



## A Financial Planning Framework for Artificial Intelligence

September 2024

PAC Insights is Park Avenue Capital's monthly commentary exclusively for our clients. This commentary is designed to provide you with insights on trending topics in the markets, but always in the context of long-term financial planning.

This month's topic: Artificial Intelligence. This is currently a hot button issue, and our commentary, while longer than usual, is intended to provide a basic framework for better understanding and using this complex technology.

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### QUICK HITS



- The AI revolution isn't on the way, it has already arrived.
- We offer a framework for understanding, learning from, and adapting to AI, with four take-aways.
  1. Engage with AI to Understand its Potential and Limitations.
    - Stay ahead of the curve, channel your leadership, and continue to develop and learn.
  2. Embrace AI's Transformative Potential and Prepare for its Consequences.
    - Anticipate what disruption looks like, monitor the large technology firms, and maintain the long view.
  3. Employ AI to Enhance Expertise, Not to Substitute for it.
    - Your expertise is irreplaceable, use AI to augment, and guard against generic outputs.

#### 4. Define and Articulate a Responsible AI Investment Strategy.

- Focus on trends and diversification, look toward the large tech companies, and recognize that disinflationary forces are good for consumers but bad for many companies.

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*“Throughout the country, journals and pamphlets proclaimed the railways as a revolutionary advance unparalleled in the history of the world. They not only focused on the economic benefits of railway transport, but concerned themselves with its more widespread effects on human civilization...There was no limit to the imagined effects of this revolution...From an investment point of view, it was argued that railway shares would remain ‘safe in a midst of panic.’”*

- Edward Chancellor, Devil Take the Hindmost; A History of Financial Speculation

## Introduction

From the peak, British railway stocks plummeted 85% in 1850 and the total value of all railway shares was less than half of all the capital put into them. At the same time, railways completely changed the social and economic fabric of the industrialized world. The Internet boom of the late 1990s resulted in a similar simultaneous bubble burst and transformation of our society. The adoption of breakthrough technologies is often uncertain and messy in real time while most benefits are felt later.

We are optimistic about the transformative potential of Artificial Intelligence (AI) and the intent of this historical lookback is simply to guard against excess speculation and over-concentration.

As your financial advisors, our role is not to be AI cheerleaders nor doomsayers. Our role is to understand and navigate the potential benefits and challenges of AI's integration with the global economy and the implications for your long-term plan.

In this commentary we will explore four key areas and offer a take-away for each:

1. What is AI?...beyond the media buzzwords.
2. Disruption...can have profound benefits, but also real consequences.
3. PAC Use Cases...how we are using AI in investment strategy.
4. AI Investment Case...balancing opportunity with risk management.

The AI revolution isn't on the way, it has already arrived. We hope this commentary will help you better understand, think about, and employ AI.

## What is AI?

AI appears to be a once in a generation technology that will eventually touch every industry and aspect of life. AI is not just mechanical, but can augment or even substitute for human thinking. This is simultaneously exciting and terrifying.

LLMs (large language models) are sophisticated predictive language models. They don't "know" anything. They use patterns and vast amounts of text data to learn how to predict the next word or sequence. Yet it can feel like you are talking with an actual person. Therein lies the duality of AI.

Historically innovative technologies cause anxiety and fears regarding humans being displaced, and some early studies suggest that AI can improve productivity up to 80% in certain job types. Yet, in aggregate, technology has brought massive improvements in efficiency and contributed to the highest standard of living the world has ever seen. Many are asking whether AI advancements are occurring at a faster pace than previous technologies.

It is crucial to acknowledge that there is a potential for widespread disruption, and this is exactly why understanding, learning, and adapting is critical.

### **Take-Away 1. Engage with AI to Understand its Potential and Limitations**

Not just once. Your goal should be to become reasonably proficient in AI:

1. **Staying Ahead of the Curve.** Your children and grandchildren will need to understand and use this technology. Engaging with AI now will better equip you to guide their development.
2. **Call to Leadership.** If you are in a leadership role understanding how AI can help your enterprise may offer an edge.
3. **Career Development.** Early adoption of AI can help set you apart and demonstrate that AI is a complement to talent, not a replacement.
4. **Continuous Learning.** Whether working or in retirement, look for ways AI can improve your life.
5. **Informed Decision Making.** Personally or professionally, AI can help you frame problems and make more informed decisions.

AI is almost surely here to stay. While we should always verify AI's results never relying on it exclusively, there are opportunities for all of us to embrace and benefit from the technology.

## **Disruption**

Disruption is often portrayed as a uniformly positive force that drives innovation and improvements, and often only focuses on winners. But disruption cuts both ways, often creating unintended negative consequences.

The excitement and narratives of new technologies often miss one crucial trade off: any technology that makes something more efficient reduces or eliminates something else.

Consider the PC and Internet revolutions. While they have fundamentally changed the way we live and work, they have left a trail of once dominant companies in its wake – think AOL, Cisco, IBM, Intel, Compaq, Dell, Hewlett Packard. This also ignores the many companies that died along the way.

In aggregate, technology disruption tends to result in value creation for the winners, but value destruction for the disrupted. To the extent there are net economic benefits, they are usually unevenly distributed, leading to economic and political disorder.

### Take-Away 2. Embrace AI’s Transformative Potential and Prepare for its Consequences.

1. Anticipate what disruption in your field could look like. Be prepared to adjust to the changes.
2. Monitor the large technology companies. If you seek clues on how AI may impact the economy and jobs, good and bad, start with keeping an eye on what the largest companies are doing.
3. Maintain the long view. AI’s impact will likely unfold over years. Try to be strategic and filter out short-term distractions.

## PAC Use Cases

We are committed to learning and using AI to enhance our services and value proposition to clients, however, that will never change the foundation of our financial planning philosophy with clients.

Our approach to AI aligns with Northwestern Mutual’s ethical, secure, and measured guidelines. We have found uses cases to help in our daily operations:

1. Editing and clarifications. We don’t use AI to write for us, but it can help with language or general clarifications on subject matters.
2. Portfolio Analysis. We use AI to save time in our inputs and data management for our analytical models, saving time and improving accuracy.
3. Research. We use AI to help organize news and research articles, by prompting AI to find specific areas of interest we give it.

We are most interested in advanced analytical projects and next we describe one successful use case.

#### *Global Asset Allocation Model*

One of our most successful AI projects was the development of a sophisticated global allocation model. We started by prompting AI with our view of the world and instructed AI with specific insights and a framework to create a “country score”. This exhibit shows the output for three countries.

<b>United States</b>	<b>Germany</b>	<b>China</b>
• Political System: 10.0	• Political System: 9.0	• Political System: 3.0
• Demographics: 7.0	• Demographics: 5.0	• Demographics: 6.0
• Economic Zones: 10.0	• Economic Zones: 9.0	• Economic Zones: 5.0
• Trade Relationships: 10.0	• Trade Relationships: 10.0	• Trade Relationships: 3.0
• <b>Score: 9.0</b>	• <b>Score: 7.9</b>	• <b>Score: 4.4</b>

Upon project completion, we asked the AI to explain to the project:

Prompt: Please summarize the exercise we did together. Focus on the process and your capabilities, not the specifics of the study, but explain in simple terms the global allocation model.

AI: In our recent exercise, we leveraged advanced AI capabilities to construct a global allocation model tailored to today's complex geopolitical and economic landscape. By combining various metrics such as political stability, demographic trends, economic integration, and trade relationships, we built a framework to objectively evaluate the investment potential of different countries. AI enabled us to process and analyze vast amounts of data swiftly, allowing us to assign scores that reflect the relative attractiveness of each market in a rapidly changing world. This model is a prime example of how we use AI not just to crunch numbers, but to provide insightful, data-driven strategies that align with our long-term investment philosophy.

While this is a sufficient analysis, we note that the success of this project required a deep level of expertise and understanding of global markets as a starter. The AI augmented our insights, but it could not have created this model without our comprehensive understanding and directives.

Additionally, when we asked AI to recommend a global equity allocation strategy for a new advisory firm starting from scratch, it gave us generic responses like any global investment managers' web site. This highlights a critical limitation of current AI models - they are constrained by training data, which relies on publicly available free information.

### **Take-Away 3. Employ AI to Enhance Expertise, not to Substitute for it.**

1. Your expertise is irreplaceable. The most effective use of AI is to guide it based on your expertise, experience, and insights. You must know what you want to accomplish, otherwise AI will offer little help.
2. AI as a compliment. When we are not experts in a field, use AI to advance our learning, but do not expect to become an expert based on AI.
3. Guard against generic outputs. AI is only as good as the free data on which it is trained. The more general your prompt, the more generic and flawed your AI output will likely be.
4. Continuous learning. Use AI incrementally to see how it can advance your projects and ideas. Innovation and progress come from new ways of doing things, and it is highly likely your AI is trained on the old ways.

## **Investment Case**

As your financial advisors, we prioritize a disciplined, long-term approach rather than making specific market or stock predictions. However, we recognize our clients' interest in hearing our views on technology and AI investments.

We do believe that AI is a foundational shift that will likely redefine industries and reshape big parts of the economy. Much like the advent of the internet and the rise of smartphones, AI has the potential to create entirely new markets and disrupt others in ways we can't predict today.

*The Next Phase?*

In our view, the next winners in AI will likely be the companies that use AI infrastructure to innovate for products and services that achieve mass adoption, which we have not seen yet. It seems reasonable that the winners will likely create entirely new business models and experiences that we can't conceive of today. In turn, many investors will seek to identify companies that can apply AI in new ways that truly redefine industries or efficiencies and might hit home runs. But most will likely strike out.

For clients with the volatility tolerance, we complement U.S. stock exposure with a modest allocation to a technology ETF, and a smaller allocation to a semiconductor ETF. This approach recognizes that technology and semiconductors are required for the winning technologies to emerge, and removes the peril of single company investment on portfolio outcomes.

All that said, we remain cautious about chasing AI performance. The market has bid up the prices of the direct AI infrastructure (semiconductor) players and most of the large technology companies are spending massive amounts of capital in pursuit of an end game that no one can yet see. The only prediction we are comfortable making is that the future state of AI will look different than exists today and from what most can envision.

#### **Take-Away 4. Define and Articulate a Responsible AI Investment Strategy.**

1. Focus on trends and diversification. Rather than betting on individual companies, which carries outsized risk, we recommend exposure to diversified technology ETFs. This implementation captures the broader trends, and ensures you own the winners, without the concentration risk associated with picking the individual winners.
2. Platforms- Large Tech. The long-term value in AI is likely to come from the platforms that can dominate in ways like how Apple and Google have in their respective businesses. The large technology companies today may have insurmountable advantages with their current scale, massive cash flows and investments into AI.
3. More Unbundling. If we can use AI for specific projects, imagine the potential to develop use cases for a cross section of industries and services, like health care, education, government, and our own financial services. Expect a lot of disruption in this group, as well as personalization at scale. This personalization will likely create unlimited opportunities for niche players, something akin to app developers on the Apple platform.
4. Data as an asset. AI models are currently trained on available, free data. Companies and sectors that leverage data may find attractive AI markets.
5. Disinflationary impact. Technology has been a massively disinflationary force. If inputs to production go down, the relative advantage of adoption will likely also decrease. In other words, there is no guarantee that businesses that adopt AI will derive higher market valuations. We think this is the most underappreciated aspect of AI sentiment today.

## **Conclusion**

As we all navigate the evolving AI landscape, our commitment to your long-term financial plan and responsible portfolio allocations remains steadfast. While we highlighted portfolio views, our

largest long-term bet is optimism. The second largest long-term bet is innovation, which all of us own through the largest, most capitalized, and most dynamic companies in the world.

The potential transformations from AI are fascinating, but this is a journey where we will experience many revelations and corrections. We seek to better understand AI technology so that we can continue to evolve our expertise, understand implications, and drive value in client relationships.

*The opinions expressed are those of Park Avenue Capital as of the date stated on this communication and are subject to change. There is no guarantee that any forecasts made will come to pass. This material does not constitute investment advice and is not intended as an endorsement of any specific investment or security. Please remember that all investments carry some level of risk, including the potential loss of principal invested. Indexes and/or benchmarks are unmanaged and cannot be invested in directly. Returns represent past performance, are not a guarantee of future performance and are not indicative of any specific investment. Diversification and strategic asset allocation do not assure profit or protect against loss.*