The Disruptive Strategist Q3 2023

Marketing material for professional, institutional and accredited investors.
Capital at risk.

Executive Summary

In their latest Newsletter, the Disruptive Growth team looks at whether history is repeating itself with an artificial intelligence (AI) capex bubble, the development and testing of robo-taxis on public roads, the convergence of sport and digital platforms in The Kings League, how Temu is shaking up the internet landscape, and the proliferation of GLP-1 weight loss drugs.

Mark Hawtin reviews Q3 2023, highlighting a tough environment for some parts of the equity markets, including some of the AI-driven stocks finding their valuations hard to justify. Crypto has so far been the pick of the bunch in year-to-date performance.

Mark also examines the AI capex bubble, citing examples from history of when a "build it and they will come" approach led to irrational exuberance and losses for many investors, but ultimately some long-term gains for disruptors.

Pieran Maru looks at the exciting introduction of robo-taxis, including participants such as Waymo, Cruise and Tesla's Dojo, with testing being carried out on the streets of San Francisco.

David Goodman writes on The Kings League, brainchild of FC Barcelona legend Gerard Piqué, which is disrupting traditional football and using social media platforms for ready-made distribution.

Asian low price e-commerce marketplace Temu is expanding globally, becoming the most downloaded app in the US. Wendy Chen explains how it is achieving success.

Finally, Kevin Kruczynski considers the considerable impact of GLP-1 weight loss drugs on the healthcare sector, and particularly medical device companies.

Q3 Market Summary

Mark Hawtin

Global equities posted a negative return in Q3 2023, with the S&P 500 down 3.6%. Rising interest rates were the main culprit in the decline, as investors became more cautious about growth prospects following a yield surge of over 20%; 10-year US Treasuries closed the quarter at 4.7%. This has been likened by some commentators to the equivalent of three further 25 basis point (bps) rate hikes by the Federal Reserve (Fed).

The first half of 2023 was dominated by the performance of the Magnificent Seven ('M7', as they have now become known); Apple, Microsoft, Alphabet, Nvidia, Amazon, Meta and Tesla. While the S&P 500 rose 9.1% in the nine months to end September, the equal-weighted S&P was flat, suggesting that equities more broadly have remained cautious throughout the year. Growth investing has been dominated by the M7 but Q3 saw that group underperform, even though earnings revisions were clearly positive on the Q2/Q3 guide prints. Such has been the extent of the earnings per share (EPS) revisions upwards and performance (downwards) that according to Goldman Sachs, the M7 are now trading at relative PEG ratios not seen for over seven years.

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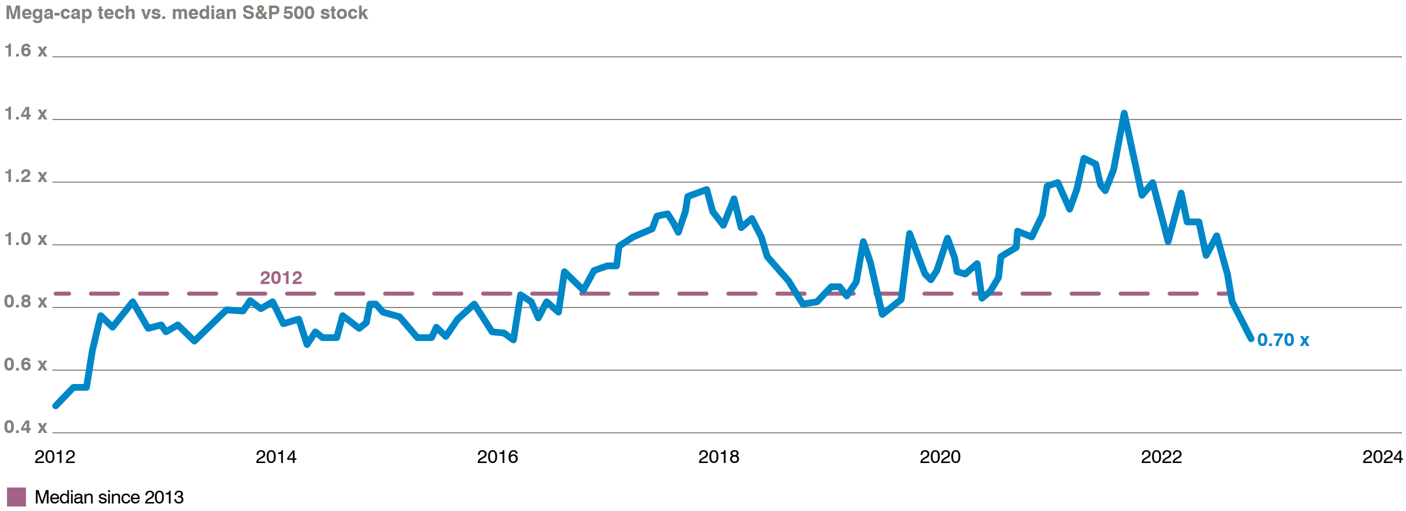
Chart 1: Relative PEG ratios



Source: Goldman Sachs Global Investment Research. Past performance is not an indicator of future performance and current or future trends.

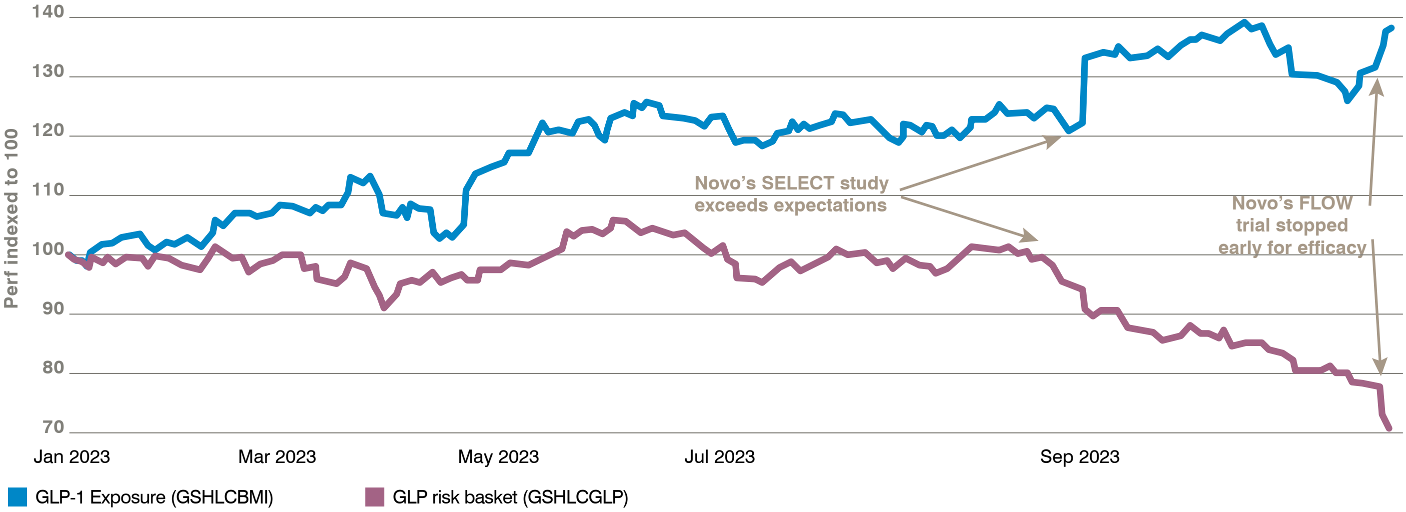
We believe this is a major de-risking feature of the growth equity market in what are uncertain times. Outside mega-cap, the third quarter of 2023 was marked by a series of strange interplays amongst sub sectors. Those perceived to be sensitive to consumer spending struggled – payments names were smashed over the quarter, led by high-flying Adyen in Europe which fell over 50% on a profit warning. Most names moved markedly lower; Block -34%, Worldline -20%, Toast -17% and PayPal -12%. Retail Internet also suffered; Farfetch fell 65% as investors worried about the viability of the business, Etsy fell 24% and Germany's Zalando -20%. Of interest, renewable names also struggled. We have always found it hard to justify the valuations in this sector or in many cases the moats that exist – SolarEdge in the US fell 52% (and was the worst performing S&P 500 stock), and in Europe popular names Orsted and Vesta fell 40% and 16% respectively. (Source: relevant index, for period 1July 2023 to 30 September 2023).

Semiconductors finally started to ease back again on economic worries with analogue names in particular weakening and some of the AI-driven companies finding their oxygen-starved valuations just a little too hard to hold. Even Nvidia, who reported another spectacular quarter, only managed a marginal 2.8% gain.

Crypto has been a highlight of the year-to-date performance, with Bitcoin up 65% and, although Bitcoin fell in Q3, Coinbase managed to make small gains as the regulatory backdrop started to ease. Not only did Ripple win a significant court case against the SEC, the courts also upheld Greyscale's appeal against the SEC over allowing it to issue a Bitcoin cash ETF. Our long-term thinking is that crypto will need to be separately regulated under new laws and the wins over the SEC are helping to move in that direction as they show that securities law is not necessarily fit for purpose in the digital world.

One Q3 theme that surprised us was that of medical technology – the iShares Medical Device index fell 20% during the quarter as investors were concerned that the Novo Nordisk GLP-1 drug for diabetes, that has been found to significantly help weight loss, led to a raft of intricate investment cases that claimed there would be less need for many other medical procedures. The chart below shows just how pronounced this has been and in many cases we find the evidence flimsy at best. This might open up a number of interesting opportunities in the medical device market where the power of AI and networking are having a significant impact on demand.

Chart 2: GLP-1 exposure versus risk



Source: Novo Nordisk. Past performance is not an indicator of future performance and current or future trends.

The puts and takes of the GLP-1 drugs are covered by Kevin Kruczynski in a separate section below.

The AI capex bubble - is history repeating itself?

Mark Hawtin

In the 1800s the UK saw a railroad bubble driven by intense speculation in railway shares, which reached its peak in 1846/47. The belief that railways would revolutionise transportation and trade, and the availability of cheap credit, led to track being laid at a rapid pace, increasing from 100 miles in 1830 to 1,500 miles in 1840, with a surge to 6,000 miles in 1847 creating the biggest railway network globally [1]. At 25% of GDP, the amount invested equates to a staggering USD 4 trillion in today's money, according to Andrew Odlyzko in his book, The Railway Mania of the 1860s and Financial Innovation.

At its height, the bubble saw the formation of hundreds of new railway companies, many of which were based on unrealistic plans for lines that would never be built. Investors poured money into railway shares, driving up their prices to unsustainable levels. The bubble began to burst in late 1845, when a number of factors combined to dampen investor enthusiasm. These included a series of high-profile railway accidents, concerns about the financial viability of many of the new railway companies and a rise in interest rates. The bursting of the railway bubble led to a financial crisis in the UK, and many investors lost heavily. However, the bubble also had a number of positive long-term effects, including the development of a nationwide railway network that helped to boost economic growth.

There is a familiar ring to this moment in history, perhaps most recently incarnated in the Internet boom and bust period of 1999-2002. The capex cycle then was spent on fibre optic cable to build out huge amounts of capacity ahead of expected demand for internet services. Again, the capital spend was of epic proportions. In 1996 fibre optic cable extended one million miles in the US. This surged to 10 million miles by 2000, according to the Federal Communications Commission, with new companies like WorldCom and Global Crossing raising mountains of debt to finance the build. When WorldCom went bust in 2002 it had USD 100 billion of debt; Global Crossing had USD 25 billion. The utilisation rate of networks at the time, according to TeleGeography, was just 20% and by 2010 only reached 30%. Again, irrational exuberance led to limitless capital and debt being made available to build for the future. As with the railroads, while this irrationality was inevitably stamped out with investors losing substantial amounts, the legacy infrastructure enabled the Internet wave to take hold. Short-term pain for irrational investment often leads to long-term gain for disruption.

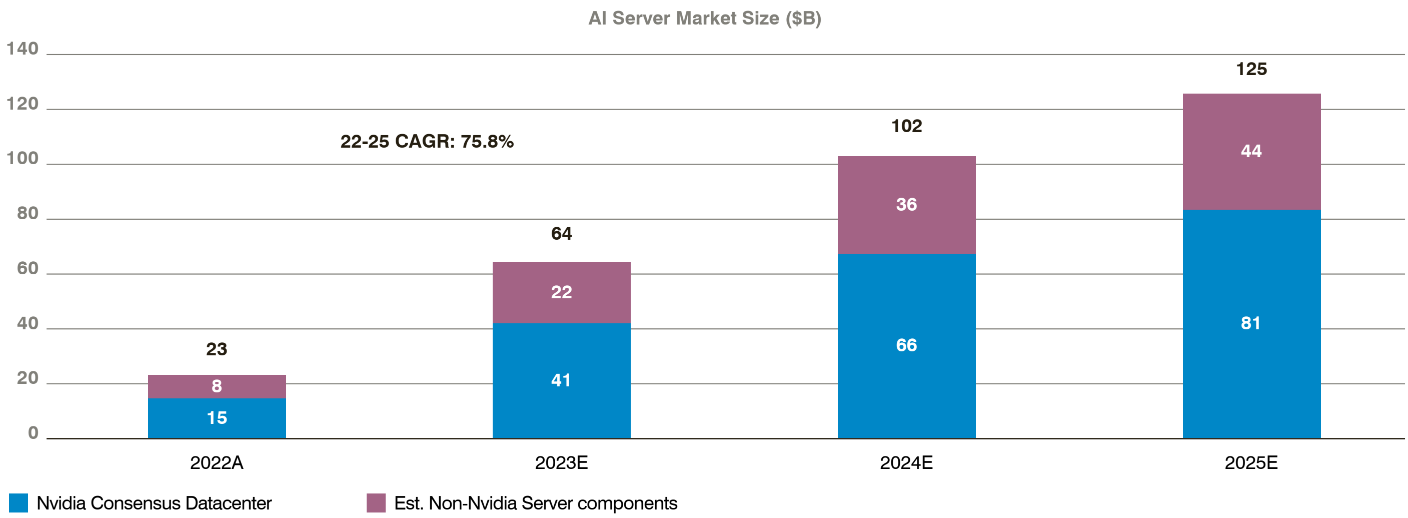
[1] Source: Government Policy during the British Railway Mania and the 1847 Commercial Crisis | British Financial Crises since 1825 | Oxford Academic (oup.com)

The big question being asked today is whether the surge in AI infrastructure investment will end up the same way as these previous investment cycles. We believe not; the impact will be far less dramatic, particularly for share prices, but there are some reasons for short-term caution. The introduction of consumer-friendly interfaces such as Bard and Chat-GPT have put access to AI capability within everyone's reach. This catalyst has led to a surge in infrastructure investment, led by the need for graphics processing unit (GPU) chipsets from Nvidia. Its Q1 earnings report this year reinforced that when it reported one of the biggest USD guides higher of any company in history. The AI arms race was out of the starting blocks and demand had surged. Nvidia is targeting a huge increase in production capacity and Jason Huang, its CEO, has predicted that USD 1 trillion will be invested in the next four years upgrading data centres for AI. This is supported by research from the Dell'Oro Group that anticipates USD 500 billion of datacentre capex in 2027. Compare that to the level of investment in the auto and truck industry, for example, at an annual USD 33.4 billion (source Wikipedia).

These capex numbers are enormous and in truth no one has any real idea if the capacity will be used or not, or how quickly, but there is a real concern that AI is so important that not investing will entail missing out on a disruptive technology that could be bigger than the Internet was 10-15 years ago. However, the requirement for a sensible return remains. Open AI is said to make about USD 1 billion in revenues and Microsoft has said it hopes to generate about USD 10 billion from its Copilot product. These numbers are small in relation to the investments being made. Sequoia Capital wrote a piece on this recently, suggesting current GPU sales levels of USD 50 billion annually would require at least USD 200 billion of use case revenue to justify the investments. Clearly we are a long way from those levels today.

A recent research note from Bernstein attempts to frame the size and scale of investment in AI infrastructure; that demand is shown in the chart below. The implied 75% compound annual growth rate (CAGR) from 2022 to 2025 is totally unprecedented in IT infrastructure cycles and would equate, in 2025, to a build out equal to the total data centre server market existing today. That seems a very tall order – it is worth noting that the average growth rate of the server market has been just 3% compound over the last 25 years according to Bernstein!

Chart 3: AI server market size implied by Nvidia consensus numbers (USD billion)



Source: Bloomberg, Bernstein estimates and analysis. Assuming GPUs are ~65% of the BOM for an AI server. Past performance is not an indicator of future performance and current or future trends.

It is our belief that abundant capital, often from very cash-rich mega-cap technology-driven companies, will drive the build out well ahead of demand, regardless of a possible use case shortage in the early stages. This is not ultimately a bad thing as AI will make significant productivity enhancements to the corporate world, but it is likely to create an air pocket for infrastructure providers. We have seen this for other data centre providers in 2022/23 as 'data centre optimisation' has become the buzz phrase for a lack of new investment in capacity. We could easily see a quarter or two where GPU chipset demand drops sharply as existing capacity is digested. This will likely result in a difficult period for the shares of infrastructure providers like Nvidia. As a result, we believe that the next set of investment targets should be more focused on the users of the AI infrastructure rather than the builders of it. This spans sectors across the landscape including healthcare, transportation, retail, financial services and industrials.

Robo-taxis: The floodgate experiment let loose on the streets of San Francisco

Pieran Maru

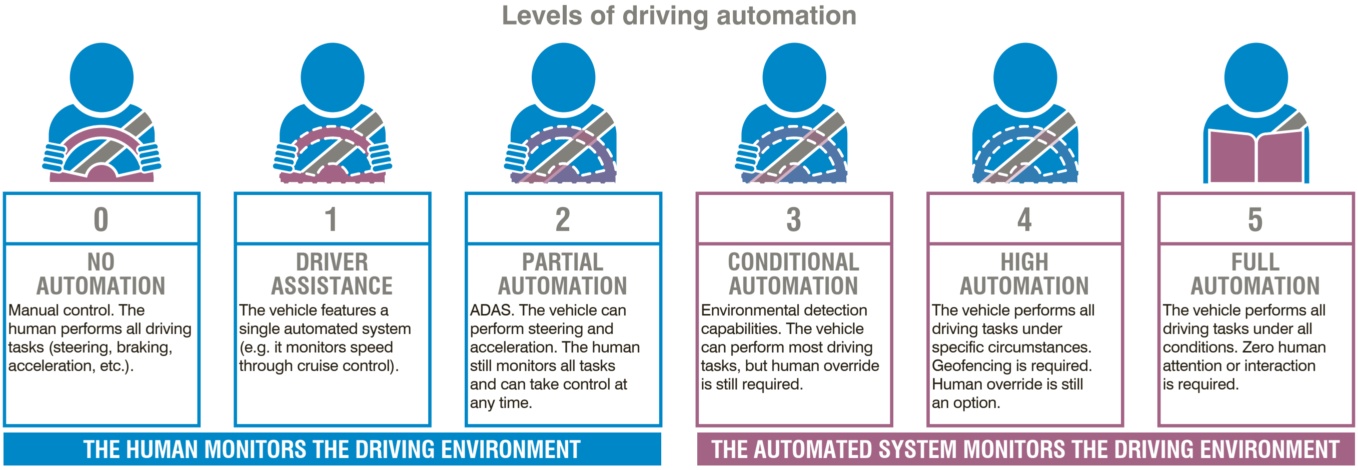
San Francisco has always been in prime position for the development and testing of robo-taxis on public roads. Fuelled by a thriving ecosystem of autonomous vehicle start-ups and a supportive regulatory environment, the city has emerged as an epicentre of activity. This reputation was cemented in August 2023, after the California Public Utilities Commission (CPUC) voted in favour of allowing robo-taxi operators Waymo and Cruise to commercially operate a 24/7 service. The CPUC decision followed an intense public hearing that lasted more than six hours, with proponents highlighting robo-taxis could contribute to the city's tourism – just as the infamous cable cars have. However, others highlighted the erratic behaviour, numerous unexpected stops and safety concerns for other road users. Some protestors even resorted to 'coning' robo-taxis by placing a cone in a disruptive manner that stopped the vehicles.

Waymo, with a waitlist of over 100,000 riders, is now setting its sights on expansion in Los Angeles and plans for operation in Austin, Texas. However, the road has not been quite as smooth for its counterpart, Cruise. In a swift turn of events, Cruise reduced its fleet by half, due to a request from the state Department of Motor Vehicles (DMV). This was attributed to a number of incidents, including a collision with an emergency response vehicle.

Source: https://waymo.com/media-resources/

Although self-driving robo-taxis have taken the headlines, much of the activity has been in advanced driver-assistance systems (ADAS) and partial/conditional automation systems available today in passenger cars. So what kind of automation do robo-taxis fit under, and where does it leave the future for mass market passenger cars?

ADAS – What level counts?



Source: https://www.synopsys.com/automotive/autonomous-driving-levels.html

As defined by SAE International, driving automation consists of six levels on a scale of 0-5. The robo-taxis in San Francisco are considered Level 4 high automation in which automated driving features do not require you to take over driving and can operate in a geofenced area. Meanwhile, passenger cars are more commonly offered at Level 2. Mercedes has been offering Level 2 driving partial automation for several years, with features including lane keeping assist, automatic emergency braking and adaptive cruise control. More recently, its Drive Pilot system became the first Level 3 autonomous drive system to receive US state approval. Its conditionally automated driving can take over all driving in certain conditions such as speeds of up to 40mph on the motorway and in heavy traffic. However, Level 3 still requires human override when notified.

Dojo

One company at the forefront of harnessing all the video data produced and training its neural networks is Tesla. Dojo is Tesla's purpose-built training supercomputer, using its own AI model to train on the data from its vehicles to accelerate development of its Full Self-Driving (FSD) functionality. At present, improvement in FSD is limited by its ability to collect and process video data from vehicles. By developing an advanced supercomputing architecture using a custom silicon system in house, Tesla predicts Dojo will be one of the top five supercomputers in the world by GPU count. It is often debated as to whether Tesla is simply an auto company or is a tech company; Dojo helps push the barbell to the tech side. One analyst at Morgan Stanley recently estimated the Dojo supercomputer could add USD 500 billion to the company's market value via new addressable markets such as faster adoption of robo-taxis, network services or offering its FSD capabilities to other car manufacturers. Overall, robo-taxis and driving automation has the potential to make our lives more convenient while improving safety. As the technology continues to develop, with the cost of deployment coming down, we can expect to see autonomous vehicles, including robo-taxis, become an increasingly common sight.

The Kings League: The Convergence of Sports and Digital Platforms

David Goodman

In an era when traditional TV viewership for football is declining, the Kings League represents a paradigm shift in sports entertainment. Using an innovative tournament model, it blends elements from e-Sports with conventional football to offer a distinctive fusion of sports and technology-driven entertainment. An exciting spin on an old format, not surprisingly it has captured the attention and engagement of younger audiences, potentially transforming sports broadcasting.

Disrupting traditional football

In 2022, FC Barcelona legend Gerard Piqué noticed a change in the way his children watched football through social media channels, most notably forwarding the action to accommodate their short attention spans and craving more fast-paced content. Spotting an opportunity, Piqué embarked on a mission to reimagine traditional football and make it more entertaining for a younger audience.

Piqué and his partners invited amateur football players to apply online to play in a new 7-a-side league. He received an overwhelming response of more than 11,000 applicants. In addition, Piqué and his partners collaborated with fans to create a fresh set of rules that would invigorate the game, introducing innovative elements that challenge conventional norms. These included:

- **7-on-7 amateur football:** A smaller team format ensures more action-packed gameplay.
- **Unlimited substitutions:** Players can be substituted at any time during matches.
- **Expanded rosters:** Each team boasts 12 players along with two guest players.
- **Shortened indoor field:** The compact field amplifies intensity and excitement.
- **Penalty box for cards:** Red and yellow cards come with specific penalty box durations.
- **Sunday showdowns:** All games take place exclusively on Sundays – the ultimate day for soccer enthusiasts.

Secret weapons unleashed

An innovative strategic twist adds suspense and unpredictability. Bonuses include instant penalties, temporary removal of players, double points for goals within a minute, stealing the opposition's card, and a joker card for any of the four bonuses. These rule changes bring excitement and unpredictability to every match.

Here's the genius – the power of streamer partnerships

Perhaps The Kings League's smartest move resides in its distribution strategy. Unlike traditional soccer structures, Piqué and his partners opted for a streamer ownership model, with matches livestreamed on social media.

This is attracting a new generation of football fans. By partnering with popular streamers who boast millions of followers on platforms like Twitch, YouTube, TikTok and Instagram, the league has garnered an impressive fan base of 13 million.

The Kings League's social media presence is a testament to its success:

- **Twitch:** 2.9 million followers
- **YouTube:** 718,000 subscribers
- **TikTok:** 6.3 million followers
- **Instagram:** 2.3 million followers
- **Twitter:** 801,600 followers

This clever approach allows fans from all around the world to watch matches for free.

Gone are the days of cable TV subscriptions or costly streaming packages – now everyone can enjoy the exhilarating action through the Kings League's social media channels. The league also collaborates with streamers to simulcast matches on their channels without any commercial interruptions.

Monetising the vision

In the era of digitisation, the potential of monetising streamer partnerships is vast and untapped. The league is leveraging the power of microtransactions, ie encouraging fans to show support for their favourite teams and players through small financial contributions during live streams. These can come in the form of virtual gifts, paid emojis or premium subscriptions.

Looking forward, there are likely to be plenty of opportunities to host exclusive pay-per-view events. While regular matches are free to watch, certain high-stakes games or behind the scenes events might be ticketed, allowing for an extra revenue stream.

Finally, never underestimate the power of merchandise. The league already capitalises on its popularity by selling branded gear and apparel. It collaborates with streamers to create limited edition merchandise, which can generate a sense of exclusivity and urgency that drives sales.

The goal is not just to monetise but to deepen the engagement between fans, streamers and the league. When done in the right way, monetisation can enhance the overall fan experience, creating a win-win situation for all involved parties.

A new era for sport

Piqué's vision is not just revolutionising how football is played – it is the poster child for transforming sport itself. With its captivating gameplay and strategic partnerships, The Kings League has become a phenomenon that is captivating both die-hard fans and casual viewers alike. But what sets this league apart from others?

The answer almost certainly lies in it going beyond being just another sports event; it offers an experience that resonates deeply with today's generation.

1. A fusion of sports and entertainment: The Kings League combines top-tier football skills with the infectious energy and entertainment value of popular streamers.

2. Inclusivity at its core: By embracing digital platforms as distribution channels, the league ensures that anyone passionate about football can join in on the excitement.

3. Unleashing creativity: The collaboration between players, fans and streamers cultivates an environment where creativity thrives, enriching the game with unique and unexpected moments.

4. A global community: The Kings League transcends geographical boundaries, uniting fans from all corners of the world under a shared passion for soccer and digital entertainment.

Reinventing sport for the digital age

The Kings League is reinventing football and set to redefine sports in the digital age. With innovative gameplay, strategic partnerships and free accessibility on various platforms, the league has captured millions worldwide.

As we stand at the precipice of this new era, it is worth contemplating that every traditional sport is primed for innovation. The disruption sparked in football serves as a guiding light, illuminating the way to a reimagined sports landscape.

Bending to the digital age, all sports are ready to be reinvented, ready to be disrupted. It is more than a change, it is a metamorphosis that will redefine how we play, connect, inspire, and grow. The world is ready. Are you?

The Temu effect: How an Asian ecommerce entrant shook up the US internet landscape

Wendy Chen

In September 2022, a newly launched ecommerce platform named Temu made a grand entrance in the US through its extensive advertising campaign in Times Square New York. In just four months, Temu, with its 'shop like a billionaire' tagline, became one of the most downloaded apps in the US, overtaking WhatsApp, TikTok and Instagram to sit on the top-ranked app list in Apple and Google Play stores.

Yet Temu's endeavour is not limited to the US. Half a year after its successful launch in the US, Temu expanded its footprint to Australia and New Zealand in March 2023, and launched its first UK website the following month. This was swiftly followed by a serial launch in the eurozone across Germany, Netherlands, Italy, France and Spain. As at August 2023, just one year since inception, Temu has ventured into over 40 countries across the globe, with more than 100 million active users in the US alone, and around 40 million app downloads worldwide in September 2023.

How does 'shop like a billionaire' work?

The general feedback on Temu merchandise is about its absurdly low prices. One can get a decent dress for less than USD 2 and wearable electronics for less than USD 5. It has greater stock-keeping unit and larger variety of products than many of the neighbourhood dollar stores, while offering lower prices than most ecommerce platforms (even during discount seasons).

The secret recipe behind Temu's price competitiveness is its 'fully-entrusted business model', which stands between the usual first-party (1P) e-commerce model (while the platform acts as a retailer to sell products directly) and third-party (3P) e-commerce model (while the platform acts as a marketplace for retailers to sell product themselves).

Under such a model, Temu sources products directly from factories, asking for nothing but shipping packages to Temu's warehouses in destination countries, while Temu will take care of the rest. Temu oversees customer acquisition, pricing decisions, logistics fulfilment and after-sales service. With such a model, Temu retains its authority on quality control, delivery process and customer experience (benefits of the 1P model), while still benefiting from a wide selection of merchandises and easy scalability (benefits of the 3P model). Moreover, by shortening the supply chain from factory to platform, Temu has not only saved costs but also avoids taking inventory risk.

US internet peers: winners and losers amid the oriental impact

Being one of the fastest growing online retail platforms this year, Temu has undoubtedly impacted many business models in the US and other destination countries, both online and offline.

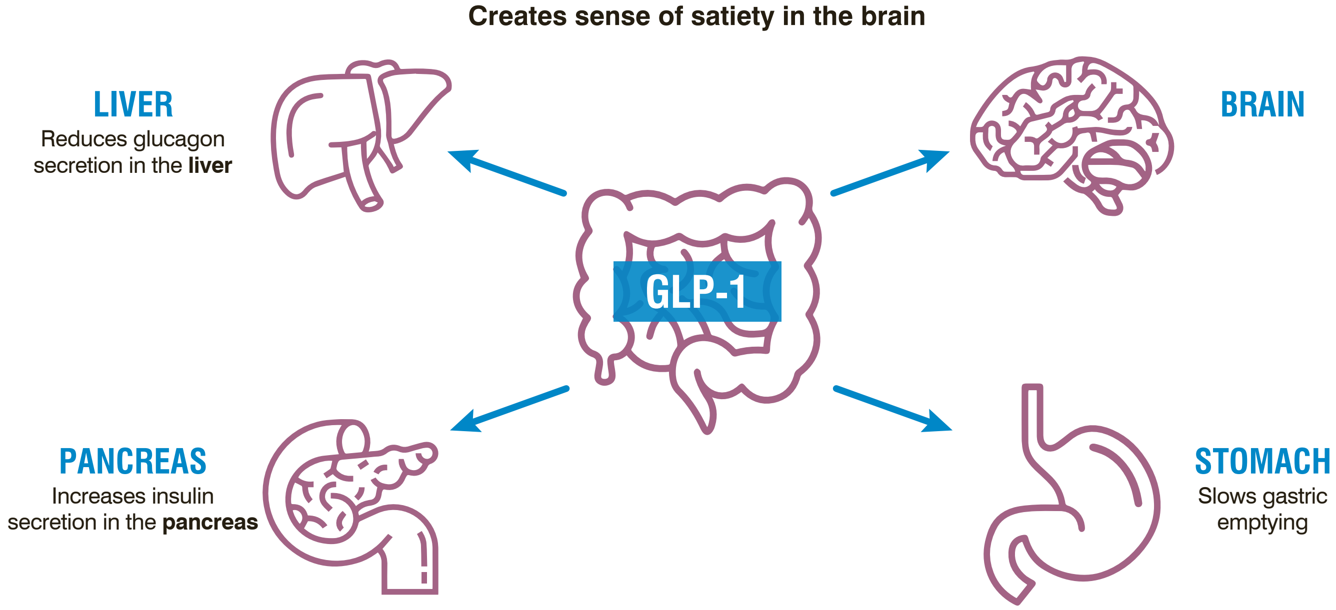
- **Offline retail:** As a natural substitute for the dollar stores, the 'Temu threat' has been a driver of share price underperformance for US discounters such as Dollar Tree (DLTR.US), Dollar General (DG.US) and Five Below (FIVE.US).
- **E-commerce:** The rise of a new e-commerce platform with a staggering user acquisition speed has not only outcompeted US players like Amazon, eBay and Etsy, but also threatened its fellow Asian ecommerce incumbents like Shein. It is estimated that 15% of US consumers have been exposed to the brand, reaching the ubiquity other platforms took years to achieve after only a few months. Unsurprisingly, multiple rounds of counteracting campaigns have been planned by its competitors.
- **Advertising technology:** With a 30-second advertisement during the 2023 Super Bowl that cost USD 14 million, Temu, along with its parent company Pinduoduo (PDD.US) has become one of the largest players in the US advertising space. Such an aggressive global expansion campaign, together with counteraction by the incumbents (such as Shein), has driven a notable incremental growth of digital advertising spending in 2023.

The rise of GLP-1 weight loss drugs

Kevin Kruczynski

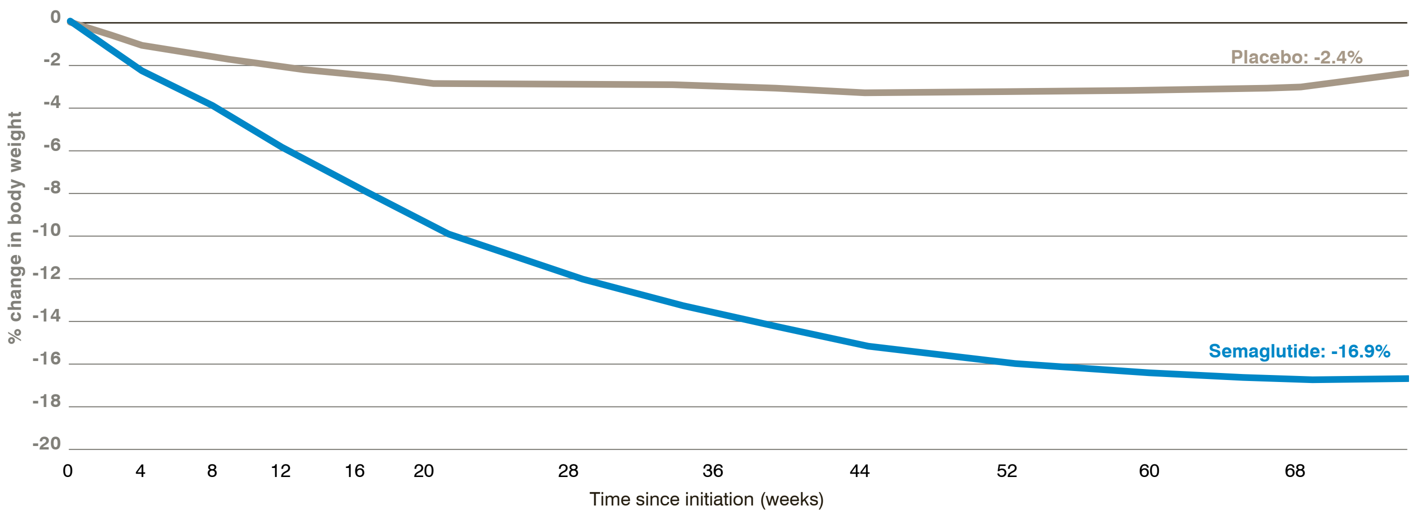
Glucagon-like peptide-1 (GLP-1) drugs are transforming the healthcare scene. These drugs, such as Ozempic and Wegovy (brand names for Semaglutide), are being hailed as game-changers in the treatment of diabetes and obesity. They function by mimicking the action of the body's natural GLP-1 hormone, suppressing appetites, contributing to weight loss and better management of blood sugar levels. The results have been astounding, with trial results showing patients losing between 15% to 26% of body weight within 18 months, depending on drug and dose. We believe the significant market opportunity for weight loss drugs, with over 650 million obese adults worldwide, has made GLP-1 drugs extremely attractive and profitable; given this backdrop some analysts are predicting that the anti-obesity market may become the largest pharmaceutical market in history.

GLP-1 mechanism of action when blood sugar levels increase



Source: Novo Nordisk Investor Presentation 2022.

Chart 4: The pivotal STEP 1 trial showed greater than 16% weight loss



Source: Novo Nordisk

Unsurprisingly the rise of GLP-1 drugs has had a ripple effect, extending beyond pharmaceutical companies to touch other industries such as food retail, consumer packaged goods, restaurants and medical devices. Traditional weight loss companies like Jenny Craig have felt the tremors, with some closing their weight loss centres due to the popularity of these drugs. Others have adapted and incorporated these drugs into their weight loss programmes. Retailers with pharmacies such as Walmart and Kroger initially reported increased foot traffic from GLP-1 prescriptions, but more recently Walmart reported lower average basket size and calories purchased. On the flip side, the pharmaceutical companies that focus on this area will be obvious beneficiaries; it should also be a boon for the health insurance industry as the population gets healthier over the long term. One prediction took things a step further and suggested one of the less obvious beneficiaries could be airlines given the potential for fuel savings if the average passenger was a few kilograms lighter.

The share prices of medical device companies, particularly those specialising in diabetes and obesity management, are beginning to feel the pressure. However, it is not all doom and gloom. While GLP-1 drugs are indeed impactful, they are not without their setbacks. Side effects, cost concerns and patient persistence issues can still make medical devices a more appealing option for some. This underscores the necessity of maintaining a diverse range of treatment options for optimal patient outcomes. In the diabetes market, for instance, continuous glucose monitoring (CGM) and insulin pumps are not expected to be overwhelmed by the new drugs due to concerns over patient access, complications and patient falloff. Dexcom recently pointed out that it is seeing CGM device use increase in type 2 diabetes patients who are using GLP-1 drugs. Similarly, in the weight loss segment, bariatric surgeries continue to provide more sustainable clinical outcomes compared to the drugs. Despite the promising potential of GLP-1 drugs, they are not expected to replace medical devices entirely. The future will most likely see a coexistence of GLP-1 drugs and medical devices, each playing an integral role in patient care.

GLP-1 drugs are indeed transformative, but they are not without their challenges. As they continue to disrupt the medical landscape, a balanced approach that includes both pharmaceuticals and medical devices will be crucial for sustainable patient outcomes.

Outlook

Mark Hawtin

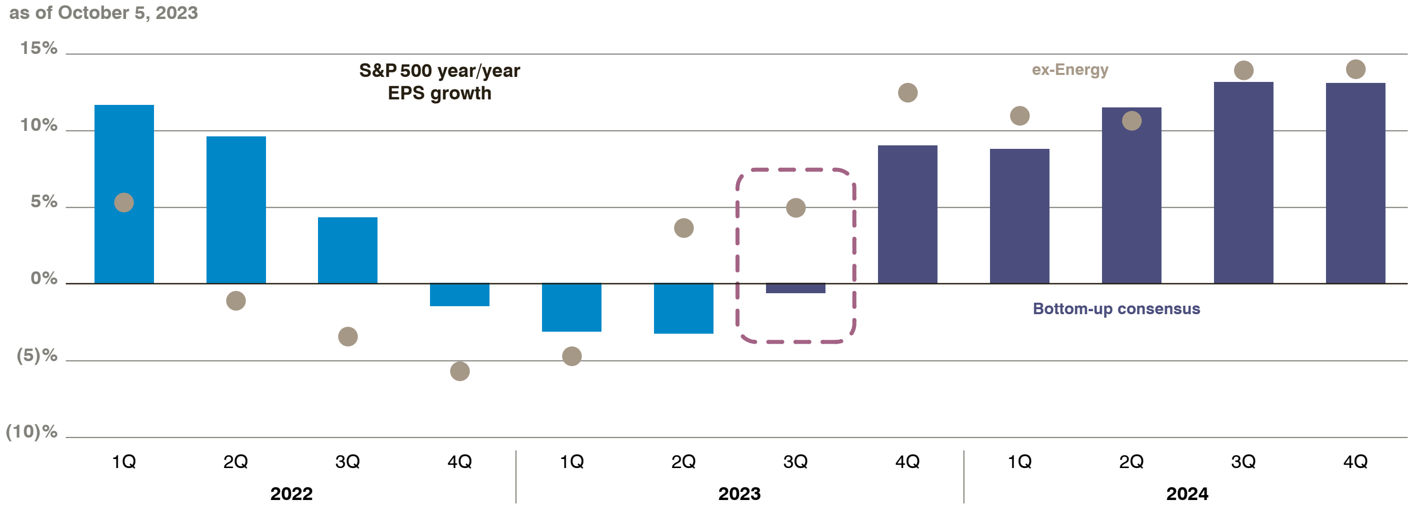
The market move in bond yields may well have done a lot for the narrative that rates have peaked. As outlined in the first section of this newsletter, yields imply three further rate rises from the Fed. Against this backdrop, and with a compression in valuations for growth equities driven by a combination of price weakness and positive earnings per share (EPS) revisions, we see the setup as constructive for Q4 2023. Clearly the tragic events in Israel have increased overall uncertainty and there is no way to calibrate the longer-term impacts or the extent to which this may develop into a much bigger Middle East conflict. However, on balance, we believe that the backdrop supports a positive run into the end of the year for corporate growth.

At the same time, there are clear pockets of valuation that look very compelling. The most obvious exposures to AI may have done more than enough for now but there are peripheral themes that we think will be strong beneficiaries in the form of some software as a service (SaaS) companies, as well as non-computer parts of the data centre investment theme. We are coming off the back of a three to four quarter data centre optimisation trend that has all but stopped some demand areas for capex in the data centre. We believe this will turn in Q4 and heading in 2024 the storage theme looks ripe for investment again.

Another arena of very compressed valuations is China, where the growth subset looks ridiculously cheap on fundamentals. The technical picture is still very mixed and so it is hard to take an all-in approach, but we are keen to ensure exposure to the domestic names in particular that are beneficiaries of the overall disruptive trends.

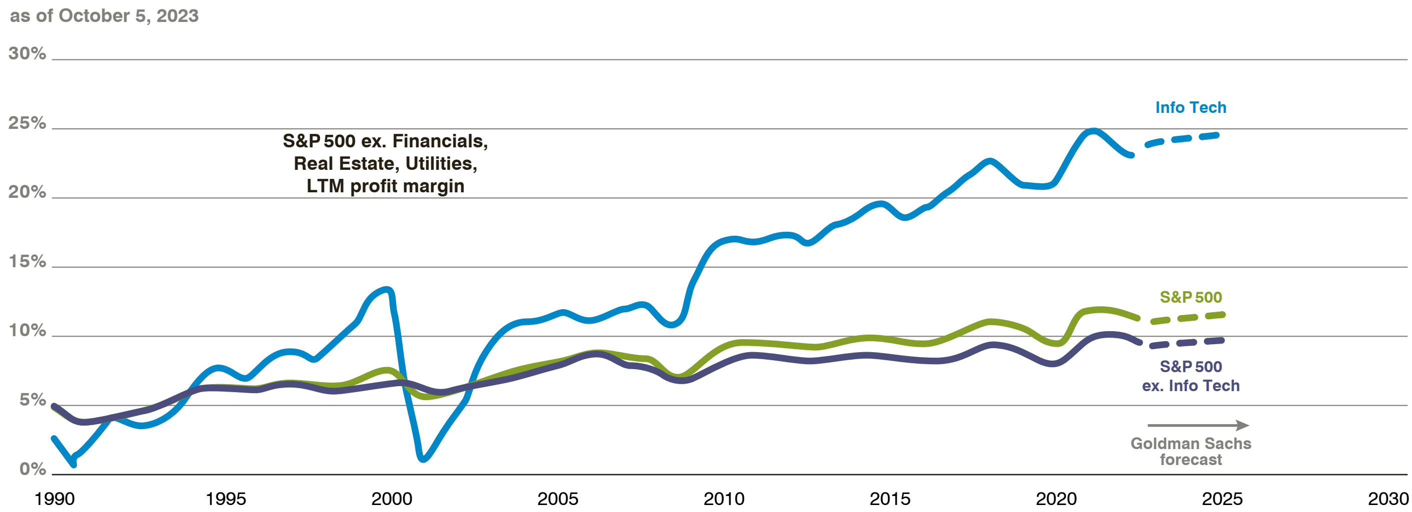
With interest rates looking like they have peaked, inflation that is headed south and valuations more reasonable, the stage is set for growth to reassert, in our view. The two charts below suggest earnings growth in the US has troughed on a broader market basis. At the same time, margins for growth companies, as measured by information technology, continue to drive higher and away from the market average, further reinforcing the value of these companies in a low growth environment.

Chart 5: Consensus expects S&P 500 EPS growth troughed in 2Q



Source: FactSet, Goldman Sachs Global Investment Research. Past performance is not an indicator of future performance and current or future trends.

Chart 6: Info Tech margins have been double S&P 500 margin levels



Source: FactSet, Goldman Sachs Global Investment Research. Past performance is not an indicator of future performance and current or future trends.

Finally, the compression in relative valuation for the M7 names (see first section) likely makes the Q3 reporting season a potential positive catalyst for re-ratings. While there are question marks over Apple with the iPhone 15 launch success, as well as Tesla as it continues to cut prices to stimulate unit demand, the more economically sensitive names might well surprise positively; that would mean Amazon in retail, Meta and Google in advertising and Microsoft in broader consumer and enterprise demand. Many companies we speak to have indicated that, after a period of uncertainty, IT spending is picking up reflected in stronger order books. That spend is still expected to outpace broader growth by some margin and this should be picked up in many of the investment targets that we are invested in.

See "Important disclosures and information" on the following page.

GAM Investments

Important disclosures and information

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