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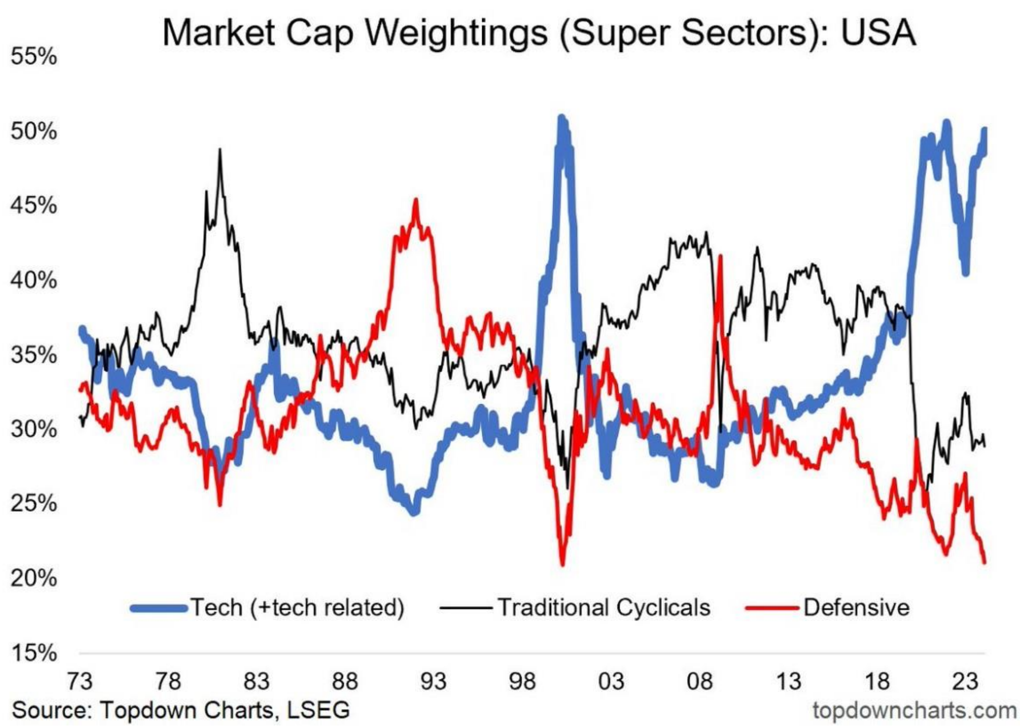
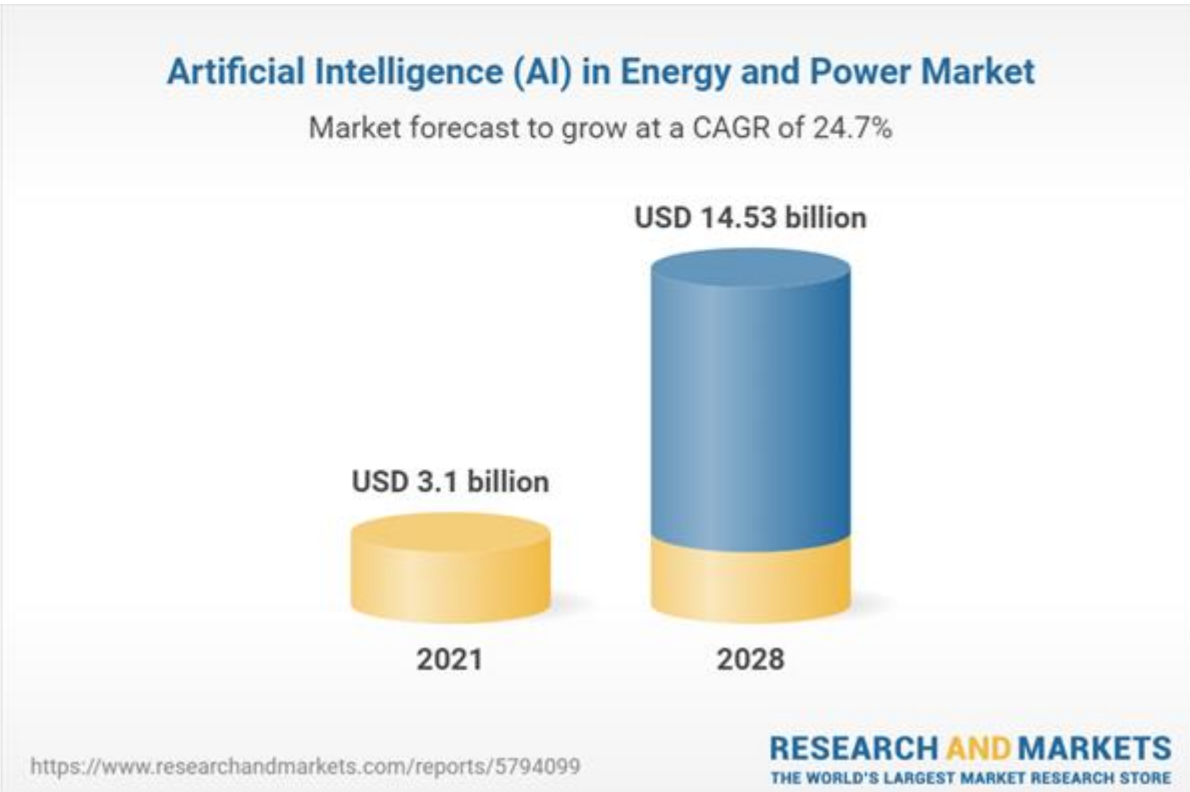
March 1, 2024
Investor Update

February has turned into an all on frenzy for AI related stocks and Bitcoin. There are echoes of 2021 happening right now with the only exception being this time there are far fewer participants in the mania. In fact, even the Magnificent 7 stocks have turned into the Fabulous 4 as Apple, Tesla, and Alphabet (Google) are all down significantly for the year.

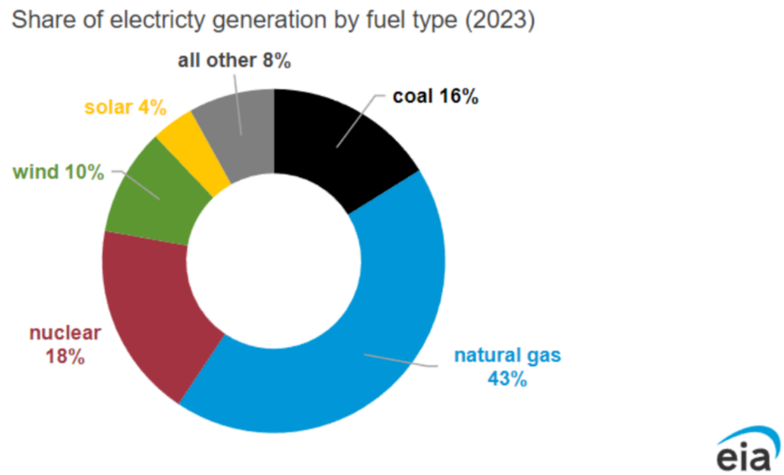
One thing that happens in markets is when momentum takes hold both to the upside and the downside it moves far more than anyone can expect. This is true of individual companies and of entire markets or sectors. It is one of the reasons that while AI is driving certain stocks to the moon, other cheaper beneficiaries for example in Chinese technology can not catch a bid. Bidu is down nearly 40% in the last year and sports a paltry 9 P/E multiple simply because it is a Chinese stock and downside momentum in China is greater than the exposure to AI you get from this company. To illustrate this in a broad sense, the below chart looks at the US market and breaks it into Technology, Defensives (food, utilities, healthcare), and cyclicals (industrials, banks, energy). As you can see these thematic sectors tend to perform for a long period of time and then reverse. Right now, technology is near record highs (blue) and defensives are near record lows (red). Each time a sector got to an extreme, it reversed those gains for several years.



When you have a dominant theme in the market, like we do right now surrounding AI it is important to look at what other areas would benefit from this. When you have a transformational change for the economy it tends to benefit more than just the sector making the change. This happened with railroads, the industrial revolution, and the internet. If AI is going to be the next transformational force then others will benefit. One thing that I like to do is find the easiest beneficiary. To use a recent example, I will go back to 2005 when smart phones were just starting to become popular. It was virtually impossible to know who the winner was going to be in the race for best smart phone. Remember, blackberry was by far the early winner released in 2002 with the IPhone not coming until 2007. However, in order for smart phones to work, the speed of the internet and the demand for data was going to be huge so tower companies and data companies were massive beneficiaries. As we come to today with AI, if AI is going to be transformational, then the demand for electricity is going to be astronomical. In fact, power demand is expected to increase almost 25% per year through 2028.



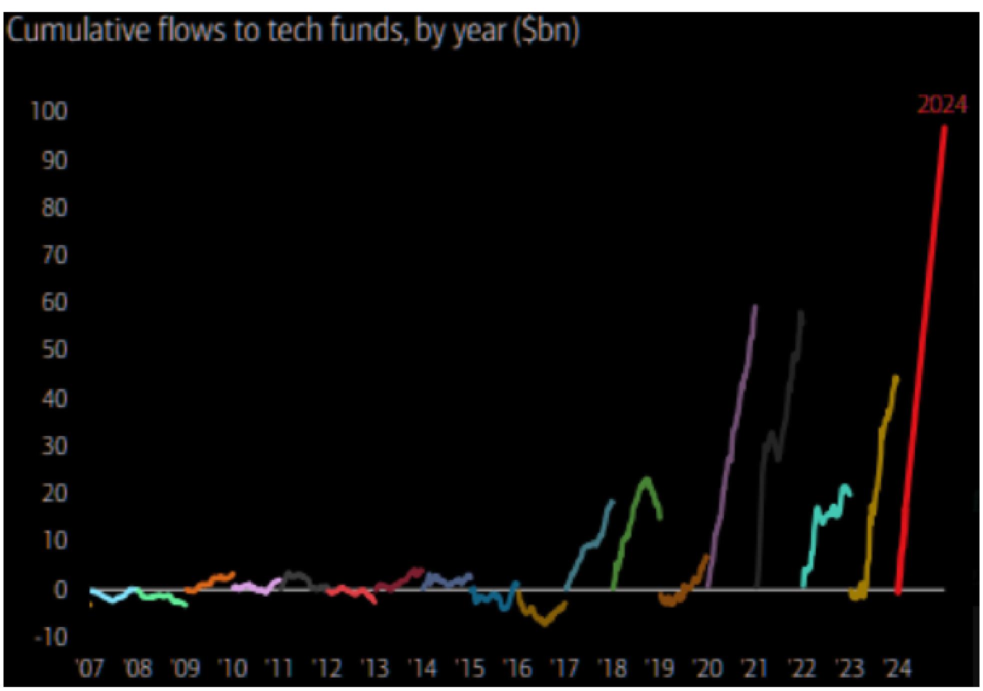
What is even more fascinating right now is that the biggest beneficiaries of increased power demand are performing awfully. You simply cannot have a proliferation of AI without a massive increase in electricity generation. Whether you want to look at utility companies down 25% from 2022 peak, solar companies down over 50% from 2022 peak, or natural gas which is down over 80% from 2022 peak, all of the direct beneficiaries are simply not participating. Furthermore, as much as green energy and lower emissions receive the headlines, the fact remains that Natural Gas is by far the biggest contributor to electricity generation here in the United States. There is simply no way the other sources of electricity can meet the demand in the near future without natural gas. In fact, in 2021 cold weather alone almost sparked a complete failure of the power grid in Texas.



Data source: U.S. Energy Information Administration, *Electricity Power Monthly*

Either, AI is not going to be all it is cracked up to be or the electricity complex is about to see a historic run in performance. What is even better from the electricity perspective is that electricity generation does not need AI to work as an investment moving forward, while AI does need electricity to work. This is what a generational opportunity looks like when unloved, unnoticed asset classes are at cheap valuations and can provide plenty of upside when the narrative reaches the mainstream.

Market participants currently are still under the assumption that this is not a bubble because in 2000 and 2021 there were many bad companies stock prices going higher at the same time and that in 2023/2024 it is being led by a few "Great" companies. This is the exact definition of a bubble because people believe it and rationalize it. While this bubble may look different, it is definitely a concentration bubble in technology. In 2 months, tech flows have already surpassed the yearly outsized flows since 2017.

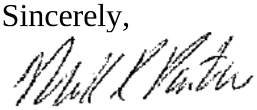


This is coming at the same time that the price to sales multiple is breaking out to new all-time highs. Remember in 2000 we didn't reach 8x sales and that was the top. In 2021 we surpassed 8x sales and that was the top before a nasty 2022. Today we are approaching 9x sales and expectations are that this is "the beginning."

Moving forward, we are not going to make a call on AI and what it is going to do for the economy and stock market. The reality is that it is going to take years to know the real winners and there are going to be players entering that do not even exist today. Our view is that there are going to be other beneficiaries that are priced very cheaply and provide the potential for outsized forward returns. Additionally, even if AI becomes transformational people are still going to eat, use their phones, heat and cool their homes, and take medicine when they are sick. These are basic needs that will never go away regardless of technology or the economy. Right now, those defensive stocks are priced as if humans are going to be taken over by AI machines……. In which case, none of this really matters anyway.

If you would like to get a more in depth explanation along with some additional charts, send an email to markpainter@everguidefinancial.com and we can schedule a call.

Sincerely,



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