

Entry Points Alert | Capitalizing on the Emergence of A.I.

Transcript



David T. Cohen, CFA
Portfolio Manager

Capitalizing on the Emergence of AI

Portfolio Manager David T. Cohen, CFA, explores investor opportunities around AI in the value space.

Catalysts in Play | Artificial intelligence (AI) is creating a seismic shift in today's world, constantly altering how we navigate our everyday lives. From self-driving cars to digital chatbots, AI also offers huge growth potential for the economy.

Today, the market is paying attention to AI's early winners—such as Nvidia, which designs and sells graphic processing units and chip systems—whose valuations are being driven by lofty expectations for future growth. But there are also a wide variety of opportunities in the value space to capitalize on the emergence of AI technology.

Entry Points | By recognizing the early signs of emerging success stories, value-minded investors can capitalize on the shifting landscape caused by AI and achieve financial gains in a part of the market that has thus far been associated largely with growth investing. Among the areas of the market where we are finding such opportunities:

Data centers 2.0 | There's a new investment cycle underway that will redesign how computing is done in the cloud and the enterprise level, creating opportunities in both areas. There are broader plays here. As larger amounts of data are processed, the scale of that data increases exponentially. The ability to network that data, connect it, process it, and move it through the system will become increasingly important, leading to opportunities in data center networking chips.

The healthcare sector | While AI is being used in healthcare settings to assist in diagnostics and to maintain and track medical records, another possibility is to apply it to new drug discovery.

The financial sector | For years, the financial sector has been a leader in investing in artificial intelligence. Large banks, for example, have been using natural language processing and Large Language Models (LLMs) to create chatbots, which have begun to reduce the need for customer contact and physical branches. As this grows in popularity and scale, banks are able to earn more profit at scale.

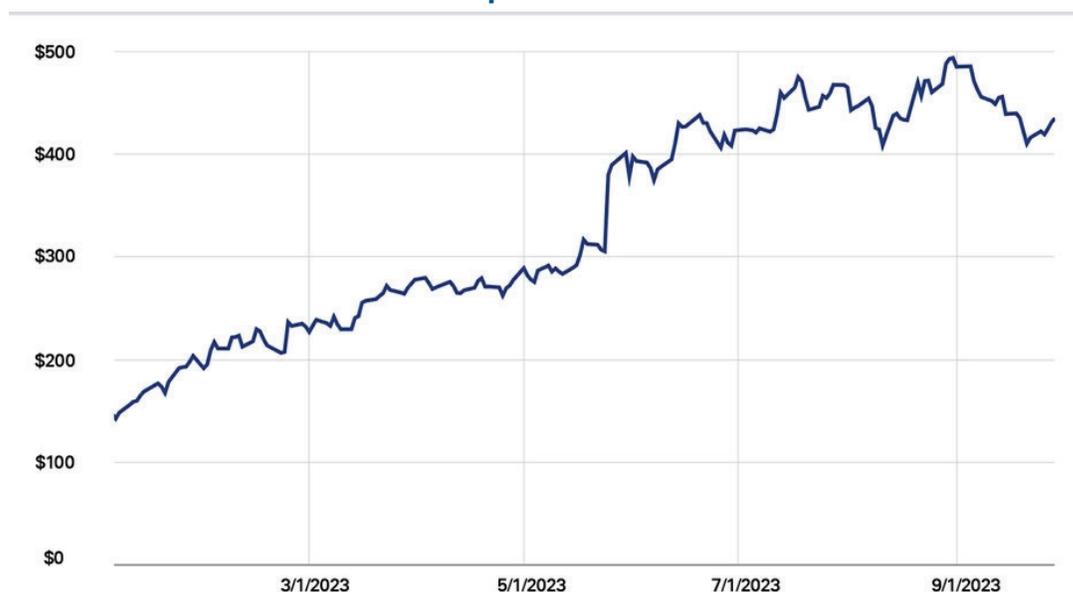
Active Strategy | It's no secret that the impact of artificial intelligence will continue to be felt across industries and sectors—and not just in areas where growth investors operate. At Boston Partners, we don't want to pay simply for the potential for future growth. Rooted in our "Three-Circle" stock selection process, we want high-quality businesses trading at inexpensive multiples and improving momentum for our investors.

David T. Cohen, Portfolio Manager at Boston Partners

Artificial intelligence or AI is in nearly every headline as of late. Many investors probably associate AI with betting on growth or tech startups, but that's only part of the story. I'm David Cohen, portfolio manager of Boston Partners. On this edition of Entry Points, we look at the wide variety of opportunities in the value space to capitalize on the emergence of this new technology.

It's not that AI is a startup industry that's trendy, it's an emerging technology that has huge growth potential for the economy. So when growth investors look at AI, they're betting heavily on specific winners. No winners. So companies like Nvidia, a clear winner in the data center, they provide the GPU, the compute engine for AI. That stock has been bid up to 20 times sales and 40 times earnings, which is extremely expensive relative to its history. And then Microsoft, which is likely to be a winner in deploying generative AI, is now trading at a 2% free cash flow yield, which is very expensive relative to its history. It's not that those companies can't or won't deliver the revenue that is needed to support those valuations in time. It's just that the growth investors are

NVIDIA Corporation Stock Price



Source: Nasdaq historical data.

paying a lot for that potential growth. What we try to do at Boston Partners is not pay for that future growth. What we're trying to do is find free optionality. We don't want to pay for a dream. We want to find a high quality business that's trading at an inexpensive multiple that's getting better over time. The first thing that becomes apparent is that the data center is going to be re-architected. That's a complicated way of saying that

there's an investment cycle that's going to redesign how computing is done in the cloud and at enterprise level. And there are a lot of opportunities tied to both of those.

AMD is a company that we bought last year in our portfolio. It was trading at a 7% free cash flow yield, which is a very attractive multiple for a high quality business. And we think they are in the pole position to be the key second player to Nvidia in that market. AI won't only be confined to the data center, it's also likely to move to the edge over time. Processing is going to happen on your smartphone, on your computer, and in your car. Qualcomm is a very inexpensive stock that we own, which owns leading edge technology that is likely going to enable the move of AI to the edge. With respect to generative AI and the big tech companies, most of them are quite expensive. Microsoft, which we mentioned earlier, it's trading at a 2% free cash flow yield. Facebook has gotten quite expensive. The one that we own is Google. Google has an amazing nine products with over a billion users, so the scale of the data they're capturing is unmatched in the world other than maybe by Facebook. And so as they apply generative AI technology to that data, to process it to make new products, it should improve the customer interface and the user experience of Google Maps, Android search, and all of the above. The market's been very focused on the compute engine for AI, but there's a broader play here, which we think is important. As you process huge amounts of data, the scale of that data increases exponentially. And so the ability to network that data, connect it, process it and move it through the system becomes more important. So data center

Google Products and Users



Source: Google.

networking chips are going to be a huge opportunity. We own a semiconductor company in our portfolios called Microchip. It's known as an analog semi company that also sells micro-controllers. But hidden within it is this data center networking chip business, which is benefiting from AI and is growing at a 25 to 30% clip. We think they're well positioned to continue with that growth rate over the long term, and we think it's going to unlock significant value for shareholders.

We've talked about semiconductors and re-architecting the data center infrastructure, but there's a host of other opportunities that are likely to emerge for AI investments. We think the technology is so ubiquitous, it's going to impact stocks across industries and sectors in the market. And that's because it's going to eliminate costs and it's going to generate revenues for various industries. It can literally transform some industries. The financial sector has been a leader in investing in artificial intelligence. They started many years ago using natural language processing and LLMs to create chat bots, which are starting to eliminate the need for branches and for customer contact. Every customer contact that they can replace with a computer allows them to earn more profit. And this

is happening at scale within the large banks already.

Another industry which we think is very interesting is health care. The big picture here is to apply it to new drug discovery. And we think that's nascent but it's possible. Bristol-Myers is a company that we own in our portfolios, and they've started to rework their R&D effort to incorporate AI. It's way too early to say whether they're going to be successful in this effort, but they are doing it and you're not paying for it in the stock. The other clear winner from this AI investment cycle is companies that possess huge amounts of data at scale. It's not intuitive, but if you think about Intercontinental Exchange, this is a company that owns the New York Stock Exchange. They also own exchanges that trade commodities, interest rates and fixed income. Huge amount of buyers and sellers, businesses, investors participate in these markets every day. They take that data that they generate and they repackage it and sell it to customers to provide insights, so data analytics business. AI is going to be huge for that. There's going to be new products that come as a result. There's going to be new algorithms that allow them to process the data better. And with these big proprietary datasets, there's really no end to what the products that you can create.

At Boston Partners we think many businesses across all industries and sectors are going to benefit from the deployment of artificial intelligence. It's less about diversifying our portfolio than it is about recognizing changes. And so it's our job as "Three-Circle" investors to really get ahead of those trends and capture them. So if we can find inexpensive businesses with high quality fundamentals at times when they're getting better and their momentum is improving, we're positioning ourselves to add alpha for our investors.

David T. Cohen, CFA | Portfolio Manager

Mr. Cohen is a portfolio manager for the Boston Partners Large Cap Value strategy. His experience at the firm included managing a portion of the Boston Partners Long/Short Research strategy focusing on security selection within the energy sector as well as the engineering & construction, and metals & mining industries. Prior to his current role, Mr. Cohen served as an equity analyst covering these same industries. He has deep experience analyzing and understanding capital intensive commodity-oriented businesses. He joined the firm in June 2016 from Loomis Sayles where he had over 8 years of experience as a portfolio manager for their Research Fund, as well as running a global energy hedge fund. As an equity analyst he covered the energy, materials, and industrials sectors. Prior to joining Loomis Sayles, Mr. Cohen was in consultant relations at MFS Investment Management. He received a B.A. degree from the University of Michigan and his M.S. in Finance from Brandeis University. He holds the Chartered Financial Analyst® designation. Mr. Cohen began his career in the investment industry in 2004.

Disclosure

Boston Partners Global Investors, Inc. ("Boston Partners") is an Investment Adviser registered with the Securities and Exchange Commission under the Investment Advisers Act of 1940. Registration does not imply a certain level of skill or training. Boston Partners is an indirect, wholly owned subsidiary of ORIX Corporation of Japan ("ORIX"). Boston Partners is comprised of two divisions, Boston Partners and Weiss, Peck & Greer Partners ("WPG").

The views expressed reflect those of Boston Partners as of October 25, 2023. Any such views are subject to change at any time based on market and other conditions and Boston Partners disclaims any responsibility to update such views. Discussions of market returns and trends are not intended to be a forecast of future events or returns.

Estimates reflect subjective judgments and assumptions. There can be no assurance that developments will transpire as forecasted and that the estimates are accurate.

This video is not an offering of securities nor is it intended to provide investment advice. It is intended for information purposes only.

Index Definitions

Alpha: A measure of performance on a risk-adjusted basis. Alpha takes the volatility (price risk) of a product and compares its risk-adjusted performance to a benchmark index. The excess return of the product relative to the return of the benchmark index is the alpha.

Free Cash Flow Yield: A financial solvency ratio that compares the free cash flow per share a company is expected to earn against its market value per share. The ratio is calculated by taking the free cash flow per share divided by the current share price.

Boston Partners | One Beacon Street, Boston, MA 02108 tel: 617-832-8200

www.boston-partners.com

Boston Partners (UK) Ltd. | 32 Cornhill, London, EC3V 3SG tel: +44 (0)20 3356 6225

www.boston-partners-uk.com