AI & Metaverse strategy

AI demand is outstripping supply and requires continued investment in data center capacity

- Global equity markets retreated during October with increased market volatility
- Media and gaming platforms strength ; semiconductor equipment manufacturer weakness
- We started positions in strategic play on AI-related infrastructure growth

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What's happening?

Global equity markets retreated during October, with the MSCI ACWI declining 2.2%[1]. Market volatility increased as investors positioned themselves ahead of the US presidential election and digested robust economic data which led to reduced expectations for aggressive Federal Reserve rate cuts.

Third quarter earnings season is underway and for those companies in the MSCI ACWI Index that have reported their first-quarter numbers, 52% have reported better-than-expected earnings. For the Strategy's investments, this compares favourably with 88% reporting better-than-expected earnings[2].

Portfolio positioning and performance

The AI & Metaverse strategy posted positive performance and outperformed the broader equity market during the month.

Our investments in the 'AI Applications' sub-theme provided the strongest contribution over the month. Social gaming platform Roblox was a strong contributor after reporting impressive third quarter results, with bookings accelerating to 34%[3] year-over-year and record daily active users, approaching 89 million[3]. Social media and camera company Snap also performed well after several challenging quarters, delivering better than expected revenue growth with particular strength in direct response advertising. This strong performance was partially offset by online gaming company Netease and technology conglomerate Sony. Both companies have recently struggled with new game launches. We exited Netease and reduced our exposure to Sony.

[1] Source: Bloomberg in USD as of 31/10/2024
[2] Source: Bloomberg as of 01/11/2024
[3] Source : Roblox Reports Third Quarter 2024 Financial Results, 31/10/2024

Within 'AI Enablers', semiconductor test equipment provider Advantest performed strongly after significantly raising its full year guidance on stronger demand for high bandwidth memory and AI-related testing. Data centre power and cooling solutions provider Vertiv contributed positively after reporting robust order growth driven by AI infrastructure build-out. This strong performance was partially offset by weakness from semiconductor equipment manufacturer ASML after cutting its 2025 guidance and expressing caution about China demand normalisation. Semiconductor company AMD was also weak over the period despite raising its data center GPU revenue outlook, investors likely expected a more aggressive revision.

Hyperscale cloud providers continue to signal strong capital expenditure plans to support AI infrastructure deployment. Post results, consensus estimates now suggest that quarterly hyperscale capex is trending toward $60 billion[4]. Major cloud providers including Amazon, Microsoft, Meta and Alphabet all indicated that AI demand is outstripping supply and requires continued investment in data center capacity. While growth rates may moderate from current levels given increasing base effects, absolute spending levels remain robust.

During October, we started a position in two utility companies, NextEra and Brookfield Renewable, as a strategic play on AI-related infrastructure growth. We believe we are at an inflection point in power demand, driven primarily by the rapid growth and increased energy consumption of AI data centres. Both companies, in our view, are well-positioned to capitalise on AI datacentre power demand while helping customers meet critical environmental requirements. Earlier this year, Brookfield Renewable announced a partnership with Microsoft to develop over 10.5 gigawatt of new renewable capacity. NextEra Energy is one of the world's largest generator of renewable energy and is seeing strong interest from data centre and technology customers.

We exited Chinese online gaming and entertainment company NetEase as the company is facing headwinds and has recently cancelled some underperforming games.

We also reduced our exposure in a few names: entertainment and technology conglomerate Sony as well as Chinese ecommerce and cloud computing platform Alibaba. We trimmed our position in Nvidia, as again it became a very large position in the strategy at greater than 8% of the strategy's assets. Finally, we trimmed our position in Simulation Software company Altair following a bid from German Industrial company Siemens. We have owned Altair in the strategy since inception (April 2022) and it has been a strong performer for us during this period.

Outlook

The strategy has been reshaped to encompass both Artificial Intelligence (AI) and the Metaverse, which is enabling us to capture even more interesting growth opportunities while future-proofing the portfolio. By seizing one of the most important themes of our generation, the strategy can adapt to investors seeking to capture exposure to this fast-moving sector, and its growing set of credible long-term growth opportunities.

Over the past few months, we have witnessed a remarkable convergence between the Metaverse and Artificial Intelligence. As we progressed into this change, it became increasingly clear that AI was not just a parallel development, but a powerful accelerator for the Metaverse itself. Many of the pioneering companies in our portfolio have been at the cutting edge of AI innovations and we strongly believe that the synergies between these technologies are offering unprecedented opportunities.

At present, a significant portfolio of our focus remains on the critical infrastructure underpinning both AI and the Metaverse - areas like semiconductors and equipment which are the foundational building blocks powering the next generation of intelligent technologies. As the demand for more powerful and efficient computing resources continues to rise, driven by the increasing complexity of AI models, we believe that companies at the forefront of chip design and manufacturing will be

[4] Source : Bloomberg consensus, 31/10/2024.

well-positioned to continue to benefit from this secular trend. As the AI ecosystem matures, we could see a wide range of applications and services embedded in various industries, driving efficiency, innovation and growth and we anticipate significant investment opportunities.

The market has been experiencing a narrowing concentration since early 2023, with mega-companies driving a significant portion of the gains. This trend reached its peak in July 2024, marking the narrowest market in over 15 years. However, since then, we have observed a modest broadening of market participation, suggesting that the anticipated shift towards a new interest rate cycle is starting to gain traction. This emerging trend could indicate the potential for a more favourable environment for equities across the market capitalisation spectrum. By focusing on key trends and maintaining a disciplined investment approach that targets well-positioned companies within our themes, we aim to capitalise on the rapid advancements in AI and Metaverse technologies across a wide range of market segments and under various market conditions.

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No assurance can be given that the AI & Metaverse strategy will be successful. Investors can lose some or all of their capital invested. The Metaverse is subject to risks including Equity; Emerging Markets; Global Investments; Investments in small and/or micro capitalisation universe; Investments in specific sectors or asset classes; ESG; Investment through the Stock Connect program.

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