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Artificial Intelligence, the Next Wave in the Productivity Supercycle

Hani Redha, CAIA, Global Multi-Asset Portfolio Manager

Productivity is like economic pixie-dust. It can generate growth without stoking inflation, and over time is the primary driver of real wages and standards of living. Environments when productivity are high are typically disinflationary and can boost profit margins when supply-led growth is fueled by successful investments in innovation rather than just raw capacity. The prospects for a productivity supercycle therefore have deep consequences for markets, in both absolute terms and relative to one another.

In contrast to the significant slowdown in investment after the global financial crisis, we've observed a remarkable resurgence in investment activity in the US post-Covid. Initially, this was a supply response to Covid-related shortages, but it has since evolved into increased innovation-driven investments in artificial intelligence (AI), quantum computing, the energy transition, and reshoring. US firms made good use of government support by investing in productivity-enhancing technology and eliminating low-productivity jobs. The labor force, in turn, went back to school and returned to the labor market upskilled and switched to higher-productivity jobs. This behavior by companies and workers was not observed in other economies and has helped productivity strength in the US to surge ahead of the rest of the world.

And all this happened even before AI rose to its current prominence. AI's dominance in recent headlines underscores its potential to shape the global economic regime, with significant implications for the macro landscape. To our eye, evidence is emerging that AI is indeed a general-purpose technology (GPT) that can propel another wave of productivity improvement.

Until recently, the US dominated the AI landscape, but now China has revealed that it is also in the race to develop and disseminate this technology. DeepSeek's breakthroughs in cost-efficient AI model training have sparked concerns about potentially reduced investment needs due to cheaper AI models. Notwithstanding a potential digestion phase of temporarily slower hardware investment, we expect continued robust investment in AI infrastructure over the medium term. Lower AI training costs will boost inferencing demand and accelerate AI applications, encouraging companies to integrate AI technologies, which in turn increases the overall demand for AI infrastructure.

We are still in the early stages of an AI-driven economic transformation. The initial phase of AI adoption has primarily focused on building infrastructure and hardware, setting the stage for future applications. As the industry transitions into the second phase – application deployment and monetization – AI's influence and demand are poised to grow.

Through our global analyst network, we are seeing AI use cases becoming more apparent through applications that companies can leverage to reduce costs. The finance sector in particular can benefit from AI across marketing, trading, and compliance, improving operational performance; it scores the highest as an AI beneficiary. FIS, a payment service provider in the US, achieved 20%-30% productivity gains with the Copilot AI program.[1] Customer service comes up consistently as an area that is highly amenable to AI support, leading to substantial cost savings through

[1]Source data from FIS company presentation as of February 2025.

About This Report

PineBridge believes that not only do differences of opinion make markets, but they also foreshadow substantial moves ahead as these differences are resolved. Once a month, investment leaders from our global multi-asset, equities, and fixed income teams meet to share their diverse viewpoints. This report reflects those discussions and debates by providing insight on the topic of the month along with snapshots of our asset class views and convictions across the firm.

reduced servicing times per customer as well as an enhanced customer experience. Another sector that is already seeing AI benefits is industrials. As an example, Rockwell Automation, a US firm that manufactures automation products, reduced downtime by 20%-40% with AI-powered predictive maintenance, and 80% of their customer service requests are resolved using General AI.[2]

Not all companies will be in a position to benefit, and some may even be disrupted by the dissemination of AI. Some legacy companies are already struggling to compete with new market entrants who quickly adopt and integrate AI technologies, underlining the importance of actively managed investment strategies in this environment. Yet overall, we expect a rapid downtrend in AI costs and a rise in AI tools as they become more commoditized, leading to widespread adoption.

The US is likely to continue to be the AI leader in the phase ahead, yet the availability and improving cost efficiency of AI tools will lead to a global adoption akin to the internet over time. Although markets are facing heightened uncertainty at the moment, investors should not lose sight of the exciting environment we are in. Pullbacks in the stocks of leading players should be seen as opportunities to gain exposure to the productivity and growth that lie ahead.

Conviction Score (CS) and Investment Views

The Conviction Scores shown below reflect the investment team's views on how portfolios should be positioned for the next six to nine months. 1=bullish, 5=bearish, and the change from the prior month is indicated in parentheses.

Global Macro

Sam McDonald
Sovereign Analyst,
Global Emerging Markets
Fixed Income

CS 3.00 (unchanged)

Strong upward revisions to November and December payroll numbers and a hot Consumer Price Index (CPI) print underpin our short-term view that the US economy is in "Trend." Our 12-month outlook, however, remains less positive as uncertainty over trade, federal job cuts, tax cuts, AI, immigration restrictions, and regulatory changes mount. Employment growth is likely to slow this year, driven by lower immigration, but the unemployment rate will likely creep lower on the back of lower labor supply. We expect a moderate slowdown in growth to begin in the latter half of the year, but that remains compatible with our "Soft Landing" scenario.

While the headline January non-farm payroll number of 143,000 was weaker than expected, largely due to the impact of wildfires and colder-than-expected weather that affected construction and leisure, revisions that added 49,000 and 51,000 jobs in November and December, respectively, pushed the three-month moving average to 237,000, up from the low of 83,000 in August. In the household survey, the number of workers who reported they were employed but not at work due to bad weather increased to 591,000 in January, higher than the 112,000 level in December. Other labor market indicators also point to a stable labor market in the near term, with initial claims falling back to 213,000; continuing claims have also remained broadly flat.

January CPI surprised on the upside at 3% year-over-year (y/y), with volatile core components like used-car prices and auto insurance costs putting pressure on headline numbers. Progress continued on underlying service inflation, however, with rents rising by 0.3% month-over-month (m/m), suggesting that a gradual cooling in rental inflation is progressing. Rising core goods prices have returned as a contributor to inflation in January, having been a drag for most of 2024, supported by the deflationary environment in China. Inflation expectations have also increased, partially driven by tariff concerns.

Retail sales data disappointed to the downside, falling by 0.8% m/m. While it is usual to have post-holiday declines, the weakness was stronger than expected and across the board. Weather impacts may have weighed on the print, as well as front-loading ahead of tariffs in the fourth quarter, but the University of Michigan consumer sentiment indicator also fell in January. Given that the labor market remains firm and income growth remains healthy, the consumption outlook this year should still be supportive for US growth, albeit less of a tailwind than in 2024.

Outside the US, geopolitical concerns in Europe will boost defense spending, and the likelihood of a trade conflict between the European Union and the US is rising. The European Central Bank (ECB) remains relatively confident that disinflation should continue to play out during the year, supported by wage indicators and surveys moving lower.

[2]Source data from Rockwell Automation company presentation as of February 2025.

Rates

Gunter Seeger
Portfolio Manager, Developed Markets Investment Grade

CS 3.50 (+0.25)

Our bearishness continues to grow. Here's why. Imagine you are Federal Reserve Chair Jerome Powell, and that you must set rates for 2025 today against a backdrop of the following seven "givens": Government deficit spending is at $2 trillion, or 8% of GDP; you were wrong about inflation being transitory, so the press cites inflation daily; you have cut rates four times and bond yields have risen substantially; a Boston Fed study in January expects President Trump's tariff plan for Canada and Mexico will cause core Personal Consumption Expenditures (PCE) to rise only between 0.5% and 0.8% (reciprocal tariffs and steel and aluminum tariffs were not included); the price of nearly every asset (homes, equities, gold, bitcoin) is near or at an all-time high; the unemployment rate is 4.0%, and 1.8 million jobs have been created over the last 12 months; and disasters in North Carolina, California, and Kentucky will keep homebuilding supply chains tight.

The reasons above make it incredibly difficult for the Fed to lower interest rates in the foreseeable future. The government's huge spending is a natural inflation machine. The economy needs something deflationary to counteract that inflation fire. Interest rate cuts now have little hope of lowering prices for middle- and low-income Americans. The Fed will have difficulty cutting rates without a severe slowdown in the economy.

Credit

Steven Oh, CFA
Global Head of Credit and Fixed Income

CS 3.50 (unchanged)

US policy actions are creating uncertainty and disruptions both domestically and globally. While tariffs thus far have remained a negotiating tactic and have not yet materialized, uncertainty over international trade as well as over the impact of a weakening of traditional global strategic alliances and a dismantling of various government functions introduces risks that there will be breakage in the process. With government-supported jobs being a primary component of US employment growth in recent years, that component of unemployment should increase as the year progresses and weigh on economic growth. The offset will be the yet-to-emerge stimulative policies that are being anticipated by the markets.

With higher risks arising from uncertainty at the same time that complacency characterizes risk markets, we maintain our defensively tilted score. While our previous defensive posture was primarily about maintaining a beta risk exposure and diversified asset allocations, we would now shift incrementally more defensive in asset risk positioning as well. While current yield will continue to be the driver of excess returns, it will be prudent to commence tilting toward investment grade (IG) at current tight valuation differentials. We would also be more cautious of European exposure due to a combination of weaker economic trends and tariff/foreign policy uncertainty.

Currency (USD Perspective)

Anders Faergemann
Senior Sovereign Portfolio Manager, Emerging Markets Fixed Income

CS 3.00 (unchanged)

A soft landing for the US economy is still our baseline outlook over a 12-month timeframe, corresponding with a neutral US dollar outlook. However, short-term turbulence amid trade tensions and unconventional policies (such as immigration and government spending) highlight the uncertain path toward this market equilibrium.

In case we remain in our "Trend/Higher for Longer" scenario, we can't rule out the US dollar hitting new highs for the year before a slowdown in US economic activity in the second half can lead to a more sustainable reversal in the dollar into year-end. In addition, renewed evidence of long-term productivity gains in the US vis-à-vis Europe make the US dollar outlook increasingly positive notwithstanding current positioning and short-term valuations.

Historic correlations suggest the US dollar is mainly driven by yield differentials, yet anecdotal evidence underscores how divergence in monetary policy expectations and US exceptionalism have been persistently supportive of a stronger US dollar. With the Fed on hold and the ECB still determined to support eurozone growth through rate-cutting, we could see further euro weakness in the first part of the year.

US exceptionalism embraces the progress made by the US economy in recent years, with growth and productivity clearly outpacing that of the eurozone. While the combination of the wealth effect and a higher propensity to spend in the US have been major factors in driving economic growth, technology investment above and beyond Europe have catapulted the US economy into a new sphere of influence. AI and tech investments suggest US potential growth could increase in coming years, providing fundamental support for an even stronger US dollar.

Trade tensions in the first half of 2025 may weigh on the euro and the Chinese renminbi, suggesting the US dollar is in a strong position to hold onto its gains and target parity vis-à-vis the euro.

Emerging Markets Fixed Income

Joseph Cuthbertson, CFA
Sovereign Analyst

USD EM (Sovereign and Corp.)
CS 3.00 (unchanged)

Local Markets (Sovereign)
CS 3.25 (unchanged)

The macro environment continues to be favorable for most emerging market (EM) nations, with the improving fundamental trend remaining intact. Better fundamentals are reflected in the number of sovereign credit rating upgrades in 2024, the best year for upgrades since 2011. Looking ahead, the upgrade candidates far outweigh downgrade candidates in number and aggregate index weight. These numbers include several potential rising stars (Oman, Serbia, and Azerbaijan). Our expectation for commodity prices is also optimistic for the asset class.

EM spreads remain anchored by US macro data, which indicates a robust growth environment in the near term. But rising risks around tariffs will be harmful for some EMs, and near-term trade uncertainty will weigh on growth and investment. Nevertheless, our forecast for the EM-DM growth differential in 2025 continues to paint a positive picture for EM assets. EM countries facing tariffs or cuts to aid or budget support appear to be developing a playbook to navigate these challenges swiftly. So far, the spillover from such events to the wider EM community has been limited. We expect the market will differentiate among EM names and discern where sound policymaking and a credible direction of travel for fiscal and monetary policy can be found.

January was busy for sovereign primary markets, with some US$58.3 billion issued, of which US$40.9 billion were IG names. For scale, this is around one-third of our total issuance expectations for the year. January, fortunately, saw the highest monthly cash returns this year, with some $16 billion in maturities. While January's issuance was IG-heavy, we saw Egypt, Turkey, and Benin issues in the high yield (HY) space. All had healthy books, a good sentiment indicator for the asset class.

With fourth-quarter corporate earnings starting to appear, results have been broadly neutral to positive. We expect the quarter's performance to affirm our view that the fundamental picture remains solid. The default expectation for 2025 for the CEMBI BD HY index is 1.7%, which is at the lower end of the 10-year range. Supply expectations for 2025 as a gross number are higher than 2024, but the net is lower than 2024's US$83 billion, which underpins firmly positive technical support for EM corporates. Primary activity was busy in January, with a gross supply of US$66 billion, above the average supply of US$60 billion for the month. Combining this with scheduled and unscheduled cash flows, the net financing for the month turned positive at US$18 billion. Deal demand was strong from EM and crossover investors, and secondary performance was generally positive. February should turn out to be a quieter month for corporate primary issuance, with net cash flows closer to neutral.

EM central banks are likely to remain conservative in the face of persistent US inflation, expectations that the Fed will become more cautious given uncertainty around policymaking and any second-order effects from these policies, and the possibility of a potentially stronger US dollar. This means a slower pace of cuts, with many countries possibly leaving rates above their neutral level.

Multi-Asset

Deanne Nezas, CFA
Portfolio Manager,
Global Multi-Asset

CS 2.50 (unchanged)

We are in a period when bottom-up micro opportunities dominate top-down macro concerns. Seeing more upside than downside risks ahead, we maintain a constructive CS of 2.5, with a bias toward increasing risk exposure in response to market jitters triggered by tariffs, immigration, or negative semiconductor news.

The macro backdrop is one of US resilience with expectations for continued widening of the global growth gap. The US economy is experiencing secular rising growth teamed with inflation levels that should keep grinding lower toward the Fed's target. While we expect a one-off increase in inflation from the next round of tariffs, likely to be announced in April and aimed at achieving trade objectives, we also expect revenue raised from these tariffs to finance an ongoing and fully paid lowering of the corporate tax rate. This backdrop is not the same for trading partners, many of which are experiencing sluggish if not stagnating economies in which imports and exports are a significantly larger percentage of their economies.

The bottom-up opportunities are driven by developments around DeepSeek. At the high end, hyperscalers will continue the race toward artificial general intelligence (AGI) dominance, providing ongoing demand for the most advanced computational capabilities. Nonetheless, the cost savings of the newer large language models likely will spur demand for all but the hyperscalers, broadening this group.

Global Equity

Christopher Pettine, CFA
Global Equities Analyst

CS 3.00 (unchanged)

Developed equity markets have shrugged off headline policy uncertainty around US tariffs and government efficiency downsizing and remained in an uptrend. Europe has led, followed by the US and Japan. Although inflation and interest rates remain elevated, markets appear to be looking past that toward a more business-friendly environment of lower taxes and deregulation. China markets are showing signs of life from AI drivers and some early signs of stimulus.

Earnings revisions are gradually turning positive. Earnings growth is broadening out to sectors beyond technology and communication services to include cyclicals and some defensives. Consumer spending remains supported, and inventory destocking is largely completed. Company commentaries also suggest signs of improvement. The equity market remains concentrated in terms of leadership and there are many ways to be wrong. Greater clarity on tariff impacts and a general reduction in uncertainty is needed.

Global Emerging Markets Equity

Taras Shumelda
Portfolio Manager,
Global Equities

CS 3.00 (+0.25)

We have become a bit more conservative on risk, with global EMs becoming fully valued in the context of the current earnings outlook, and additional earnings upgrades and lowering of global risk premia needed to generate further upside.

This has been an eventful month for EM equities. DeepSeek and its impact on AI and related demand are still being evaluated. Investors are adding to Chinese companies that are most likely to benefit from DeepSeek's growth. Alibaba has signed a cooperation agreement with DeepSeek, as well as with Apple. Xi Jinping's invitation to meet with Alibaba founder Jack Ma is a turnaround from the days when the Ant IPO was stopped and Ma went into a self-imposed exile. The Trump administration is not moving as quickly or as forcefully as expected with the imposition of trade tariffs, although this may change. The first stages of talks between the US and Russia to end the war in Ukraine have begun. Concerns abound that the US is excluding Ukraine and the EU from the negotiations and may appease Russia.

In Latin America, trade and political threats from Washington seem to have abated, helping the market focus on bottom-up fundamentals. Opinion polls in Brazil showing Lula's popularity declining gave rise to hopes that a more disciplined government will gain power after the 2026 elections.

Fourth-quarter earnings have been mixed. Banks and technology component makers released generally good results and somewhat optimistic guidance. Other sectors had both winners and losers with no clear trend emerging. In terms of returns, the two areas of greatest outperformance were Chinese AI and Ukraine peace process exposures. On the portfolio level, we bought a Saudi telecom stock, reduced a Korean chip manufacturer, and reduced a Hungarian generic pharma stock.

Quantitative Research

Qian Yang
Fixed Income
Quantitative Strategist

Our US Conviction Score slightly improved, staying in the optimistic zone, while the credit spread remains unchanged and the curve steepened by three basis points.

Global credit forecasts greatly improved but continue to be negative, relatively favoring DM to EM. In DM industries, the model favors brokerage and banking and dislikes basic industry, consumer goods, and utilities. Among EM industries, the model likes financials and pulp and paper and dislikes transportation, metals and mining, and utilities.

Our global rates model forecasts lower yields for the UK, North America, and Oceania and higher yields for Japan and most European countries.

The rates view expressed in our G10 Model portfolio is neutral to slightly overweight global duration. It is overweight the UK and Oceania and underweight most of Europe, Japan, and North America. Along the curve, it is overweight six-month, 10-year, and 20-year durations. It is underweight two-, five-, and 30-year durations.

All market data, spreads, and index returns are sourced from Bloomberg as of 19 February 2025.

About PineBridge Investments

pinebridge.com

PineBridge Investments is a private, global asset manager focused on active, high-conviction investing. We draw on the collective power of our experts in each discipline, market, and region of the world through an open culture of collaboration designed to identify the best ideas. Our mission is to exceed clients' expectations on every level, every day. As of 31 December 2024, the firm managed US$190.3 billion across global asset classes for sophisticated investors around the world.

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