Epoch Investment Partners, Inc.

GSFM FUNDS MANAGEMENT

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MEDIA RELEASE

AI stocks are due for a retrenchment, but AI benefits are real and will take decades to play out

US equity market strength over the past year has been driven by the magnificent seven and artificial intelligence (AI) players, and this trend is set to continue into 2025 and beyond, according to Dr Kevin Hebner, global investment strategist at Epoch Investment Partners, fund manager partner of GSFM.

But he says it is not a trend that can continue indefinitely.

"The consensus expectations for earnings growth this year for the entire S&P 500 is 12 per cent, but that is just an average, and for 493 companies it's only 5 per cent, roughly in line with nominal GDP growth. For the magnificent seven it is 55 per cent.

"We have this enormous dichotomy that's being driven by the build out of infrastructure to support AI. These are all the picks and shovels, including the compute, the clouds, and the semiconductors, that make up the operating stack.

"This is going to drive earnings certainly through 2024 and into 2025, but beyond this is less certain," he says.

Looking more broadly at the magnificent seven, Dr Hebner believes there are three reasons to think we may be in the midst of an AI bubble, similar to the tech bubble in the late 1990s.

"There is enormous concentration in terms of stock market cap for a small number of stocks, valuations are extreme and there is a euphoria of public comment driving prices.

"It's always the case that there are titans. Titans rise and titans fall and over the past 30 years there has been a lot of movement in the top 25 tech companies, with the exception of Microsoft and maybe Apple.

"With a disruptive technology like AI it is not clear which ones will or will not be able to pivot or adapt, which is why I don't think it makes sense just to go out and buy the incumbents, particularly now when there are several reasons to believe that we are in the early stages of an AI bubble.

We are only at the beginning of a new age of new technologies for consumers and businesses – and it is a decade-plus long process. Dr Hebner says it's not yet clear which aspects of AI will actually add economic value to businesses and households, similar to the experience with previous general-purpose technologies (GPTs).

"A decade may sound like a long time. But looking at the experience with previous GPTs – such as the internet or electricity - it did take a long time to see the economic value-add. So investors will need to be patient."

AI has already seen success in areas including coding and marketing copy, however Dr Hebner believes that healthcare and education are sectors which will benefit the most from AI.

"Healthcare represents about 20 per cent of GDP and is one area where we hope AI will have a substantial impact, even though it is highly institutionalised and resistant to change. We can see positive impacts in areas such as diagnostics or drug discovery."

"Similarly we see education as another big beneficiary of AI. We are already starting to see these positive impacts.

"We've also seen unconventional applications of AI, one of which I like the most is from agricultural equipment company, John Deere. It has made inroads with its combine harvester, a labour saving machine designed to cultivate seeds. The company now has more software engineers than it does mechanical engineers.

"The combines they produce perform numerous tasks across a field such as seeding, fertilising and de-weeding. The combines test the soil by taking samples and access the quality of the soil and what tasks need to be performed. All these tasks are performed using satellite GPS, so drivers aren't even needed to navigate these machines.

"John Deere is a very interesting case of a traditional company trying to pivot and become an AI company.

"AI augments our abilities, and it is going to make us better. We need to embrace it in the same way that we needed to embrace PCs and the internet and appreciate how they would help us do our job even better.

"Companies that invest in AI to achieve efficiencies and cost savings, are the ones that are on our investment radar," he says.

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About GSFM

GSFM was established in 2007 as a subsidiary of the Grant Samuel Group. In 2016 Canadian wealth manager CI Financial Corp (CI) purchased an 80 per cent stake in the business, previously held by Grant Samuel.

GSFM specialises in marketing funds managed by high calibre local and international managers to Australian and New Zealand institutional and Australian retail investors, and has formed partnerships with eight specialist investment managers:

- New York based Epoch Investment Partners, Inc.
- Tribeca Investment Partners, a successful Australian boutique manager headquartered in Sydney
- Payden & Rygel, a Los Angeles based independent investment management firm
- Munro Partners, an independent global equity manager based in Melbourne
- London-based Man Group plc

- Tanarra Credit Partners, a specialist in private credit instruments
- Access Capital Partners, European independent private asset manager
- Australian Entertainment Partners, to produce the AEP Screen Fund, an investment vehicle dedicated to supporting Australian film and television endeavours.

GSFM represents approximately $9.56 billion funds under management (as at 31 March 2024).

www.gsfm.com.au

About Epoch Investment Partners

Epoch Investment Partners Inc. (TD Epoch) manages a variety of investment strategies with different investment objectives, but they share a common philosophy centred on the belief that the generation and allocation of free cash flow represents the best predictor of shareholder return. The Epoch Global Equity Shareholder Yield Fund (Hedged) and The Epoch Global Equity Shareholder Yield Fund (Unhedged) are distributed by GSFM in the Australian Market.

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