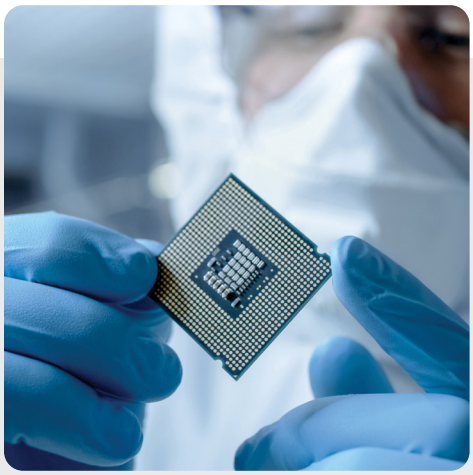


AI-fueled boom: who benefits?

From Winslow Capital

In a recent investment industry survey, nearly 80% of respondents believed that generative artificial intelligence (AI) would have a transformative effect on the global economy.[1] This should come as no surprise as AI sentiment is reaching a near-fever pitch based on the potential of an AI-driven productivity boom. While the prospect of AI has been discussed for many years, a topic that has garnered less media and market attention is the implication of evolving global demographic trends. While these two topics may at first appear to be separate, we view them as intertwined. We believe both factors are likely to be key drivers for the global economy in general, the U.S. economy in particular, and U.S. growth equities as an asset class. Our research points to two key conclusions:

- We believe AI beneficiaries are likely to be disproportionately comprised of traditional growth industries which have the necessary attributes and business models to capitalize on the AI revolution.
- We believe AI productivity boosts are poised to skew meaningfully toward select economies, while other economies may struggle.

In this paper, we explore the first topic; in a subsequent paper, we will address the likely disparate outcomes for global economies as AI and demographic trends evolve.

An AI-fueled productivity boom

We believe generative AI has the potential to substantially increase productivity and creativity across a broad range of functions and industries. Process and efficiency improvements, basic task automation and data analysis are examples of how AI can drive economic growth.

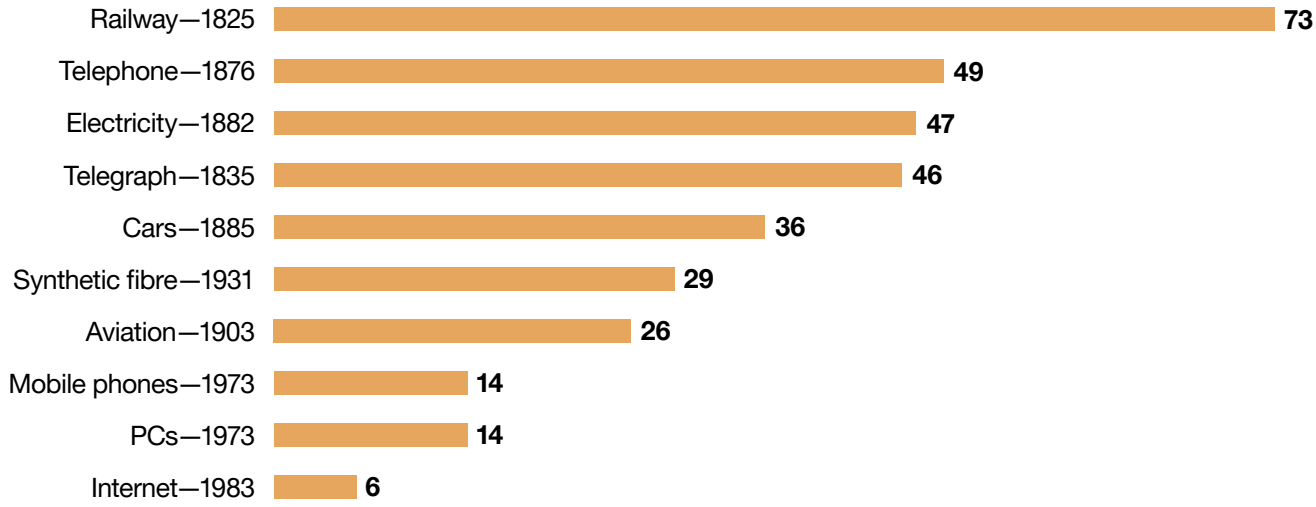
History may provide an interesting guide to the cadence of this transformation and the magnitude of the productivity boost. The difference in adoption timeframes of new technologies between developed and emerging economies has continued to narrow since the Industrial Revolution (Figure 1). However, the usage intensity of the adopted technology has diverged as have the implied aggregate productivity enhancements.

The more accelerated the usage curve, the more pronounced the impact on economic productivity growth as the full scope of the advancements becomes more evident and as complementary innovations and use cases evolve.[2] AI is already being utilized with other technologies such as image and video analysis, autonomous applications, and data analytics. Corresponding improvements in productivity abound.

Perhaps not surprisingly, product launches leveraging key innovation trends have also accelerated rapidly to reach mass-usage levels. Exemplary of this is ChatGPT. Within five days following its launch in November 2022, it bested other key product trends by 90% or more as demonstrated in Figure 2.

Driven by the flywheel effect of elite universities, science and innovation investment, and technological adoption, the U.S. ranks highest amongst innovative large global economies. The U.S. has been the vanguard of innovation breakthroughs since the introduction of automobiles and the U.S. is again positioned for an AI-driven productivity boom.

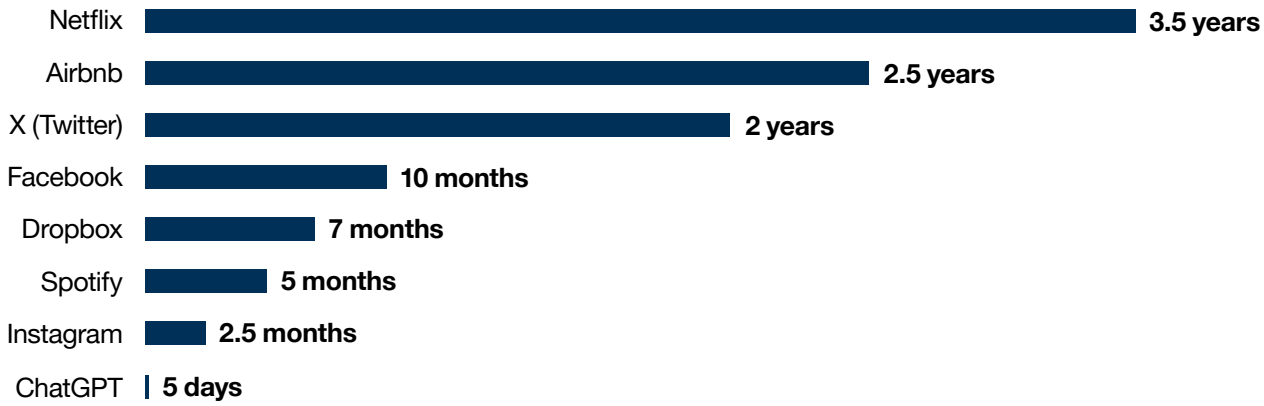
Figure 1. Technology adoption lags (years)



Source: American Economic Journal: Macroeconomics 2018, Comin and Mestieri.

Figure 2. AI adoption at a non-linear rate

Time needed to reach one million users



Source: Statista; company announcements via Business Insider/LinkedIn; https://www.statista.com/chart/29174/time-to-one-million-users. Airbnb user defined as nights booked; Instagram user defined as number of downloads.

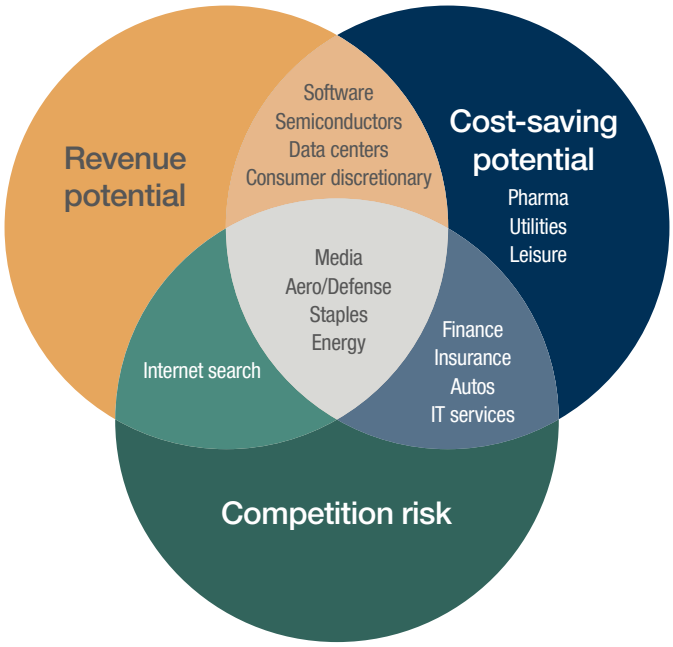
Scale and sector distinctions

We anticipate AI will impact every company. However, unlike other key innovation cycles, we model AI advancements as favoring incumbent businesses. Capital requirements, capacity to leverage massive, fully vetted databases and the ability to distribute services to a sizable list of existing customers, all point to advantages for large existing businesses. These companies can add on, and in many cases are already adding, services to clients — enhancing both pricing power and retention. Large companies typically have IT departments that can keep them at the forefront of AI advancements. We believe there will be, of course, some fascinating and disruptive new businesses formed, but new businesses may face more formidable challenges than encountered in previous cycles, where incumbents often protected legacy businesses at the expense of embracing new technologies.

A framework for assessing the sectors most likely to benefit from AI adoption is to analyze the interplay of potential revenue, cost savings and competitive positioning enhancements (Figure 3).

Our research notes select semiconductor and software companies are positioned to generate incremental revenue growth and operating leverage — and the markets have noticed, with total returns for the semiconductors and software industries within the Russell 1000® Growth Index up 107% and 61%, respectively, for the twelve months ended 1/31/2024 versus the 21% return for the S&P 500® Index over the same period.[3] Growth equities are likely advantaged in this environment and notably, semiconductors and software companies are much more prominent within the Russell 1000® Growth Index, representing nearly one-third of the Index versus about 20% of the S&P 500® Index and just 6% in the Russell 1000® Value Index. Other growth companies such as large cloud computing aggregators, consumer discretionary companies, and specific industrial holdings such as those serving data centers are also potential key beneficiaries according to our research. As noted in our framework, we believe industries that may face disruption include finance, IT services, and internet search providers. In all cases, however, ongoing fundamental analysis and selectivity will be paramount as AI usage continues to unfold.

Figure 3. Impact of generative AI



Source: UBS estimates. UBS Global Research and Evidence Lab. Will Generative AI deliver a generational transformation? May 26, 2023. Winslow Capital modified the chart by condensing sector names, adding data centers and removing industries less relevant to large cap growth.

Summary

- The AI-induced productivity boom is underway and we believe it is poised to expand rapidly.
- With distinct positioning and an innovation flywheel, we believe the U.S. economy is advantaged in this backdrop.
- We believe disproportionate exposure to those sectors most likely to generate AI-induced revenue growth and cost saving favors large-cap growth equities.

We look forward to visiting with you next quarter as we dive into our subsequent paper on the impact of evolving AI and demographic trends.

1. Source: Capital Economics, “AI, Economies and Markets—How artificial intelligence will transform the global economy.”

2. Source: American Economic Journal: Macroeconomics 2018, Comin and Mestieri.

3. Source: FactSet as of 1/31/2024.

INDEX DEFINITIONS

The **Russell 1000® Growth Index** measures the performance of the large-cap growth segment of the U.S. equity universe. It includes those Russell 1000® Index companies with higher price-to-book ratios and higher forecasted growth values.

The **Russell 1000® Value Index** measures the performance of the large-cap value segment of the U.S. equity universe. It includes those Russell 1000® Index companies with lower price-to-book ratios and lower expected growth values.

The **S&P 500® Index** is a stock market index that measures the stock performance of 500 large companies listed on stock exchanges in the United States.

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