
Weekly Market Flash

It's Prove It Time for AI Stocks

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Artificial intelligence has never been far from the center of debate about what is driving the stock market in 2024; in fact, there is precious little else that has come to mind recently on the subject. This week saw three companies jostling and elbowing each other for the pole position as Most Valuable Player in the S&P 500 (and, by extension, the world) – Nvidia, Microsoft and Apple, all of which have a strong case to make as a center of AI excellence (Apple has been a bit late to the game, but arguably could be the company that most directly pushes generative artificial intelligence into the bloodstream of the American consumerati). Nvidia, in particular, has had a stunning run on the basis of its dominant position as supplier of the graphic processing units (GPUs) needed for the vast language learning modules and related technologies developed in AI data centers. Even more impressive than the company's tripling of value in the past twelve months is that, thanks to triple-digit growth over the same period, its price-to-earnings ratio is less than half what it was one year ago.

Earnings Call Hype

Outside the rarefied world of the top few companies, however, the AI narrative is not quite the no-holds-barred hype machine that it was last year. In 2023, as share prices soared for anything that seemed to have an AI theme attached to its business model, companies across the full spectrum of industry sectors fell over themselves telling analysts on their quarterly earnings calls about how central generative AI was to their plans for the next twelve months. Investment firms took note: Citi put together something called an "AI Winners Basket" while the likes of BlackRock and Invesco crafted AI-centric exchange traded funds (the "Robotics and Artificial Intelligence" ETF and "AI and Next Gen Software" fund respectively).

Those funds have hit a rough patch this year, relatively speaking. About 60 percent of S&P 500 stocks are up for the year to date, and roughly the same proportion holds for names in the information technology sector of the index. But around 60 percent of the AI Winners Basket stocks are down for the year, and more than half of the BlackRock and Invesco vehicles are also in negative territory since January. This suggests that investors are taking a more critical approach to evaluating AI business cases, and not just buying up whatever management teams are hyping up on their earnings calls. We see this as a positive development. For companies able to prove that proprietary AI technology is embedded in their strategic business models, the growth scenarios justifying expensive valuations can be plausible. For others, the sooner they come down to earth, the less likely the AI hype metastasizes into a dot com-esque bubble.

The Hype and the Power

Outside the spotlight of glitzy AI storytelling, there is a much less sexy corner of the market that is starting to see its financial prospects improved by the needs of AI-centric Big Tech. Specifically, the need for power – lots and lots of power. The so-called "AI factories" buying tens of thousands of Nvidia GPUs to crunch massive amounts of data into their language learning modules have a seemingly bottomless need for power in whatever form they can obtain it from the energy grid. Wonder why the dowdy utilities sector – traditionally the home of high-dividend stocks with snails-pace growth – is up more than 11 percent this year and trailing only information technology and communications services sectors among S&P 500 sectors? Demand from AI is also giving a boost to fossil fuels companies even while tech leaders like Microsoft scramble to develop and commercialize experimental clean-energy technologies. For now, a

significant clean energy breakthrough at sufficient scale seems far off. For the sake of our planet, not to mention not busting the energy grid's current capacity to service our homes and offices, we hope that happens sooner rather than later. Meanwhile, there does not appear to be an end in sight for the energy demands of AI.

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