ARS INVESTMENT PARTNERS

THE OUTLOOK

October 5, 2023

IN THIS ISSUE...

Since we are already running record-high fiscal deficits at the top of a business cycle, fiscal policy can no longer be used to cushion an economic downturn without creating a major economic dislocation.

The current market dynamics are leading to a broadening of opportunities to include industries such as industrials, energy, materials, and others that were previously underinvested.

Transitioning to the Next Normal

The manifold forces driving today's economic activity and the outlook for the coming period will result in an economy that differs markedly from anything we have experienced. The many forces at work include the return to more historical interest rates, geopolitical fragmentation and attendant dangers, the reindustrialization of the United States economy with leading-edge technology resulting in greater productivity, the climate transition, and a realignment of the world order. In all past cycles, the monetary and fiscal policies of the US could always work together to cushion the economy from significant economic setbacks. Today, however, this is no longer the case. Since we are already running record-high fiscal deficits at the top of a business cycle, fiscal policy can no longer be used to cushion an economic downturn without creating a major economic dislocation. Therefore, the entire burden is on the Federal Reserve's monetary policy. The previously mentioned political environment also would appear to make a unified Congressional response to any economic dislocation difficult.

Given present conditions, it is easy to overlook the opportunities being presented in the markets today. For some time, we have defined three major shifts occurring simultaneously: a meaningful increase in the cost of living, a realignment of the world order, and the reindustrialization of the global economy. These changes and the subsequent policy responses are defining the most critical investment opportunities for the next decade, creating additional revenues and profits for those that benefit. However, market participants need to factor in one major shift into their investment thinking: the need to adjust the security selection process to this higher-for-longer, but more historically normal, interest rate environment. With the cost of capital rising from near zero just 18 months ago, investors will need to reassess their current portfolios and focus on companies best positioned for this new economic era. In recent times, the stock market returns have been driven by a handful of mega-caps, including Apple, Amazon, Alphabet, Meta, Microsoft, Nvidia, and Tesla. These companies account for around 30% of the S&P 500 market cap and over 60% of the 2023 market returns, according to S&P Global. The current market dynamics are leading to a broadening of opportunities to include industries such as industrials, energy, materials, and others that were previously underinvested.

ARS Investment Partners, LLC
529 Fifth Avenue, Suite 500
New York, NY 10017
212.687.9800

October 5, 2023

Coming into the year, most market participants were too pessimistic, and many are now coming to grips with a stronger stock market and a more resilient United States economy despite the obvious ongoing challenges. Back in January, ARS had a divergent view as we saw the U.S. economy being stimulated by the massive fiscal policy support, particularly the American Rescue Plan, Bipartisan Infrastructure Act, CHIPS and Science Act, and Inflation Reduction Act. Coupled with the need to address the climate transition, use advanced technologies to increase productivity, and upgrade national security in the face of global fragmentation and increased risks, we expect these forces to continue to drive capital flows into the United States and offset some of the headwinds facing the economy. The U.S.'s historic economic strengths, including our reserve currency status, the depth and maturity of our capital markets system, and the abundance of a dependable supply of energy, tend to reassert themselves in times of global stresses, and this is the case again today.

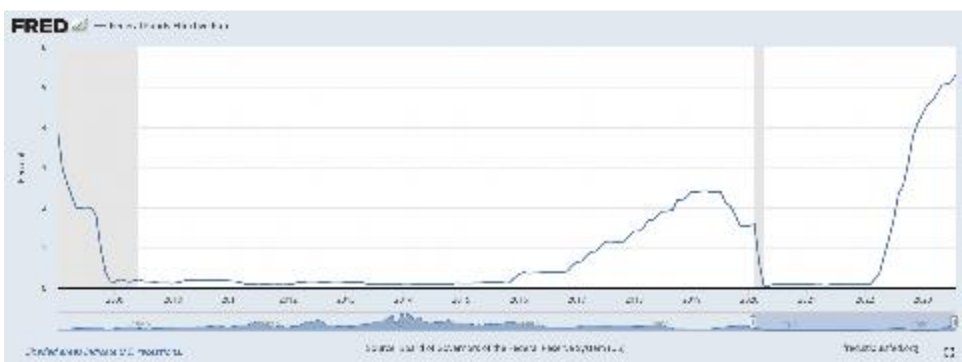
The U.S.'s historic economic strengths, including our reserve currency status, the depth and maturity of our capital markets system, and the abundance of a dependable supply of energy, tend to reassert themselves in times of global stresses, and this is the case again today.

Inflation Is Moderating, Cost of Living Is Rising

"Inflation has moderated somewhat since the middle of last year, and longer-term inflation expectations appear to remain well anchored, as reflected in a broad range of surveys of households, businesses, and forecasters, as well as measures from financial markets. Nevertheless, the process of getting inflation sustainably down to 2 percent has a long way to go."

– Jay Powell, Chair of the Federal Reserve, September 20, 2023

Chart 1. Federal Funds Effective Rate — 1980–2023



ARS Investment Partners, LLC
529 Fifth Avenue, Suite 500
New York, NY 10017
212.687.9800

October 5, 2023

We are coming to the end of the "new normal" or easy money era that helped define the post-Great Financial Crisis period, and this change will have major implications for investment strategy.

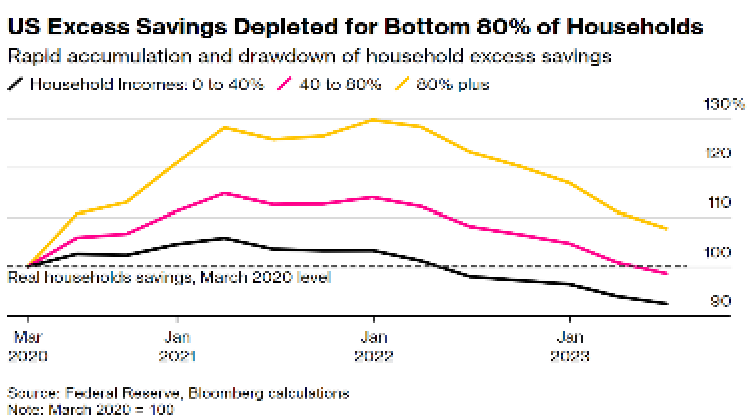
We are coming to the end of the "new normal" or easy money era that helped define the post-Great Financial Crisis period, and this change will have major implications for investment strategy. Chart 1 shows that the federal fund's effective rate had been held at near zero for more than a decade and then abruptly raised to 5.25% over the past 15 months. Similarly, the European Central Bank (ECB) has raised rates from a low of -0.50% in 2019 to 3.90% today on one of its three key benchmark rates. For some time, Fed Chair Powell has been steering the market perception to what it considers a more appropriate policy for the health of the economy for the medium- and longer-term.

Chart 2. Federal Funds Effective Rate (1954–2023)

Current interest rates are at levels where the economy has experienced reasonable growth in the past, but it will likely be some time before we achieve significantly higher levels of growth.

The reality is that the markets are returning to more historical levels of interest rates as shown in Chart 2 which illustrates the fed funds rate back to the 1950's. Current interest rates are at levels where the economy has experienced reasonable growth in the past, but it will likely be some time before we achieve significantly higher levels of growth as we have had in the past.

Chart 3. Consumers' Excess Savings Highlights the Gap Between the Haves and Have-nots



ARS Investment Partners, LLC
529 Fifth Avenue, Suite 500
New York, NY 10017
212.687.9800

The Federal Reserve's measure of the Core Consumer Price Index does not capture changes in food and energy costs; therefore, consumers face higher costs of living than those captured by the CPI. At the present time, the recent wage increases won by many workers have yet to be fully reflected in the system. For example, California Governor Newsom just signed legislation increasing the minimum wage for fast food workers to $20 per hour, and the UAW is seeking wage increases in the 30% range over 4 years, plus benefits and a shorter work week.

Moody's projected that the medium-income U.S. household's basket of essential goods and services has increased by $734 per month versus 2 years ago.

Cost of living is the measure of a basket of essential items that a household requires. Recently, Moody's projected that the median-income U.S. household's basket of essential goods and services has increased by $734 per month versus 2 years ago. The median income level is approximately $74,500 and the cost-of-living increase annualizes to $8,808. Gasoline prices are on the rise, food prices remain high, and wages are rising forcing companies to adjust by increasing prices or finding ways to cut costs. Insurance is another area where households are experiencing higher costs, with auto rates being raised by 7.5% to as high as 15%, and homeowners' policy rates are increasing as well. While wage gains continue to be pushed through, many workers find the cost of living a significant challenge.

Risks Present in the System

While many of the longer-term issues are obvious, the solutions are complicated, expensive, divisive, and require significant planning and global coordination.

At the start of the year, the World Economic Forum published its Top Ten Risks 2023 report addressing the severity and impact of the risks to the global system over the next 2 and 10 years respectively. At the top of the list for the near term were the cost-of-living crisis, weather, geopolitical concerns, failure to mitigate climate change, and social and societal polarization. Longer term, climate remains at the top of the list, as well as ongoing geopolitical considerations and forced migration. While many of the longer-term issues are obvious, the solutions are complicated, expensive, divisive, and require significant planning and global coordination. Aside from the risks facing the world stemming from the inflation fight, global fragmentation, and the war in Ukraine escalating or expanding in Europe and to other theaters such as Asia, the Middle East, and Africa, there are other more immediate issues for the global and United States economies.

At the press conference following the recent Federal Open Market Committee meeting, Chair Jay Powell highlighted five developments he is watching to help the FOMC determine the trajectory of the economy. These involve:

1. The UAW strike
2. Possible government shutdown
3. The resumption of student loan payments
4. Higher-for-longer interest rates
5. Impact of the recent rise in oil prices

We believe that the risks, such as those described above, often mask many of the best opportunities available as investors tend to seek safety rather than opportunities in times of heightening uncertainty.

ARS would add a few other issues we are monitoring, including the possible return of austerity policies in Germany and Europe, weakening military support for Ukraine, demand for U.S. Treasuries to finance the deficit, commercial property weakness, and a debt blow-up, possibly coming from China. Additional considerations for the United States involve the availability of workers with the skills for today's economy and the failure of Congress to address the many shortcomings of U.S. immigration policy properly. And we also have a critical Presidential election next year with two front-runners with the most unfavorable polling results in recent history. Geopolitical risks remain elevated and may even increase as China's economic woes pressure President Xi and the Communist Party to act on Taiwan. We believe that the risks, such as those described above, often mask many of the best opportunities available as investors tend to seek safety rather than opportunities in times of heightening uncertainty.

ARS Views into Year-End and Beyond

"We are entering a world of major transitions in labor markets, energy markets, and geopolitics, all of which can lead to larger and more frequent relative price shocks."
– Christine Lagarde, President of the European Central Bank, September 5, 2023

The two biggest opportunities stem from stimulants in the system that did not exist before as they do today — climate change and generative AI (artificial intelligence).

As the world continues to adjust to the unusual nature of the global economy, ARS expects a prolonged low-growth environment with big opportunities for a limited number of countries and companies. The two biggest opportunities stem from stimulants in the system that did not exist before as they do today — climate change and generative AI (artificial intelligence). While both are exciting for the intermediate and longer term, ARS expects investors will experience a bumpy ride until these areas have more rational valuations to support the near-term hyped-up expectations. The countries that will benefit will be those with relatively favorable demographics, fiscal policies to support the ongoing transitions, access to dependable sources of energy, national corporate champions driving the technological revolution, and low dependence on autocratic nations for key resources. Importantly, much depends on three big issues: the extent of China's economic woes, the ability of central banks to tame inflation without causing a severe recession, and the ability of the world to adjust to higher interest rates that will remain higher for longer than currently anticipated.

Below are some key points for investors to consider:

1. Interest rates will remain higher for longer as the Fed needs to avoid a recession due to the current fiscal and monetary position of the United States, while the global system is dealing with a strong dollar, slower growth, higher rates, and more persistent inflation.
2. Given the low-growth environment, companies will have big opportunities to implement productivity enhancements to protect profit margins and increase productivity to offset rising costs and labor market challenges.
3. The U.S. remains the best house in a bad global neighborhood due to its distinct competitive advantages, including its leadership position in advanced technologies, and should continue to attract capital from around the world.
4. It is especially important for investors not to overvalue the qualitative opportunity and focus on the quantitative — watch out for taking excess risk on qualitative factors unsupported by reasonable valuations.
5. The current environment favors the ownership of business versus fixed income due to the continuing loss of purchasing power in bonds.
6. Governments will need to monetize their debts and deficits as budgets are mostly fixed with little opportunity to reduce spending due to massive needs for nations to address big-ticket items including the climate transition, infrastructure spending that can no longer be postponed, the digital transformation and labor market issues (availability and skills).

Despite what is a difficult outlook, we are particularly positive about investing in the companies that are best positioned to benefit in the transition to the next "normal," and many of these businesses are not well represented in the typical institutional portfolio. We believe AI will have a tremendous impact on every industry, but one industry we are most excited about is healthcare, and the potential impact on significantly reducing costs and improving healthcare outcomes in the U.S. Presently, annual U.S. healthcare spending is approximately $4 trillion or 16% of gross domestic product (GDP) which is much higher than other nations. A few ways that AI will transform healthcare include accelerated research and development, enhanced medical diagnosis and treatment recommendations, personalized patient engagement and adherence, predictive analytics, automating administrative tasks inherent in the system, drug discovery, analysis of medical images, and reduction of errors. With the development and introduction of vaccines, the pandemic showed what the industry can do when it is focused and supported. While incredibly impressive, we believe this effort is nothing compared to what lies ahead.

Despite what is a difficult outlook, we are particularly positive about investing in the companies that are best positioned to benefit in the transition to the next "normal," and many of these businesses are not well represented in the typical institutional portfolio.

ARS Investment Partners, LLC
529 Fifth Avenue, Suite 500
New York, NY 10017
212.687.9800

October 5, 2023

We favor energy (fossil fuels and alternative energy sources), steel, rare earth, semiconductor and capital equipment, defense, and healthcare companies which will be among the primary beneficiaries.

Our team continues to identify a select group of companies that are selling at attractive valuations with reasonable to robust growth characteristics, and the ability to navigate the challenges described in this Outlook. As previously mentioned, we favor energy (fossil fuels and alternative energy sources), steel, rare earth, semiconductor and capital equipment, defense, and healthcare companies which will be among the primary beneficiaries. Given the risks in the fixed-income markets, high-quality, dividend-paying companies are attractive vehicles to offset higher living costs and provide protection of capital from the erosion of purchasing power. Moving forward, opportunities for equity investors will be shaped, in part, by the focus of governments and corporations' spending on specific segments of the economy. This focus will also help offset some of the challenges consumers may encounter due to increased living costs.

We see an outlook unfolding that is vastly different from any we have previously experienced, marked by different economic circumstances that will create new investment opportunities.

Published by the ARS Investment Policy Committee:
Stephen Burke, Sean Lawless, Nitin Sacheti, Greg Kops, Andrew Schmeidler, Arnold Schmeidler, P. Ross Taylor, Tom Winnick.

ARS Investment Partners, LLC
529 Fifth Avenue, Suite 500
New York, NY 10017
212.687.9800