SPRING 2024 | VOL. 32 | NO. 2
QUARTERLY PERSPECTIVE

Understanding the Artificial Intelligence Landscape as a Value Investor[1]

by Will Williams
Chairman, President & CEO

Ever since January 2023 when Microsoft announced a $10 billion investment in Open AI, the creator of the AI tool ChatGPT, artificial intelligence (AI) has been the dominant theme behind the meteoric rise of several large technology firms. The most notable of these companies is Nvidia, the maker of the most innovative and powerful graphics processing units (GPUs). Over the past 14 months or so, Nvidia has increased in value by $1.7 trillion, becoming the third largest member of the S&P 500 Index, trailing only Microsoft and Apple.

To put this in perspective, this market capitalization gain alone over an incredibly short period of time would equal the total capitalization of the largest U.S. bank, JPMorgan Chase, the largest retailer, Walmart, and the largest energy company, Exxon Mobil. With this as our backdrop at DVI's recent quarterly board meeting, there was plenty of discussion about AI and how we—a valuation-conscious, dividend-focused equity manager—are maneuvering these uncharted waters.

Value investing at DVI revolves around the principle of buying undervalued assets with the expectation of long-term appreciation and, ideally, a current dividend payout that is meaningful and ever-increasing. When applying this approach to AI investments, we believe in looking beyond the hype and focusing on companies with solid fundamentals and sustainable competitive advantages: Do they have a history of embracing technology advancements to enhance productivity, profitability, and to sustain their "wide moat" competitive advantage? So instead of chasing the latest AI startups or Magnificent Seven giants, value investors may find opportunities in mature well-established companies that are integrating AI to enhance their day-to-day operations. Similar to the emergence of the internet in the late 1990s, we believe AI is a powerful tool that companies can adopt to drive additional productivity from their existing operations.

Here are some practical examples of how several different industry groups can utilize AI to enhance their daily operations:

Insurance

- *Automated Underwriting:* AI-powered underwriting systems can automate the decision-making process by quickly analyzing applicant data and determining appropriate coverage and premiums. By leveraging machine learning algorithms, these systems can continuously improve their accuracy over time, leading to better risk management and pricing strategies.

Banking

- *Loan Underwriting and Credit Scoring:* AI-powered algorithms can streamline the loan underwriting process by analyzing borrower data, such as credit history, income, and employment status, to assess creditworthiness and determine appropriate lending terms. By automating and optimizing this process, banks can reduce manual errors, improve efficiency, and make faster lending decisions.

Healthcare

- *Diagnosis and Treatment Planning:* AI algorithms can assist healthcare providers in diagnosing diseases and planning appropriate treatment strategies. For example, AI-powered diagnostic tools can analyze medical imaging scans, such as X-rays, MRIs, and CT scans, to detect abnormalities and assist radiologists in interpreting results more accurately and efficiently.

Manufacturing

- *Optimized Maintenance Scheduling:* By accurately predicting equipment failures and maintenance needs, AI-powered predictive maintenance systems enable manufacturers to schedule maintenance activities more efficiently. Instead of relying on fixed schedules or reactive repairs, manufacturers can prioritize maintenance tasks based on the criticality of equipment, production schedules, and resource availability, minimizing downtime and maximizing equipment uptime.

continued on page 2

Understanding the Artificial Intelligence Landscape as a Value Investor[1] ...continued from Page 1

Utilities

- *Distributed Energy Resource Management:* With the growing adoption of distributed energy resources (DERs) such as solar panels, wind turbines, and energy storage systems, utilities face new challenges in managing grid operations efficiently. AI algorithms can optimize the integration and management of DERs by forecasting their generation output, optimizing dispatch schedules, and coordinating their operation with grid constraints and regulatory requirements.

Significant Power Requirements[2]

There also is a growing awareness of the huge amount of energy needed to support AI data centers, which consumed about 460 terawatt hours (TWh) of electricity in 2022 and could surpass 1,000 TWh by 2026. The International Energy Agency reports that AI currently draws as much as 1.5% of all current global electricity. According to a recent article in *Scientific American*, simply supporting 1.5 million Nvidia servers per year could consume 85.4 TWh of electricity annually—more than many small countries such as Argentina, the Netherlands, or Sweden. It comes as no surprise that technology companies are becoming far more interested in traditional utilities, energy infrastructure, and, recently, nuclear power generation. In fact, in June of last year, Microsoft inked an agreement with Constellation Energy to supply one of its Virginia data centers with nuclear-sourced power.

DVI's Value Proposition

There is no question that the introduction of AI has changed the investing landscape once again. DVI continues to shape its disciplined, value-oriented investment management process to take advantage of this technology disruption while also maintaining a significant emphasis on the superior risk characteristics of our equity strategy. Prioritizing risk management is what has differentiated DVI from our industry peers for nearly four decades. We take the long view as investment fiduciaries and deeply care about the clients that we serve.

[1] Artificial Intelligence tools, specifically ChatGPT and Google Gemini, were used in this article.
[2] Sources: *Scientific American*, *The New York Times*, International Energy Agency, Capital Group

A message regarding one-day settlement cycles (T+1), beginning in May 2024:

On May 28, 2024, settlement cycles for most stock trades and other securities will shift from two business days (T+2) to one (T+1). This industry-wide change requires no action on your part; the new T+1 settlement period will automatically be applied to any trades on or after May 28th.

T+1 offers greater convenience for investors, including quicker access to funds from security sale and enhanced market liquidity. A shorter settlement period also reduces the systemic risk that can occur when trades take longer to settle. This shift to T+1 also aligns with global standards, as many international markets have already adopted or are considering shorter settlement periods.

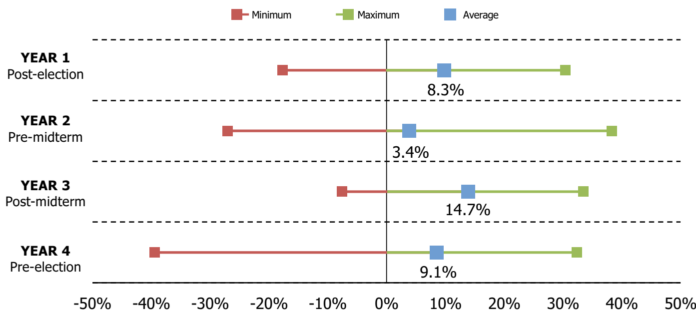
If you have questions about how this transition could affect your individual situation, please reach out to your Relationship Manager for further discussion.

Election Years and the Stock Market

by Brian Christensen, CFA®
Senior Vice President & CIO

As the political rhetoric escalates and the 2024 presidential election draws near, many clients have expressed concerns about investing in this environment. The political division is certainly unsettling, but do elections really matter to the stock market?

Stock Market Returns between Elections

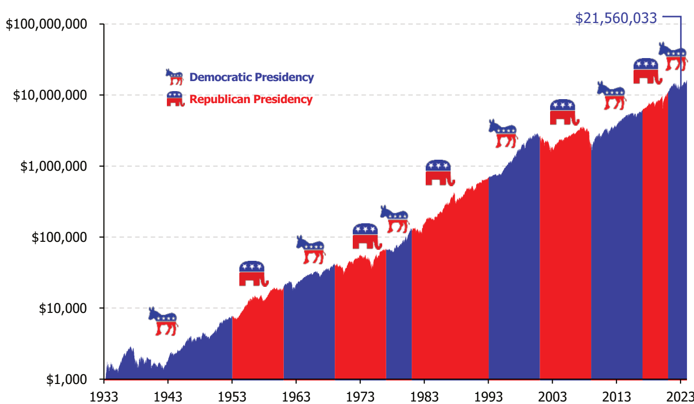


Sources: Haver, FactSet, FMR. As of November 14, 2023. Stocks are represented by the S&P 500.

Fidelity collected market data spanning from November 1950 to November 2023, focusing on 12-month intervals following presidential or midterm elections. The chart above illustrates the average, minimum, and maximum price returns observed during these periods. Since 1950, US stocks have averaged a 9.1% return during election years (Year 4). Despite the wider spectrum of potential market outcomes in the 12 months leading up to an election, the average return doesn't notably differ from other parts of the cycle. While we may experience more short-term volatility in election years, investment returns have remained attractive.

Historically, markets have been non-partisan as well. Stocks have increased in value regardless of which party held the presidency. Certainly, markets are not always going up, but over normal market cycles, stocks have moved higher. As seen in the chart in the lower left, stock prices have trended higher across all administrations, Democratic or Republican.

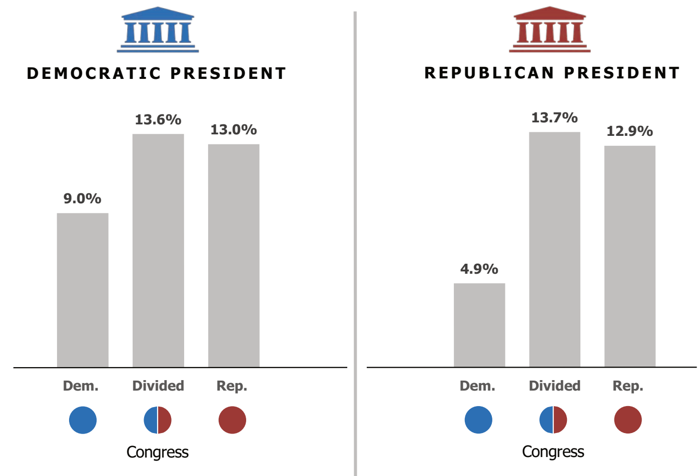
1933-2023: Growth of a hypothetical $1,000 investment in S&P 500



As of December 31, 2023. Dates of party control are based on inauguration dates. Values are based on total returns in USD. Shown on a logarithmic scale.
Sources: Capital Group, Morningstar, Standard & Poor's

Further, the market prefers gridlock! Markets dislike uncertainty, and a divided legislature prevents changes that have the potential to disrupt businesses and markets. As a result, stock returns have been the highest during periods when Congress is divided, regardless of the president's party affiliation:

Average Annual S&P 500 Performance
(1933-2022, excluding 2001-02)



Data excludes 2001-2002 due to Senator Jeffords changing parties in 2001. Calendar year performance from 1933-2022. Source: FMR, Strategas Research Partners, as of November 5, 2023

Every election brings candidates with their own agendas and policy goals, but rarely does new leadership or policy destroy a market sector. As examples, politicians have forever targeted Health Care and Energy, yet each industry continues to rank #1 and #2 respectively in world GDP expenditures.

Election year uncertainty shouldn't cause you to change a long-term investment strategy. Instead, look to the opportunity that election years provide. Some of DVI's most successful investment ideas have developed from short-term market volatility triggered by concerns over transitions between old and new administrations. Our ability to be a bit contrarian and patient in our methods has proven to be valuable, especially in election cycles. In his 2021 Berkshire Hathaway shareholder letter, Warren Buffett reminds us that "Despite some severe interruptions, our country's economic progress has been breathtaking. Our unwavering conclusion: Never bet against America."

New in 2024: Rollovers from 529 Plans to Roth IRA Accounts+

by Jeff Huizenga, CFP®, ChFC, MSFS®
Director of Wealth Strategies

Under the SECURE Act 2.0 passed in 2022, 529 plan assets can rollover directly into a Roth IRA account effective January 1, 2024. This legislation contains various rules that the IRS could interpret differently when the time comes for implementation. For example, it's currently unclear who would be responsible for any penalties should a rollover fall afoul of the rules. Despite some lingering uncertainty, here is an outline of the key rules and restrictions that apply to these 529 to Roth IRA rollovers:

1. The Roth IRA account owner and the 529 plan beneficiary ("Owner/Beneficiary") must be the same person.

2. The 529 plan must be held for the beneficiary for at least 15 years.

   529 plans allow you to change beneficiaries whenever you want. However, it's unclear whether changing a beneficiary will be permitted before a rollover, or if changing a beneficiary triggers a new, 15-year holding period.

3. Contributions made to the 529 plan in the last 5 years before distributions start—including the associated earnings—are ineligible for tax-free rollovers to a Roth IRA.

4. Rollovers cannot exceed the IRA contribution limit for that tax year ($7,000 for 2024). The rollover amount should be reduced if the Owner/Beneficiary makes "regular" contributions to a traditional IRA or Roth IRA in that year.

5. For an Owner/Beneficiary, there is a $35,000 lifetime limit on tax-free rollovers from a 529 plan to a Roth IRA account.

6. In the year of a rollover, the Owner/Beneficiary's income must be equal to or greater than the rollover amount.

7. Roth IRA income limitations are waived for rollovers.

8. For Illinois residents, these rollovers would be considered a non-qualified withdrawal subject to recapture of Illinois state tax benefits under current Illinois law. Other states may have similar provisions, so it will be important to review the particular 529 plan documents before a rollover.

Growth of $35,000 rollover from 529 plan to Roth IRA

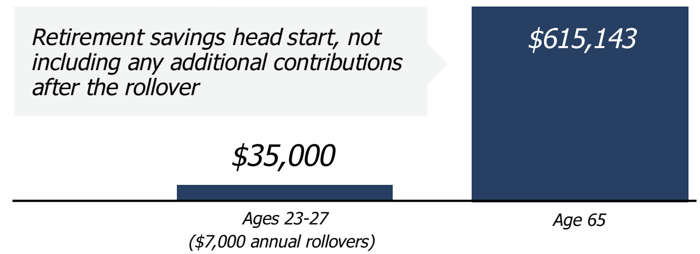


Chart assumes $7,000 annual rollovers with 7% annual returns, compounded monthly, which grow to $43,362 after five years. Sourced from J.P. Morgan Asset Management for illustrative purposes only. Contact your DVI Relationship Manager with any questions.

For now, we recommend waiting for additional clarification and guidance from the IRS before executing these rollovers, and we will continue to monitor developments as the legislation unfolds. If you want to discuss how this legislation may impact your financial planning, please call or email your Relationship Manager.

+ Sources consulted for this article include the Senate Committee on Finance, the Internal Revenue Service (IRS), and Charles Schwab & Co. and are subject to change because of new information.

DVI continues to build our team, and we are always on the lookout for talented investment professionals. To view our open positions or learn more about careers at DVI, we invite you to scan this QR code or visit: www.dviinc.com/join-team.

DVI
David Vaughan Investments

Quarterly Perspective is published by David Vaughan Investments, LLC. Copyright 2024 by David Vaughan Investments, LLC. All rights reserved. This newsletter represents opinions that are subject to change, and it does not constitute a recommendation to purchase and sell any security or to engage in any particular investing strategy. The information contained herein has been obtained from sources believed to be reliable but cannot be guaranteed for accuracy.

Peoria, Illinois | Winter Park, Florida | www.dviinc.com