

TAP INTO THE AI REVOLUTION WITH WISDOMTREE

Christopher Gannatti – Global Head of Research, WisdomTree.
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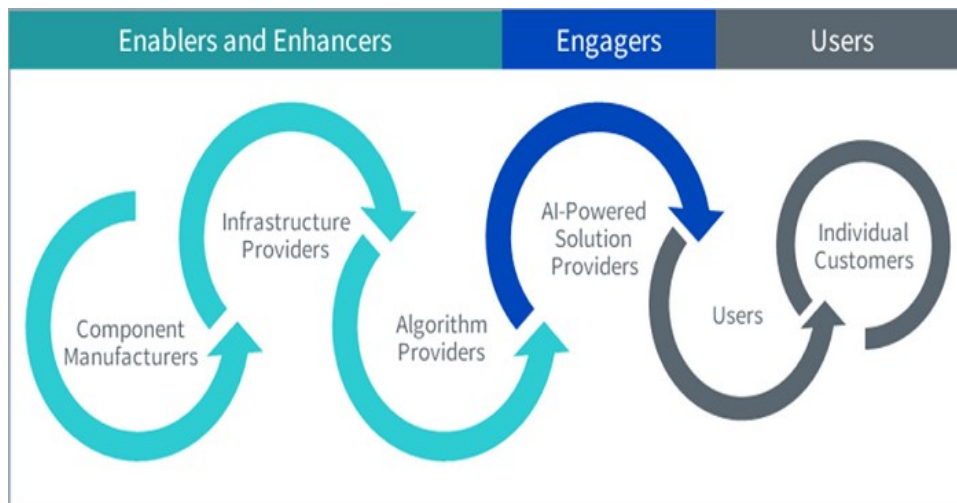
In 2023, few topics have captured the imagination of the public like artificial intelligence (AI). While ChatGPT’s release in late 2022 might have been the spark, the broader conflagration of activities in the space is far broader than that sole application.

In 2018, WisdomTree designed a strategy to capture the growth of the AI ecosystem—well before ChatGPT became a household name. What we’re seeing in 2023 is an example of an important test of any thematic methodology: how do you design an approach that seeks to capture significant growth and technology developments when you have no idea from where those developments will come?

The AI value chain

Perhaps the biggest challenge for thematic strategies, with AI near the top of the list, is organising the space. Almost every company today seeks to talk about how they are using data in better, more productive ways. AI represents an important set of tools with which to do that, but does simply mentioning ‘AI’ or ‘machine learning’ on an earnings call lead to a company being focused on AI? If we step back, there is no established definition of what an AI-company even is.

Figure 1: WisdomTree’s AI value chain



Source: WisdomTree.

If we look at Figure 1:

- **Users (customers/consumers):** many companies 'use' artificial intelligence. Take Netflix as one example of a company that is managing vast arrays of content across hundreds of millions of customers. If the idea is to have each customer with their own customised set of recommendations, AI is needed. However, is Netflix 'selling AI'? In our opinion, Netflix is selling content and the means with which to take over hours of subscriber attention. AI is a tool by which they do that. At WisdomTree, we decided not to include such 'users' of AI within our strategy.
- **Engagers (the AI powered solution providers):** to us, these are the most important companies because when they make a sale, their customers are directly using and benefitting from artificial intelligence. An example could be the software that underlies the production of chatbots or robotic process automation. It's possible that these software developers could be incorporating elements of generative AI into their systems, as and where appropriate. During the semiannual rebalances of the strategy, 50% of the strategy's total weight is allocated to this grouping.
- **Enablers:** software, by itself, cannot function, in that the best examples of successful technology companies tend to mix strong software and hardware together to let customers have the best possible outcomes. Apple, often the world's largest company by market cap, can be thought of as an important player in both spheres. When we think of the hardware upon which AI models are run, we think of semiconductor companies, predominantly. Nvidia is a great example of such a company that has aligned itself and its mission very directly with AI, to a degree almost no other major semiconductor company has been able to do. This grouping is weighted at 40% exposure during each semiannual rebalance.
- **Enhancers:** we then asked ourselves, what do we do with Microsoft, Alphabet, Apple, Amazon etc.? If these companies make a small investment in AI, by their standards, it can be an amount of money bigger than the market capitalisation of many other companies. It's also the case that these companies have the capital to do very interesting things, like design their own semiconductors. This group also includes companies that enhance the AI space through some specific AI-powered solutions they provide within their core business fields (for example, AI in agriculture). However, AI solutions do not represent the core products offered by enhancers, that is, AI does not drive the majority of enhancers' revenues. This grouping is weighted at 10% exposure during each semiannual rebalance.

Testing the robustness

In our view, a robust strategy design is able to capture the growth in a particular thematic topic, even if when we were designing the product we did not know exactly how the space would evolve. When we were designing the [WisdomTree Artificial Intelligence UC ITS ETF](#) (WTAI), for example, robotic process automation was one of the biggest topics. While it is still important, no aspect of robotic process automation has achieved anything close to the growth or excitement as generative AI, which was represented in the strategy in 2018, but not in a large exposure.

Furthermore, the take-off of ChatGPT brought a lot of attention to OpenAI, the company behind it, which is not public. However, markets, readying for a wider proliferation of the technology, responded in part with a focus on Nvidia (as an expression of a greater demand for processing power) and Microsoft (noted for its close connectivity and investments in OpenAI, alongside the potential to add these functionalities to its Bing search engine and its Office365 suite).

Figure 2: Year-to-date attribution of the top 5 GICS Industries by contribution to return (CTR)

GICS Industry	Avg wgt	Group return	CTR
Software	42.1%	29.5%	12.3%
Semiconductors & Semiconductor Equipment	37.7%	31.8%	11.8%
IT Services	4.0%	20.4%	0.8%
Machinery	4.2%	15.5%	0.7%
Consumer Finance	1.6%	19.3%	0.3%
Index	100.0%	27.08%	27.08%

Source: WisdomTree, FactSet. Period from 31 December 2022 to 31 March 2023. Index is the Nasdaq CTA Artificial Intelligence NTR Index. GICS Industry represents the third level classification in the Global Industry Classification Standard (GICS) hierarchy. Avg wgt is the average weight of each grouping during the considered period. Group return is the return of each grouping during the considered period. CTR is contribution to return during the considered period.

You cannot invest directly in an index. Historical performance is not an indication of future performance and any investments may go down in value.

Looking at Figure 2:

- One of the most notable shifts from 2022 into the first part of 2023 was the performance of semiconductors. During the latter part of 2022, if you listened to an earnings report of a semiconductor company, it was negative. CEO’s were guiding expectations downwards. The [WisdomTree Artificial Intelligence UCITS ETF](#) has tended to have a 30-40% weight to semiconductors historically so, if semiconductors are lagging, it is usually not great for relative performance. However, semiconductors started 2023 with incredible strength, a distinct shift in trend. The modern world functions on semiconductors, but the sector can be very cyclical. Focusing on the specific companies that are directly connected to AI, we believe, is a strong strategy with long-term potential for growth.
- The [WisdomTree Artificial Intelligence UCITS ETF](#) is mostly defined by the performance of ‘Software’ and ‘Semiconductors & Semiconductor Equipment’. These two GICS Industries make up the vast majority of the exposure. Software businesses tend to have high margins, but they are often newer and seeking to attain scale. There is nothing wrong with this but, if the US Federal Reserve is raising interest rates at the fastest clip we have seen since 1980, companies with their profits pushed far out in the future will see their valuations impacted. Software in general has not been an easy space since the end of 2021, where valuations were close to their peak. However, what we expect is that the nature of the software businesses makes it easy for new versions and updates, such that generative AI functionality can be added in, facilitating even more growth.

Conclusion: value chain robust to innovation

When we say, ‘value chain robust to innovation’, we mean that, whilst we do not know exactly how AI will evolve, we are confident that the strategy construction will be able to, at least in part, take advantage and provide exposure to that growth. The [WisdomTree Artificial Intelligence UCITS ETF](#) is not just semiconductors, it is not just software, it is not just companies that mentioned AI once or twice in an earnings call. These companies, each, have a strong connection to AI and are actively seeking to push the ecosystem forward. Working with the expertise of Consumer Technology Association (CTA), our expert partner for the strategy, we believe we are in a position to continually update the exposure such that we can continue to capture the trend.

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