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Investing in the AI value chain

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Artificial Intelligence (AI) could become one of the most profound innovations and largest investment opportunities in human history.

AI is a hot topic and has contributed significantly to the sharp rise of many technology stocks over the past nine to 12 months. We have just published a new, more comprehensive study, "Artificial Intelligence: Assessing and Seizing the Investment Opportunity." In this study, we segment the AI universe according to the value chain and offer investors a framework to help them invest in the sector.

We believe thinking in terms of value chains is crucial. Even in a rapidly growing industry, the high pace of innovation and the constantly changing competitive dynamics mean the success of different areas of the value chain is likely to vary. We identify three levels:

1. The Fundamental "Enabler" Level – Companies that provide the backbone for AI development, from semiconductor production to chip design, cloud and data centers, and companies involved in power supply.

2. The "Intelligence" Level – Companies that transform the computing and energy resources from the Enabler level into intelligence. This includes those developing large language models and companies owning data sets that can be converted into intelligence.

3. The "Application" Level – Companies that embed tools from the Intelligence level into specific applications. Currently, we believe the most promising application areas include co-pilots, coding assistants, digital advertising, call centers, healthcare R&D, cybersecurity, and fintech.

Thinking in value chains can also help us identify potential opportunities and risks for the success of the entire industry. For example, the Application level must ultimately generate enough revenue to "pay" for the other two levels.

Investors should first ensure they are sufficiently invested in the theme. Many have built some exposure to AI in recent months. However, the sheer growth pace of the industry means that many investors are still underinvested overall.

Second, we favor the Enabler level. Although fears of overcapacity could trigger volatility here, we believe the segment currently offers the best mix of attractive and visible earnings growth, strong competitive positioning, and reasonable valuations. In this context, we like semiconductor companies.

Third, the previous AI boom has primarily benefited the largest technology companies. We expect the AI market to be dominated by an oligopoly of vertically integrated "foundries" and monolithic players along the value chain. Therefore, aside from semiconductor companies, we also like those positioned across the entire value chain, covering chips, cloud computing, and generative AI models and applications.

Lastly, it is important to remember that it is not just about the US. China's tech giants are still trading at similar valuations as before the introduction of ChatGPT. However, they are also heavily investing in AI, and ultimately, we expect China to develop an AI ecosystem distinct from much of the rest of the world, offering opportunities as well.

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