



Market Commentary

Weekly perspective on current market sentiment

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Last week's S&P 500 Index: +1.7%

Periphery plays

Key takeaways

- Long before artificial intelligence captured the daily financial-market headlines, the U.S. power grid was in dire need of upgrading in many, if not most, areas of the country.
- That means our favored sectors beyond just Technology, such as Industrials and Utilities, are also set to benefit.

You may not have noticed it in your neck of the woods yet, but your monthly bill for electricity has likely been climbing higher over the past year or two. But in some areas of the country, like Southern California and New Jersey, electricity rates have surged and become issues in upcoming state and local elections. It is also likely that higher consumer electrical bills will be an issue in a number of next year's federal midterm elections.

But we had been hearing long before artificial intelligence (AI) captured so many of the daily financial-market headlines, that the U.S. power grid was in dire need of upgrading in many, if not most, areas of the country. Whether it is hot weather in Texas or California or cold weather in the northeast, it seems that power grids in a number of regions/states have come under extreme stress as demand has surged and production and transmission have struggled to keep pace, especially during extreme hot or cold weather events. It is not unusual for planned rolling blackouts to occur in some states, especially under extreme heat conditions when power demand overloads the system.

And then came the data centers tied to AI. These power-hungry data-processing structures have been a game changer that has forced the power-grid upgrade debate, that we all knew had to occur, to the forefront of many states' political and national industrial agendas. Overall, large-cap technology companies have been increasing their capital-expenditure (capex) estimates during each of the first two earnings reporting seasons of this year, and investors are waiting with bated breath to hear the same thing, or at the very least confirmation that the planned spending surge is still intact, in this current third-quarter reporting season. We would argue that much of the rally in the S&P 500 Index (SPX) this year is due to the huge amount of AI-related capex that companies and analysts expect.

The numbers are eye-catching and reach across multiple sectors. McKinsey & Company is expecting \$7 trillion to be spent by the end of this decade on data centers, computing power, and semiconductors. Additionally, at a Blackstone Chief Investment Officer (CIO) symposium, it was estimated that for every \$1 spent on AI, another \$3 will be spent on the supporting infrastructure.

That means we believe our favored sectors beyond just Technology, such as Industrials and Utilities, are also set to benefit. After all, companies in these sectors will be the ones to build the data centers, upgrade the electrical grid, and produce the components used in those centers and grids as well as provide the power to run all of this computer infrastructure. We are now only in the early innings of what in our view is a longer-term secular trend.

So, in the coming weeks, as earnings are reported and forward outlooks are laid out, investors need to pay attention to capex intentions of AI-related companies. AI capex dynamics have pushed the SPX higher this year, and the near- and intermediate-term direction hinges on the same.

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Each asset class has its own risk and return characteristics. The level of risk associated with a particular investment or asset class generally correlates with the level of return the investment or asset class might achieve. **Stock markets**, especially foreign markets, are volatile. Stock values may fluctuate in response to general economic and market conditions, the prospects of individual companies, and industry sectors. Risks associated with the **Technology** sector include increased competition from domestic and international companies, unexpected changes in demand, regulatory actions, technical problems with key products, and the departure of key members of management. Technology and Internet-related stocks, especially smaller, less-seasoned companies, tend to be more volatile than the overall market. There is increased risk investing in the **Industrials** sector. The industries within the sector can be significantly affected by general market and economic conditions, competition, technological innovation, legislation and government regulations, among other things, all of which can significantly affect a portfolio's performance. **Utilities** are sensitive to changes in interest rates, and the securities within the sector can be volatile and may underperform in a slow economy.

Definitions

An index is unmanaged and not available for direct investment.

S&P 500 Index is a market capitalization-weighted index composed of 500 widely held common stocks that is generally considered representative of the US stock market.

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