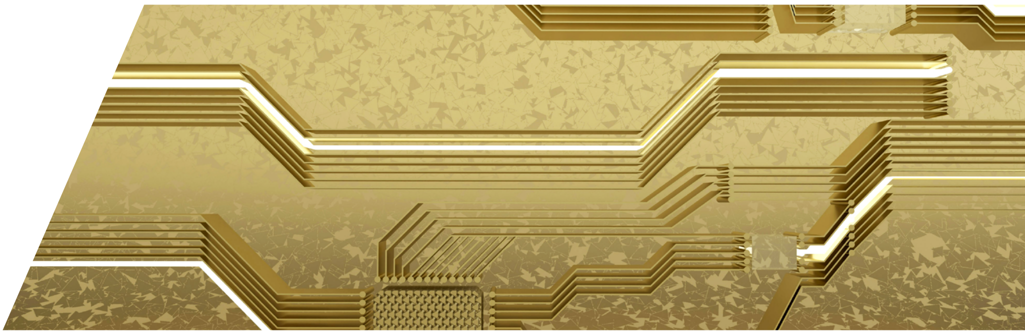
GLOBAL EQUITIES

AI'S GOLD RUSH: UNEARTHING THE NUGGETS OF QUALITY GROWTH



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- *Just as the Gold Rush miners needed tools, artificial intelligence (AI) applications and models need infrastructure. Our Comgest Global Equity strategy seeks these essential companies, favouring those with high barriers to entry and strong pricing power.*
- *Over the past two years, the AI "Gold Rush" has led to the MSCI World Index becoming concentrated in just a handful of AI-related stocks.*
- *We tend to avoid investing in early-stage foundational AI models and software due to concerns associated with intense competition or potential commoditisation.*

In 1848, Swiss-German settler John Sutter struck gold in Sacramento, California, sparking a frenzy of fortune hunters and the start of the California Gold Rush. By 1852, approximately 300,000 people, including industrialists, engineers and explorers, had migrated to California to cash in.[1]

Source: Getty Images

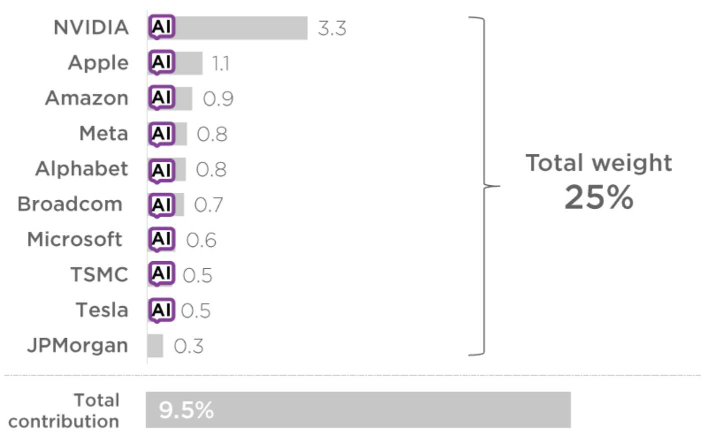
Today, a similar surge of commercial interest in AI and large-language models has captivated global markets. Recent advancements in AI have been driven by huge gains in computing power, thanks to improvements in computer chips and technology. Companies around the world are racing to integrate AI into their business models to boost efficiency, reduce costs and drive innovation.

AI BOOMTOWN DRIVES MARKET CONCENTRATION

As with gold in the 19th century, AI is quickly becoming a strategic resource for companies and governments alike. Geopolitical, military and economic power is becoming more closely associated with computer chips, semiconductor manufacturing and the AI supply chain.[2] Investor enthusiasm for AI stocks has followed suit. In recent years, the global stock market has become increasingly concentrated in just handful of AI stocks. Eight out of the top ten contributors to the MSCI AC World Index

[1] "California as I Saw It: First-Person Narratives of California's Early Years, 1849 to 1900." The Library of Congress. Accessed 12-Feb-2025.
[2] Miller, Chirs. *Chip War: The fight for the world's most critical technology.* New York, New York: Scribner, 2022.

Figure 1. MSCI ACWI – Top 10 Contributors – 2024 (% USD)



Source: Comgest/FactSet financial data and analytics, unless otherwise stated. Data as of 31-Dec-2024 expressed in USD.

(MSCI ACWI) in 2024 were American AI-related stocks, as shown in *figure 1*. As active stock pickers, Comgest believes that this concentration in AI-related stocks raises concerns about diversification and the long-term earnings potential of these leading stocks.

Our Comgest Global Equity strategy focuses on identifying companies that command significant market share across a wide variety of sectors, including healthcare and critical data services. We look beyond indices and aim to construct our portfolio with companies that can potentially exhibit robust competitive advantages, formidable barriers to entry and substantial pricing power. Based on our experience, these attributes can position a company to achieve sustainable earnings growth over the long term.

THE CASE FOR INVESTING IN AI'S "SHOVELS AND PICKAXES"

The California Gold Rush and the AI boom share several similarities, both sparking waves of fear and opportunity. Oftentimes romanticised through tales of the "forty niners", the Gold Rush saw adventurers from across the globe flock to California in search of gold. However, the true drivers of the Gold Rush—its supply chain and economies of scale, including trains, wagons, ports and hydraulic mining machines—are often overlooked. Without essential tools like shovels and pickaxes, the Gold Rush might never have happened.

Similarly, in the AI gold rush, we believe that there has been a tendency to focus on end-products rather than the various stages of the global AI value chain (as shown in *figure 2*). Just as shovels and pickaxes were used to pan for gold, chip manufacturers, data centres and developers are crucial to the creation of AI models. Given this, we tend to avoid those sections of the AI value chain where companies are racing to dominate a small market segment. From our perspective, the ultimate winners in these sections of the market are unclear due to the rapid innovation and disruption across the industry. This includes foundational models, pioneered by OpenAI, and quickly followed up by start-ups like DeepSeek, Mistral and Anthropic. These companies represent only a small portion of the overall AI market. At the same time, large incumbent software companies that are investing in AI potentially risk being disrupted by these younger companies. At this stage, we believe that it's still too early to determine whether one AI model or several will emerge as the leader in the future.

Figure 2. The stages of the AI value chain

Source: Comgest

CHIPPING AWAY THE COMPETITION

Comgest's Global Equity strategy first invested in **Taiwan Semiconductor Manufacturing Company (TSMC)**, the world's largest chip manufacturer, back in 2007 as the race to create smaller, more sophisticated computer chips was picking up at a rapid pace. TSMC, since its creation in 1987, has focused on manufacturing chips designed by developers like **Apple**. This targeted foundry business model has enabled TSMC to establish strong ties with chip designers, cut costs, optimise their production process and gain market share.

The capital expenditure and technology required to manufacture the most-advanced generation of chips have become formidable barriers for new entrants attempting to displace TSMC's market lead. Today, TSMC manufactures most of the world's leading-edge chips to run AI workloads, including those designed by **Nvidia**, **Arm** and **Broadcom**.[3] Despite these escalating demands, TSMC's extensive foundry operations have consistently generated positive cash flow, which has enabled reinvestment and organic growth.

REFINING AI ACROSS THE VALUE CHAIN

As data proliferates globally, **Microsoft** is positioned to provide services across the AI value chain, including supporting businesses with front-end applications and back-office infrastructure.[4] Microsoft's extensive portfolio, including productivity tools, IT networks, gaming and virtual reality, has fostered long-term client relationships.[5]

With Azure, the company's cloud computing platform, Microsoft provides customers with the required suite of cloud services products and network of data centres to develop and run AI applications.[6] The AI infrastructure space is very consolidated with three dominant hyperscalers[7], including **Microsoft**, **Amazon** and **Alphabet** (the parent company of Google). Microsoft has taken steps to integrate advanced models into its software and cloud services, particularly through its partnership with OpenAI.[8] As of January 2025, Azure achieved 31% year-over-year revenue growth, with AI services marking a 157% year-over-year increase.[4] Due to the substantial capital expenditures by hyperscalers in data centres, there is short-term uncertainty regarding their return on capital. However, we believe that growth and returns will potentially be significant over the long term given the industry's high barriers to entry.

DIGGING FOR QUALITY DATA

The surge in AI development has increased the demand for high-quality data, as incomplete or inaccurate data can lead to costly AI malfunctions or hallucinations.[9] **Intuit**, which specialises in tax and financial software is using AI advancements to further refine its products.[10] TurboTax, the company's flagship tax preparation software, has become a staple for both retail and professional clients in the United States.[11]

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[3] TSMC 2023 Annual Report
[4] Microsoft 2024 Annual Report
[5] Microsoft 2024 Annual Report
[6] Sweetman, Steve. "Announcing a New OpenAI Feature for Developers on Azure: Blog Azure: Microsoft Azure." Blog Azure, 7-Aug-2024.
[7] Hyperscalers are large-scale data centres, supported by leading technology companies, that provide customers with access to cloud computing services and infrastructure.
[8] Microsoft 2024 Annual Report
[9] Weise, Karen, and Cade Metz. "When A.I. Chatbots Hallucinate." *The New York Times*, 1-May-2023.
[10] "Our Strategy." Intuit. Accessed 7-Mar-2025.
[11] Yuk, Pan Kwan. "AI Boom Can Even Work on Your Taxes." *Financial Times*, 22-Apr-2024.

While Intuit is not among the AI infrastructure companies featured in our strategy, the company possesses a competitive advantage in the AI gold rush: decades of quality data.[12] There are several startups in the software developer space, but legacy developers like Intuit have established barriers to entry rooted in long-standing customer relationships and extensive repositories of quality data.[13]

BEYOND THE GOLD RUSH: MAINTAINING A VERSATILE TOOLKIT

Comgest aims to look beyond the buzz associated with the AI gold rush. As AI technology becomes more readily available, we believe that there will be fewer distinctions between foundational models. Therefore, we aim to focus on the companies that resemble the shovels and pickaxes of the last Gold Rush: the manufacturers.

Although our Comgest Global Equity strategy includes a selection of AI stocks, we are not limited to any single theme, sector or geography. We recognise that AI is still evolving, and much of its potential has yet to be realised. Given the cyclical nature of AI investments and current stock market concentration, we prefer to invest in what we consider to be quality growth companies across a variety of sectors, such as healthcare and critical data services with visibility over the long-term. Drawing on nearly 40 years of investing experience, our objective is to construct resilient portfolios capable of delivering sustainable, long-term earnings growth, regardless of market conditions.

[12] Peel, Michael. "The Problem of 'Model Collapse': How a Lack of Human Data Limits AI Progress," *Financial Times*, 24-Jul-2024.
[13] Melendez, Steven. "In the AI Era, Data Is Gold, and These Companies Are Striking It Rich." *Fast Company*, 1-Jul-2024.

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- Investing involves risk including possible loss of principal.
- The value of all investments and the income derived therefrom can decrease as well as increase.
- Changes in exchange rates can negatively impact both the value of your investment and the level of income received.
- Emerging markets may be more volatile and less liquid than more developed markets and therefore may involve greater risks.

Alexandre Narboni - Analyst / Portfolio Manager
Alexandre Narboni joined Comgest in 2009 and is an Analyst and Portfolio Manager specialising in Global equities. He is also a member of the Comgest Group's Investment Committee. Alexandre is also responsible for developing and supervising Comgest's Flex strategies, the firm's first investment strategies to employ hedging techniques with the objective of reducing volatility and drawdowns. He previously worked in the Group's US equity team. Before joining Comgest, he worked in New York in asset-backed securities at Société Générale from 2005-2007 and then as a hedge fund credit Analyst at HSBC.
Alexandre graduated from the National School of Statistics and Economic Administration (ENSAE) in Paris and Columbia University in New York where he was awarded a Master's degree in Financial Mathematics.

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Laure Négiar joined Comgest in 2010 and is an Analyst and Portfolio Manager specialising in Global equities. She is also a non-executive member of the Board of Partners and the Global Equity Team manager. Laure co-manages Comgest's Global and EAFE (Global ex-US) strategies as well as the team's segregated accounts. Before joining Comgest, she worked at BNP Paribas Equities & Derivatives in Paris and London, and prior to that worked in several roles within the US government. Laure obtained a Bachelor's degree in Public Policy from Stanford University (with Honours and Phi Beta Kappa) before graduating on the Dean's list with an MSc in Management from the HEC business school in France. She is also a CFA® charterholder.

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Zak Smerczak joined Comgest in 2016 and is an Analyst and Portfolio Manager specialising in Global equities. He is also a member of the Comgest Group's Investment Committee. Zak started his career in 2006 at Deloitte in London, initially in Assurance & Advisory Services before moving to Transaction Services where he was responsible for operational and financial due diligence. In 2011, Zak joined Mirabaud Asset Management where he worked as an Analyst covering global equities. In 2015, he moved to Polar Capital Holdings where he held the position of Analyst / Portfolio Manager for the firm's global multi-asset income strategy. Zak holds a Bachelor of Business Science Degree with Honours in Finance from the University of Cape Town. He is a CFA® charterholder and has been a member of the Institute of Chartered Accountants of Scotland since 2009.

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