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The New Tech Mania: AI

With the volatility in the markets lately, you might not realize that we are currently experiencing an outrageous investment mania. Stocks of companies that are involved in artificial intelligence have been soaring at unprecedented rates, prominently including Upstart Holdings (up 393% this year alone), C3.ai (255%), Nvidia (220%), Palantir Technologies (177%), and Meta Platforms (170%).

It’s a bit of an understatement to say this is not normal, especially for a firm like C3 which reports just $266 million in annual revenues on a market capitalization of $3 billion. And these manias typically don’t end well.

To be fair, there is no question that artificial intelligence technology is going to change our lives in a variety of interesting ways, most of which we don’t know about yet. There will come a time when AI is as ubiquitous and helpful as mobile phones or social media. The problem is that the current pioneers are not guaranteed to be the benefactors of this transformation.

We have actually been through this kind of tech mania once before, in the late 1990s, when anything with ‘.com’ after its name soared in price regardless of earnings or potential. Firms were valued not on revenues or profits but on “eyeballs,” which turned out to be a weak metric for predicting future returns or relevancy. Some of the pioneers were later superseded by larger, better-capitalized companies that simply pounced on their turf and took away their market, improving the technology in the process. Remember Ashton-Tate (database technology), WordPerfect (word processing), VisiCalc and Lotus 1-2-3 (spreadsheets), or Netscape Navigator (the Mosaic browser technology)? Chances are you don’t, but all of them pioneered important advances in technology at the time, and investors who bet on them were (to put it mildly) not rewarded.

Betting on the winners of any new technology is nearly impossible; it was impossible back then and it is today. History tells us that the astonishing runups of the early AI firms will eventually fizzle out.

From Our FSA Family

Happy holidays from the FSA family! Each year, the team at FSA shares their special holiday traditions with their families. To sprinkle a bit of our festive cheer your way, here's a glimpse into how FSA revels in the holiday season:

Family Traditions

Growing up, Ron’s family would always open one present on Christmas Eve; he promises he doesn’t follow that tradition anymore! Deneka follows the same present practice with her daughter. Similarly, Kim B.’s family was allowed to get into their stockings any time after going to bed (as long as it was after midnight). She remembers a few times waking up at 2 am to get a head start.

Hang and her kids wear traditional dresses called Ao Dai to participate in the Tết Celebration (Chinese New Year). On that day, they burn fake money for their ancestors.

Fabio’s family loves to bond and compete by playing games such as karaoke, charades, and various card games.

Jamie’s family mixes things up and does a new event each year. In the past they’ve seen the play *A Christmas Carol*, went to the Gaylord to look at ice sculptures, and played Top Golf.

CJ’s family can’t wait until December to celebrate Christmas, so

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The Looming Revert

Not many people are talking about the fact that the tax provisions in the Tax Cuts & Jobs Act of 2017 are due to revert back after December 31, 2025, to what they had been in 2017, just 26 months from now. But if and when that threshold is crossed, it could be a rude awakening for a number of taxpayers.

For example, one of the most dramatic shifts would be the estate tax rates. The federal estate tax exemption in 2017 was $5.49 million, that is, the first $5.49 million that a taxpayer passed on to heirs would pass estate-tax free. Today, that exemption is a whopping $12.92 million; for married couples, the combined exemption is $25.84 million. The "revert" would bring exemption down to something like $6.5 million, about half of what it currently is.

The Tax Cuts & Jobs Act also doubled the standard deduction, which led to fewer people going through the hassle of itemizing deductions. The standard deductions for the 2017 tax year were $6,350 for single filers and $12,700 for people married filing jointly. Today, the standard deduction is $13,850 for single filers and $27,700 for those filing jointly.

The tax table revert would generally put people in higher brackets; most Americans would pay one to four percent more in personal taxes under the old reverted-to tax tables than they are currently.

Yes, we still have two years to prepare for this. But anyone whose net worth is above the old estate tax threshold should start making plans now for how to get money out of the estate, and everybody should brace themselves for once again having to go through the chore of itemizing deductions unless Congress comes up with a new tax bill. They say that the tax code is written in pencil!

Housing Starts in Decline

Did you know that last year roughly 1.66 million new homes were constructed? This includes single-family homes (975 million), 2-4 unit residences (54.8 million), and buildings with 5 or more family units (635 million). This total number is actually down from the 1.73 million new homes built in 2021, and 2023 is on pace for a further decline to somewhere around 1.44 million residences.

These numbers are closely tracked by the U.S. Census Bureau on a monthly basis and are among the tea leaves that economists are reading to determine the health of the U.S. economy. One of their conclusions is that more construction is needed to combat a persistent housing shortage among younger people in America.

But a bigger issue might be affordability. Just over 28% of new homes sold last year were priced between $500,000 and $749,000, and from 2021 to 2022, there was a 15% increase in the number of new homes sold in that price range. Meanwhile, less than 1% of all new homes sold in 2022 were priced under $200,000.

While developers seem to be dragging their feet a bit, there is evidence that demand for new homes is strong and getting more so. Nearly half (49%) of new homes sold in 2022 were under construction when they were sold, and another 20% were purchased before construction began.

Working Remotely

Most American employees are working remotely these days. Right?

If you follow the news reports about the number of remote workers and office buildings standing empty, you might imagine that America's employees are all hunched over a laptop on their kitchen table. But a recent report by *Forbes* magazine finds that actually just 12.7% of full-time employees are currently working from home, and just 16% of (mostly small) companies are fully remote, operating without a physical office.

But 28.2% of company employees (including FSA's employees) are working under what has been described as a "hybrid model" which is loosely defined as having the flexibility to combine at-home and in-office work. Meanwhile, the majority of the workforce, 59.1%, come to the office every day. Traditional in-office work is far from obsolete.

The more educated the worker, the more likely he or she is to be working remotely; a McKinsey & Co. report found that staff people with advanced degrees (master's or Ph.Ds) were 50% more likely to work from their laptops than people without a high school diploma. That may help explain why remote workers make an average of $19,000 more a year than those who are in the office full time.

Among other findings, 57% of remote or hybrid workers say they would leave their current job if their employer stopped allowing remote work; 35% of remote employees say they feel more productive when working out of the office; and 65% of all workers desire to work remotely all the time. Another 32% say they would prefer a hybrid schedule. But at the same time, 53% of remote workers say it's harder to feel connected to their coworkers than it was when they were working in their office or cubicle.

In short, while many think everyone is working from home, most people still work at the office. However, there's a growing desire for flexible work options. Companies need to recognize this and find the best mix to keep their teams happy, productive, and connected. The future is about balancing office time with remote work.

Downturn Opportunities

We obviously can't predict a market downturn in advance, but we can certainly prepare and then react to them. With the markets in a bit of a doldrums the past few months, that preparation may come in handy in the fairly near future.

Whenever stocks go down, it opens up a surprising number of (usually temporary) planning opportunities for the alert investor. Perhaps the most obvious is harvesting losses, that is, selling positions that have gone down, booking a loss for tax purposes, and then buying a similar (but not identical) investment that is probably also on sale due to the bearish conditions. The investor retains an essentially equivalent market exposure but now has a loss to offset capital gains or income (up to $3,000 of income) on next year's tax return.

Another opportunity is a Roth conversion. That means paying taxes on the value of the shares or cash moving from the IRA into a Roth today so that you won't have to ever pay taxes on that money again. You've probably read that if you expect to be in the same or lower tax bracket in the future than you are today, then a Roth doesn't make tax sense. But if you can make the conversion at lower valuations, then the tax bill is lower today than it would be if the money was taken out after the market recovers. And some of us believe that tax rates will increase over time as well (especially when the tax cuts and jobs act end on December 31, 2025).

People who are making annual gifts to their children or heirs can get a little leverage in a market downturn. Each of us can transfer $17,000 this year to others without paying a gift tax. If you were to transfer investments that are temporarily undervalued, then that $17,000 in depressed ETFs could be a more valuable gift when the market recovers.

Down markets aren't all bad when you take advantage of them. We are happy to discuss which of these strategies make the most sense for you!

Bankruptcy Epidemic

If you're looking for something to worry about, consider bankruptcies. Normally, we see an uptick in companies filing for bankruptcy during recessions, for obvious reasons. An economic slowdown generally means fewer buyers spending less money; and companies that over expanded, took on too much debt, or were poorly managed from a fiscal standpoint can be too weak to withstand the unexpected shock to their revenues and earnings.

But right now we aren't in a recession, and yet bankruptcies around the world are soaring. S&P Global Market Intelligence, which tracks corporate health, reports that in the first six months of this year, U.S. companies filed for bankruptcy protection at a rate not seen since 2010. In England and Wales, corporate insolvencies are near a 14-year high; Germany has seen its bankruptcy rate jump almost 50% over last year to the highest level since 2016; and Japan is experiencing a bankruptcy rate that is the highest in five years.

What's going on? Even though labor markets and corporate profits overall are still at relatively high levels, there are other factors that are testing the resiliency of companies that got too far over their skis. Some firms over-leveraged themselves and were hit by the surge in interest rates. The aftershocks of high inflation were felt by companies that didn't have a lot of pricing power and were selling products at prices that became gradually unprofitable in order to protect market share. So far, the bankruptcy wave hasn't hit too many large corporations; the biggest example is U.S. housewares giant Bed Bath & Beyond.

In a nutshell, while the economy isn't currently in a downturn, bankruptcy filings are on the rise globally due to other challenges like high interest rates and the impacts of inflation. Companies that stretched themselves too thin are feeling the pinch. It's a reminder for businesses to stay cautious and for consumers to be aware of the bigger financial picture, even when times seem good.

FSA Family (cont.)

his uncle hosts a Christmas in July party. Yes, ugly Christmas sweaters are encouraged at the event!

Holiday Movies and Songs

When Mike and his family get together during the holidays, they sing Italian Christmas songs such as "Dominic the Donkey" ("The Italian Christmas Donkey") and "Eh Cumpari."

Aaron likes watching *Die Hard* (which he swears is a Christmas movie!), *Home Alone*, and *Home Alone 2*.

John jams to holiday music all December long, especially to Nat King Cole. His favorite holiday movie is *It's a Wonderful Life*.

Food Traditions

Jim puts his family to work every holiday season to make over 200 pounds of hot Italian sausage from scratch.

Likewise, Kim D. and her family make over 25 dozen donuts every December using a recipe from her grandmother (no exact measurements, of course!). On top of this, Kim D. makes peanut butter fudge and puts her husband to work making buckeyes.

Ann's Christmas dinner is not complete without having egg rolls on the dinner table, whereas Jordan's holiday gatherings always include champagne and oysters.

Dave and Mary Ann have a unique tradition about desserts. Dave hosts a pie night the day before Thanksgiving because there is just not enough room for pie after eating so much turkey. Mary Ann bakes a Christmas cake to eat on Christmas eve.

We hope you enjoyed hearing about our unique holiday family traditions. Have a wonderful holiday season with your family and friends!

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