

WILL BIG TECH HAVE FUEL FOR A H2 2023 RALLY?

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The excitement for artificial intelligence (AI) is shifting to how well the technology will drive increased revenues for tech and the broader economy. To sustain spending on high end chips, companies must see a payoff after all the spending.

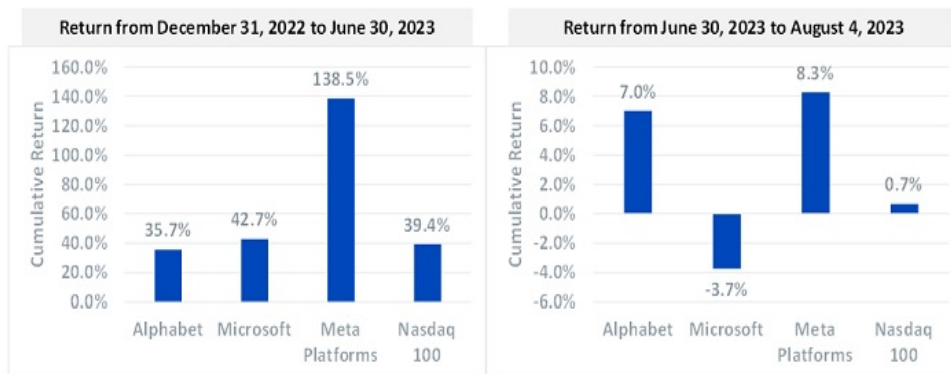
ChatGPT’s release in November 2022 was a blockbuster, with 100 million users signed up in two months. Even though Meta’s Threads achieved this same milestone in five days, ChatGPT’s achievement is seen as more consequential¹.

ChatGPT brought AI and large language models (LLMs) into the mainstream.

Whilst nearly anyone can utilise ChatGPT, it is the world’s largest tech companies that are creating, training and running them. And, thus far, a relatively narrow range of stocks is benefiting.

Microsoft, Alphabet and Meta Platforms are three companies perceived to be the furthest along in deploying LLMs, and these three companies have been central to the performance of US equity benchmarks.

Figure 1: 2023 H1 vs H2 performance so far: Microsoft, Alphabet and Meta Platforms vs Nasdaq 100 Index



Sources: WisdomTree, Factset. Historical performance is not an indication of future performance and any investments may go down in value.

If US equity markets are going to keep trading on artificial intelligence in the second half of 2023, it will remain a game of assessing possibilities and potential, as true transformative adoption is still some time away.

Microsoft—possibly the best story?

Microsoft CEO Satya Nadella was successful in convincing investors its Bing search engine, powered by a large language model from Open AI, had a chance to offer Google's search engine true competition. We see this as a public relations masterstroke, as Google's 90% plus market share looks fairly stable.² However, markets trade not on the reality but on the potential and the story.

In Microsoft's most recent earnings call, Nadella was at it again, noting³:

“...the way I think about it is we still are, whatever, inning two or inning three of even the cloud migration, especially if you view it, right, whether by industry moves to the cloud, segment moves to the cloud as well as country adoption of the cloud. There's still early innings of the cloud migration itself. There's a lot there still. And then on top of that, there is this completely new world of AI driving a set of new workloads.”

Microsoft's Azure cloud platform has emerged as a major growth engine for the company, currently achieving something roughly equal to a \$60 billion per year revenue run rate. There are few lines of business that can continue to grow in a range of 20-30% per year once hitting those levels, but this is what's needed to support Microsoft's roughly \$2 trillion market capitalisation. Generative AI is clearly viewed as further fuel—so much so that it's possible that Microsoft will spend \$50 billion on capital investment during the current fiscal year⁴.

One of the most interesting announcements Microsoft made was not during the earnings call but the week prior, when it announced Co-Pilot would be accessible across Microsoft Office 365 for \$30 per month per user. Few software packages have the reach of Office 365 and, once this is directly available, it will give investors a very direct, clear view of true AI adoption, as well as how quickly it is occurring⁵.

Alphabet—possibly the best potential?

Through all the hype, we have never forgotten that the generative pre-trained transformer was initially referenced in a paper by researchers at Alphabet . Alphabet has enormous research capabilities, but its Google search engine is so dominant that the company is often faced with a version of the so-called 'Innovator's Dilemma'. While Microsoft can take risks and deploy new versions of its Bing search engine, Google must be far more pragmatic.

Alphabet commented 70% of generative AI unicorns are using Google Cloud⁷. Models trained on massive datasets are usually most efficiently stored in the cloud, where computational workloads can be dialed up or dialed down when needed. If the generative AI reality is one that is driven by the large public cloud providers, perhaps this will be a catalyst for Google Cloud to gain market share against Microsoft and Amazon.com.

So far, there is nothing quite as concrete as Microsoft's pricing of Co-Pilot within Office 365, but it is widely expected that Google will feature new applications of its Gemini model in the second half of 2023. Google has its own enormous base of users in its Android smartphone ecosystem, as well as amongst users of Gmail. We'll have to see

if there are any direct monetisation stories that emerge, as opposed to AI simply helping the company's existing business lines perform more strongly.

Meta Platforms—an open source model but a stronger core business

Microsoft's approach is useful for analysis: it creates decisions that customers can make (things they can opt to pay for) and then we can measure this across time. However, it's not the only way.

Meta Platforms has garnered a lot of attention for releasing its LLAMA model as open source, allowing developers to work with it more directly. Of course, 'open source' means that Meta is not directly monetising this access.

The biggest use so far of AI computing power has been various forms of content recommendation. Meta has an ideal business for this, and the most recent quarter's results had the impact of AI sprinkled throughout. One that caught our attention was that Reels has reached over 200 billion views per day, and the monetisation of Reels is now at a roughly \$10 billion annual run rate⁸. Few platforms have the scale that we see with Meta (remember they include Facebook, Instagram and WhatsApp).

Enough of an engine for growth leadership to continue?

At WisdomTree, a primary question we continue to monitor regards 'value' or 'growth' as the investment style set to drive equities forward. From the Global Financial Crisis of 2008-09 until 2022, it was largely all about growth. 2022 was the year of value. The first half of 2023 saw the pendulum swing back to growth.

And here we sit, roughly one and half months into the second half of 2023.

If growth continues to lead, it is likely that 'big tech' will be central and that AI will continue to be the catalyst. We are looking forward to what details Nvidia will bring forth in its next earnings report and whether it will be enough to surprise markets higher again, like it did in May 2023. We also continue to expect further announcements from the largest companies regarding their AI efforts.

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Sources

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3. Source <https://view.officeapps.live.com/op/view.aspx?src=https://c.s-microsoft.com/en-us/CMSFiles/TranscriptFY23Q4.docx?version=f64b33fa-1c41-799b-70cf-cc2cd098555b>
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