



MONTHLY ISSUE #111 | 2nd April 2024

Embracing AI in Hollywood – and beyond

EDITORIAL VIEW

- The Hollywood screenwriter and actor strikes of 2023 were largely rooted in AI concerns
- Jobs are indeed being lost to AI across creative industries, calling for a regulatory response
- Investors should focus on companies that can best harness AI tools over the long run

GLOBAL STRATEGY

- A favourable backdrop continues to support the outlook for risky assets
- Equity upside intact for the time being, driven mainly by an earnings rebound
- Bottom-line: make sure not to miss the tipping point (later) this year

ASSET ALLOCATION

- Allocation – Still slight overweight of equities and neutral stance on fixed income
- Bonds – Turning less negative on EM debt in local currency (slight underweight now)
- Real Estate – The bottom is near, with the worst of rate concerns behind

EDITORIAL VIEW

Embracing AI in Hollywood – and beyond

- The Hollywood screenwriter and actor strikes of 2023 were largely rooted in AI concerns
- Jobs are indeed being lost to AI across creative industries, calling for a regulatory response
- Investors should focus on companies that can best harness AI tools over the long run

When the Writers Guild of America finally lifted its 148-day long strike in late September 2023, it hailed a major victory in the battle over the use of AI in the film and TV industry. The terms of the agreement signed with the Alliance of Motion Picture and Television Producers preclude studios from resorting to AI to write or edit scripts, as well as from considering AI-generated content as “source material” that screenwriters may be assigned to adapt. At the same time, however, it allows writers to use tools such as ChatGPT if they so wish, effectively putting AI under their control – not that of the studios. A model for other industries?

Indeed, for all the current AI frenzy on Wall Street, its real-life implications can be challenging. The SAG-AFTRA actors’ strike, which echoed that of screenwriters and together ground Hollywood to a halt last year, was also largely fuelled by AI issues. Background actors in particular expressed concerns about their image being manipulated by AI to fill out film scenes, no longer requiring (paid) physical presence. And on a slightly different note, in a recent interview with The Hollywood Reporter, world-renowned producer and actor Tyler Perry indicated having put his studio expansion plans on a backburner because of AI developments, specifically pointing to Open AI’s text-to-video tool Sora.

Elsewhere in the creative space, a survey conducted ahead of the 2024 Game Developers conference showed that over a third of them were hit – directly or indirectly – by layoffs during 2023. And more than half of respondents expressed concerns about future job losses. The pandemic is of course partly to blame, with gaming companies having been one of the big beneficiaries of locked-down households (and

thus seen their headcounts balloon), but AI automation also figures among the perceived threats, weighing on worker morale.

In the e-commerce space too, AI stands ready to fast replace human activity. Klarna, a leading payment provider in Europe that works with over half a million merchants, announced on 27 February that, after just one month of being live, its new AI-powered assistant had handled two-thirds of customer service chats, “doing the equivalent work of 700 full-time agents”. All that with customer satisfaction scores similar to those attributed to human agents, a faster resolution of enquiries, and fewer repeat demands.

Going back to Hollywood, in the afore-mentioned interview, Tyler Perry clearly expressed the need for some form of regulation, making it a condition for the very survival of the film-making business. How regulators respond to the AI revolution will indeed be crucial in shaping tomorrow’s world, from both an employee and employer perspective, in all content-related industries – and beyond.

In the meantime, companies have little choice but to embrace AI and evolve with it. From an investment standpoint, as we wrote a few months ago in this same publication, our goal is thus to identify those that will best integrate appropriate AI tools in their business models and train their workforce suitably. Which means looking beyond the recent crowded market rally in perceived AI supply chain winners to a time when the dust will have settled, hence building a diversified exposure to long-term AI beneficiaries.

Written by Quirien Lemey, Senior Equity Fund Manager

«For wich of the following do you anticipate your organization will use AI in the next 12 months for internal or customer production applications?»



Base: 275 AI decision-makers

GLOBAL STRATEGY

Resilient growth, disinflation and rate cuts in sight

- A favourable backdrop continues to support the outlook for risky assets
- Equity upside intact for the time being, driven mainly by an earnings rebound
- Bottom-line: make sure not to miss the tipping point (later) this year

Inflation normalisation was never going to be plain sailing and the latest data has only reinforced our view of a slow and bumpy runway to Fed rate cuts later in the year. Meanwhile, positive economic surprises (strong consumer) and a bottoming in global manufacturing momentum, alongside an orderly softening of the labour market, have driven more resilient than expected growth, supporting the outlook for risky assets regardless of ongoing geopolitical tensions.

As a result, our base case macro scenario is unchanged. Admittedly, latent risks regarding growth, inflation or geopolitical developments remain, but the timing and extent of their impact seem either distant or manageable at this point, especially with central banks potentially coming to the rescue. That said, among key downside risks, stagflation would be the worst case for balanced portfolios, hurting both equity and bond holdings – while also impeding a monetary policy remedy.

Consistent with this macro scenario, consensus earnings estimates eyeing a 10% rebound this year should be the key driver of equity upside, as valuation leeway is limited following the recent re-rating. Regarding the latter however, we do not believe equity markets to be in a bubble today. Global stocks may indeed seem expensive on many metrics, but looking beneath elevated, mostly AI-powered, index surfaces still reveals attractive pockets of value among “Less-Magnificent” stocks. A pullback in bond yields, combined with improving earnings and sentiment, should help keep equity risk premia low, but widespread multiple expansion is less likely going forward, stressing the importance of greater investment selectivity.

As far as bonds are concerned, we now consider rates to be fairly valued, investors having finally repriced their expectations of central bank rate cuts to a more realistic trajectory. It is hard to get excited about credit given current spread levels, especially at this stage of the business cycle...

This time round however, the embedded carry should shield investors from the misfortunes experienced in 2022. In today's context, we thus recommend a neutral/benchmarked fixed income positioning overall, with a selective approach in the HY/EM segments.

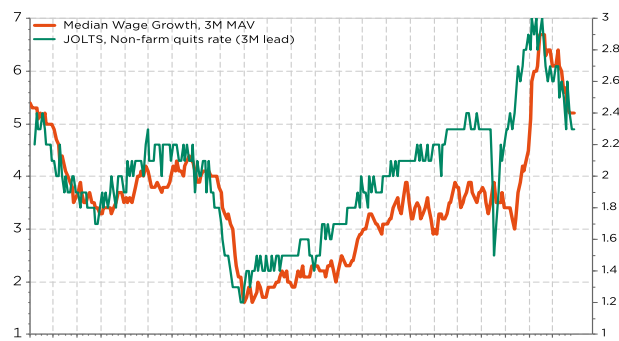
Consequently, we stick by our positive views, maintaining a constructive positioning for the coming months. Some markets might be ripe for a (healthy) consolidation after the strong start to the year, but today's more benign macro backdrop, supportive earnings trends, ample market liquidity, and improved near-term visibility all advocate for further equity upside. In this context, “cheap” tactical protections may also be considered.

While maintaining our positive equity positioning, we nonetheless carried out minor changes elsewhere in our tactical allocation grids. Specifically, while leaving our overall neutral fixed income stance unchanged, we tweaked our bond segment preferences, turning less negative on EM debt in local currency (slight underweight now) on the back of a more favourable global macro backdrop and some relative appeal vs. other fixed income assets (especially HY where valuations are stretched). And we have become less pessimistic on real estate (slight underweight now), with the worst in terms of rate concerns likely behind.

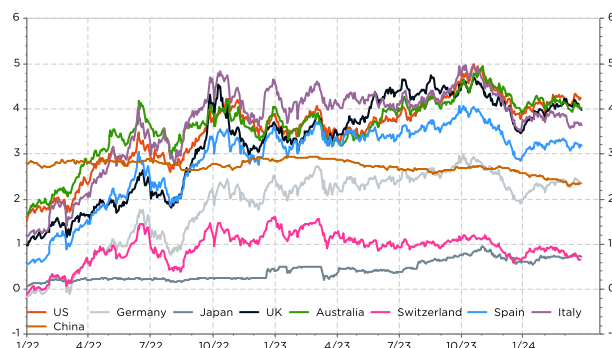
To sum up, 2024 looks set to be another eventful year for financial markets, having to deal with an economic slowdown, bumpy inflation, dithering central banks, the fate of China, a US presidential election, some real estate woes, and the still widely underappreciated impact of AI's revolutionary tipping point. The journey for investors is unlikely to prove quiet (when last did that happen anyhow?) but we still see healthy upside potential for risky assets over the coming months, favouring an all-terrain approach to portfolio construction and a well-balanced diversified allocation.

Written by Fabrizio Quirighetti, CIO, Head of multi-asset and fixed income strategies

Fed's mission accomplished, as quitters give up US median wage growth and JOLTS quits rate



A bumpy soft landing for global long rates too Selected 10-year rates have likely peaked



CONTACT

DECALIA SA
Rue du Rhône 31
CH-1204 Genève

Tél. +41 (0)22 989 89 89
Fax +41 (0)22 310 44 27

info@decalia.com
www.decalia.com

Copyright © 2024 by DECALIA SA. All rights reserved. This report may not be displayed, reproduced, distributed, transmitted, or used to create derivative works in any form, in whole or in part, by any means, without written permission from DECALIA SA.

This material is intended for informational purposes only and should not be construed as an offer or solicitation for the purchase or sale of any financial instrument, or as a contractual document. The information provided herein is not intended to constitute legal, tax, or accounting advice and may not be suitable for all investors. The market valuations, terms, and calculations contained herein are estimates only and are subject to change without notice. The information provided is believed to be reliable; however DECALIA SA does not guarantee its completeness or accuracy. Past performance is not an indication of future results.

External sources include: Refinitiv Datastream, Bloomberg, FactSet, Forrester Research, Inc.

Finished drafting on 31 March 2024