1.4%	-0.1%	-3.2%
Shanghai Composite	2,995	0.7%	7.4%	-8.7%
Shenzhen Composite	1,691	-8.0%	9.4%	-21.1%
Hang Seng	16,616	-2.5%	7.3%	-16.0%
Straits Times	3,139	-3.1%	-0.4%	-3.8%
India Sensex	72,305	0.1%	0.8%	22.6%

S&P500 Sectors	Price	YTD	1M	1-Year
Technology	3,705	9.1%	5.0%	55.7%
Health Care	1,699	6.8%	3.9%	14.8%
Comm. Services	1,472	3.8%	7.6%	30.3%
Financials	670	7.0%	4.0%	13.0%
Comm. Services	269	9.5%	4.4%	55.2%
Industrials	1,019	5.6%	6.6%	19.6%
Consumer Staples	791	3.8%	2.4%	5.3%
Energy	650	1.6%	2.1%	1.9%
Utilities	314	-2.6%	0.5%	-4.6%
Real Estate	243	-3.3%	1.6%	1.5%
Materials	547	1.3%	5.4%	6.2%

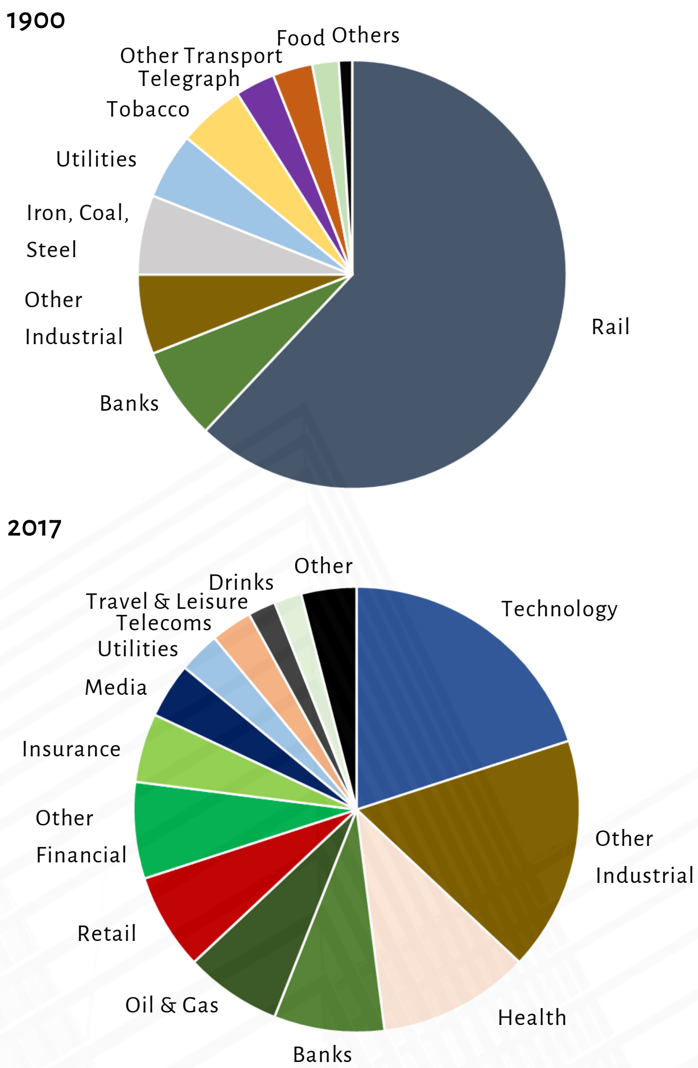
Hang Seng Sectors	Price	YTD	1M	1-Year
Commerce & Industry	8,944	-3.1%	9.3%	-16.9%
Financials	29,510	-1.1%	4.3%	-11.8%
Property	16,540	-9.8%	5.7%	-34.0%
Utilties	34,667	5.5%	7.3%	-5.2%

After yet another blowout quarter from Nvidia, the stock sped to new highs and is now the third most valuable company in the world behind Apple and Microsoft. A Google search informs that Artificial Intelligence was first incepted in 1956, making it older than Jensen Huang, the CEO of Nvidia, and also proving that you can't time the market – unless you're willing to wait 70 years. Make what you will of the stock's meteoric rise driven by recent AI obsession and terrific results from Nvidia, but there are profound implications now that AI has finally made it into the mainstream narrative.

Here is a fascinating thought to ruminate upon: what if AI replaces the need for people to learn to write code? Oh, the irony! Modern computers were created by people who thought that putting "Ctrl-Alt-Del" as a secret command would be a cool thing to do. That certainly was not intuitive. If you think about it, the whole drive of consumer computing since, say, the launch of the iPhone, has been to dumb down how hard it is to use computing devices such that the masses can finally figure them out. And thereby create an enormous, global market, of course.

However, if we had started out with AI – let's just assume the God of Computing, called Gill Bates, had bestowed the knowledge of, and tools for, AI on us from day one – then the need to learn coding would have largely been rendered redundant. Using plain English sentences, one can ask ChatGPT to write computer code. And it will do so

Chart 1: Composition of US stock market in 1900 & 2017



Source: Credit Suisse

Chart 2: Analysts' ratings and price targets for Nvidia

NVIDIA Corp		
Buys	90.80%	
Holds	9.10%	
Sells	0.00%	
Last Price :	791.12	
Citi	Buy	820.00
Baird	Outperform	1050.00
JP Morgan	Overweight	850.00
Goldman Sachs	Buy	875.00
BNP Paribas	Outperform	950.00
Jefferies	Buy	780.00
Deutsche Bank	Hold	720.00
HSBC	Buy	880.00

Source: Bloomberg, 1H Capital

almost instantly. It can write code in various computer languages, find bugs in your code or translate from one computer code to another. It is far from perfect, but we all know that it will only get better, and quickly.

Could AI, then, eventually unseat the Mega Tech Companies that dominate so much? This is a reminder of 'nothing stays the same forever' in equity land. There is a sense now that AAPL, AMZN, GOOG, etc. will be the only game in town in the stock market…forever! Does it not feel like that? Let's rewind to the year 1900. Guess the largest industry in the S&P500? Answer: Railroads. Approximately 60% of the S&P500 was made up of railroad stocks in 1900. This was the white-hot growth area of the times. Before the truck had been invented, railways linked towns and cities across the US as well as transporting coal and steel for burgeoning US heavy industry, which has largely evaporated since 1900. See Chart 1. In 1900, there were around 130,000 horses in NYC used mainly for transportation. Today for similar purposes (outside of Central Park): zero. But over 10,000 taxis.

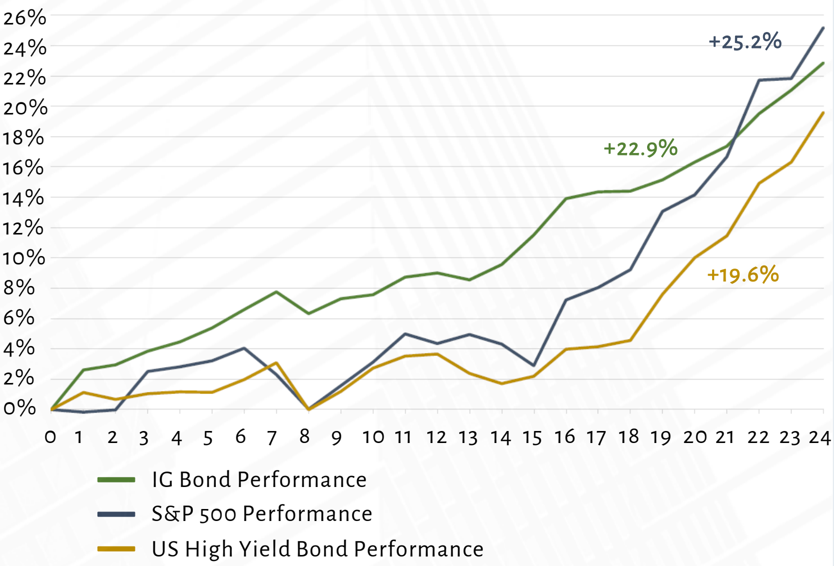
Back to the here and now. NVDA's success has recently has largely been due to the introduction of the H100 GPU in 2023. One will cost you around $40,000 and you need many more than just one if you want to run a global data center. Next up is the H200 and then the B100, which apparently will be a big step up. Hence NVDA's hyperbolic growth in data center sales, +81% y/y in Q4 2023 to $22B. There is more competition on the horizon, principally from Advanced Micro Devices (AMD), although it seems clear that NVDA dominates.

Can Nvidia (NVDA) stock be bought today? In our view, that is a very, very hard sell. Wonderful company, right place, right time – with a stock that has added $1.5 trillion in market cap in just over 12 months. It is a no for us. The problem is that if (ahem, when)

Chart 3: Past year returns of S&P500, Nasdaq100, & Nvidia

Source: Bloomberg, 1H Capital

Chart 4: Performance of US Stocks, US IG bonds, and US High Yield Bonds 24 months after the Fed cuts rates



Source: LGT Bank

NVDA eventually misses already super-high Wall Street forecasts, the stock could tank. Take Palo Alto Networks (PANW) as an example. PANW is a leading cyber-security stock that we have recommended many times over the years. It recently posted a weaker-than-expected outlook and the stock dropped -28% in a day. Such is the life of high-growth stocks. Chart 2 shows some analysts forecasts for NVDA. Baird's target of $1,050 implies +33% upside and market cap of over $2.5T!

In non-AI land, the Reserve Bank of New Zealand kept its benchmark rate unchanged at 5.5%. This was on balance as expected, but a 25bps hike would not have surprised much. However, the RBNZ guided down the chances of further rate hikes in 2024. While RBNZ Governor Orr noted that New Zealand is in a period of disinflation and the data provides more confidence of a soft landing now than it did in November, he also opined that central banks may need to hold rates higher for longer.

While the RBNZ is a smaller central bank, it has been a 'first-mover' in this rate cycle, both in terms of when it started to hike rates and by introducing the larger 50bps hikes. It is worth listening to what Orr has to say. His words led us to revisit a thought: what happened historically to US stocks and corporate bonds after the Fed starts to cut interest rates? The short answer is that, on average, they both move higher over the next 24 months, but the history is much more mixed for stocks. Chart 3, from LGT Bank, shows average performance of the S&P500, US investment-grade corporate bonds, and US high yield bonds, over the past six rate cutting cycles from 1984 to 2018. Perhaps surprisingly, performance across these asset classes are quite similar! IG bonds have delivered similar returns to stocks but with volatility and less variance among cycles.

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