CIBC ASSET MANAGEMENT

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Investment opportunities in generative AI and why inflation is still elevated

Investment opportunities in generative AI

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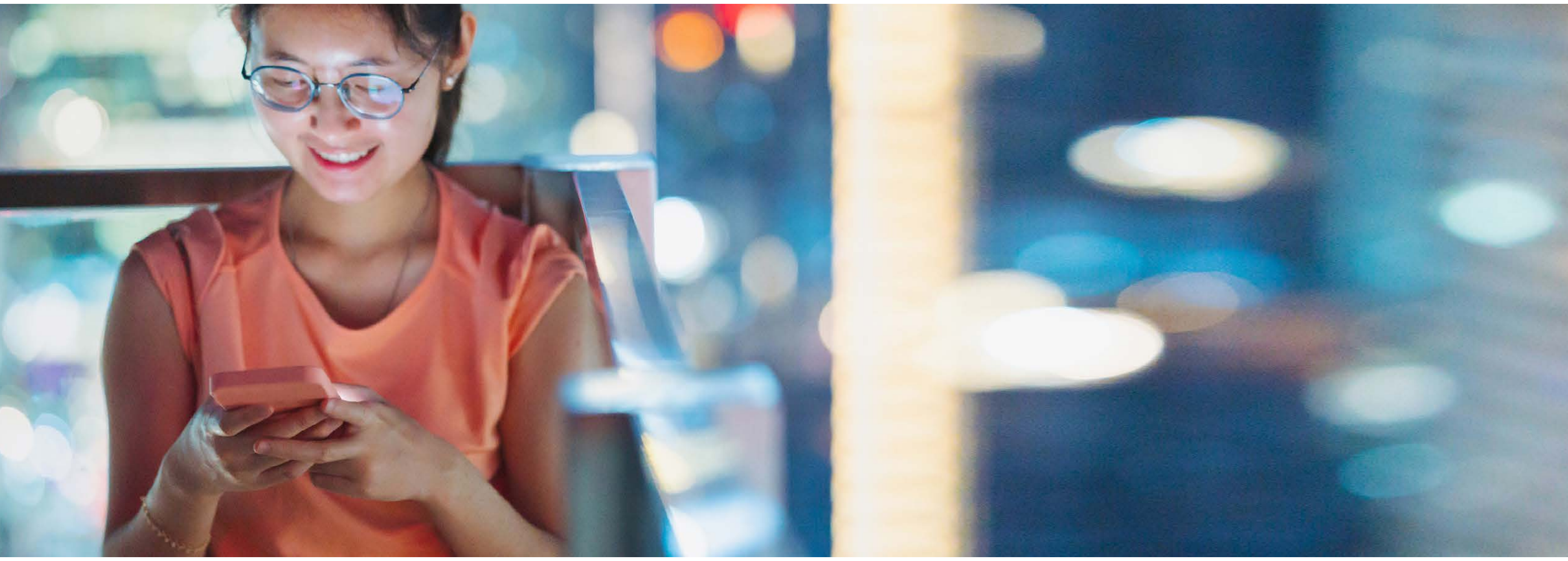

Generative artificial intelligence (AI) has captured the popular imagination. Given what can be done with tools like ChatGPT, some believe we're on the cusp of a technological inflection point rivalling the introduction of the Internet. Is it any wonder investors are looking to take advantage?

What does generative AI like ChatGPT do?

Effectively, the main function of generative AI is to make predictions. With text generation tools like ChatGPT, AI is anticipating the best next word in a sentence. Its guesses are based on a large language model it uses to put words together in a way that makes sense.

How will generative AI change what we do?

Productivity—Generative AI is expected to improve worker productivity. The most visible example of this is Microsoft. By integrating ChatGPT into products such as Office, it should enable users to simplify routine tasks and focus on more strategic ones.

Online search—Generative AI should enable consumers to ask more detailed questions and get more comprehensive answers. This has the potential to transform advertising by making it more targeted and increasing the monetary potential of each online interaction.

Services—It stands to restructure the way in which businesses unlock and make use of the data they collect, to better interact with and serve customers.

The best way to invest in AI?

From an investment perspective, the challenge is to identify the companies best positioned to provide the hardware and software infrastructure to support this paradigm shift. Key to this is being able to distinguish how much of this disruption is hype versus reality.

Though this question can really only be answered in hindsight, some context is helpful. Technology disruption has been driving productivity for the past several decades, doubling computational power roughly every two years. Technological disruption happens because the underlying technologies have progressed to the point where it becomes practical, and in some cases inevitable.

Second, people often assume disruption is a function of how compelling a new technology is, but history suggests it's more about how much friction is in the path of customer adoption. Generative AI doesn't require a drastic change in behaviour, other than to ask questions. This suggests low friction and a long runway for sustainable growth.

Have efforts to combat elevated inflation been successful?

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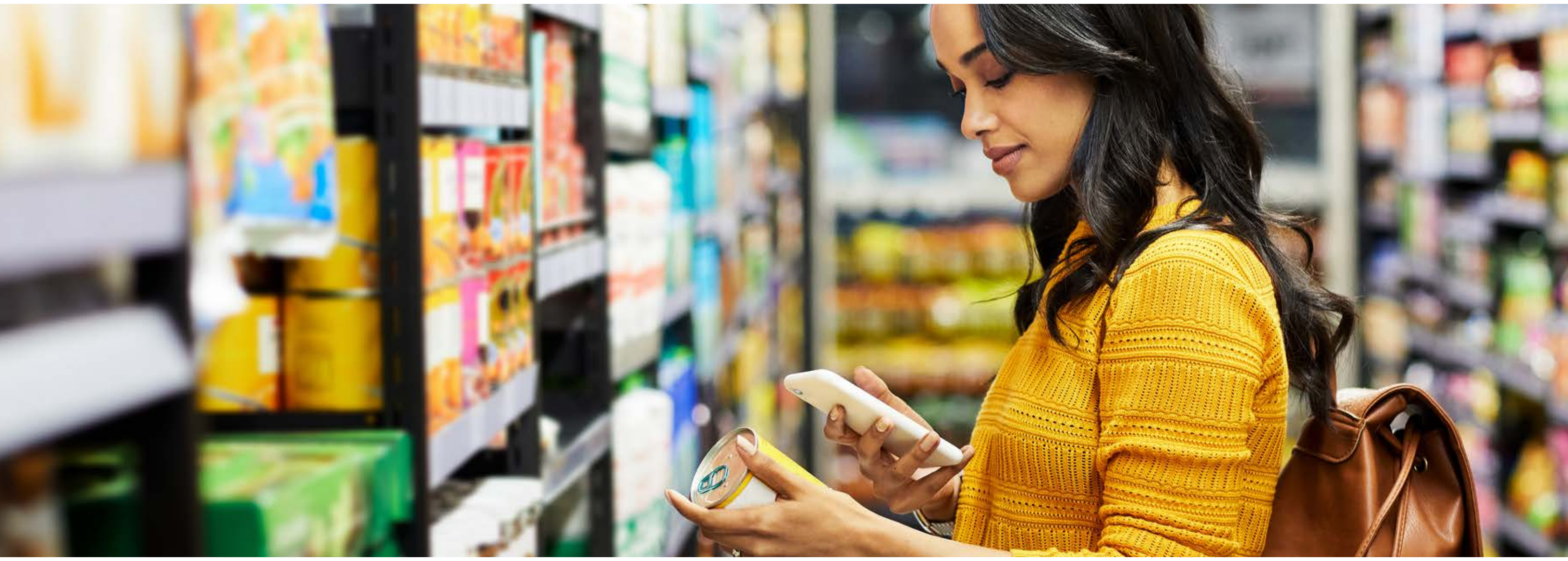

After four decades of low inflation, the past 24 months have been hindered with elevated inflation, forcing central banks to hike interest rates aggressively. In Canada, the inflation rate jumped from -0.4% in May 2020 to a peak of 8.1% in June 2022. This forced the Bank of Canada (BoC) to hike interest rates to 5% as of July 12, 2023. Inflation currently stands at 2.8%, and the BoC predicts it will reach the 2% target by 2025.

What is inflation & what are signs of elevated inflation?

The BoC defines inflation as "a persistent rise in the average level prices over time". Key symptoms of genuine inflation are deteriorating price expectations, rising labor costs and broadening of items rising in the CPI basket.

Why is Canada experiencing elevated inflation?

The pandemic caused major dislocation in the production of many goods and services, while also changing the behavior of consumers (i.e. hoarding) and policymakers (expansion of fiscal support). This resulted in much higher inflation.

The US and Canada's rise in prices over the past 24 months have been both a result of supply disruptions caused by the pandemic as well as strong demand stemming from both fiscal and monetary support in 2020 and 2021. In addition, tight labour markets in the US and Canada are contributing to more persistent inflation through higher wage growth supporting domestic demand.

What are the impacts of investing in a time of elevated inflation?

For investors, higher inflation tends to push up the cost of capital, as central banks (such as the BoC) are forced to react to rising prices by increasing interest rates. However, higher rates can offer better opportunities in certain investment classes like fixed income.

Meanwhile, persistently rising prices can dampen the purchasing power of households and become a deflationary factor for growth as seen in the 1970s.

Inflation forecast

Although the target inflation rate is 2%, we expect the US and Canada to average a 3.5% and 3.4% inflation growth rate over the next 12 months. Despite progress being done in bringing inflation back down, tight labor market conditions and more fiscal support for the economy will keep inflation persistently higher. When it comes to managing your money, expect the cost of goods and services to continue to rise. Investors should expect continued volatility in financial markets which may be reflected in your portfolio. It's important to stay invested for the long term and avoid letting temporary market conditions impact your investment strategy.

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Across a spectrum of investment solutions, we commit to best-in-class research. Dedicated sector and regional analysts focus on industry research and security-specific idea generation. Our investment professionals leverage deep and diverse expertise by sharing proprietary research across asset-class teams. By sharing insight across asset class teams, we maximize opportunities to add value to our client portfolios.

We provide our clients with our research insights and expertise on industry issues and themes that matter most to them.

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