McMurtry Investment Report – May 2024

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How to Participate in Artificial Intelligence in the Stock Market

As of the end of April of this year Technology and Communication stocks represented 29.20% and 9.10% respectively of the S& P 500 Index. Domestically Technology and Communication stocks represented 8.30% and 3.20% respectively of the TSX Composite Index.

It is estimated that about 45% of the earnings of the S&P 500 index this quarter came from Technology and Communication stocks. The amount of money being spent by non -Tech companies on using AI semiconductor chips to make their businesses more cost efficient is staggering.

Over the last several years, the big focus in the high- tech industry was on Cloud Computing and Cyber Security. While these trends continue, Generative Artificial Intelligence is the newest development.

Most equity market participants have tried to participate in AI by investing only in the large cap companies like Nvidia, Microsoft, Google, Amazon, Apple, Meta and Adobe.

The real winner has been Nvidia, the designer of the most advanced microchips that had originally been only targeted for data centers producing bitcoin.

One interesting development was the trend towards accessing information on the internet by steering away from Google Search towards ChatGPT AI 's platform. The consequence of this is that both individuals and corporations are now much more selective on what information they are looking for. Google is no longer the go to search site it used to be and they appear to be far behind their peers in Generative AI.

This AI trend is comparable to the introduction of the internet many years ago and the trend to cloud computing from the enterprise. The long -term consequences of generative AI are likely to affect all of our lives in some way. Non tech companies that refuse to turn to AI will see their competitive edge disappear almost overnight. Elon Musk is concerned that the negative consequences of AI may not be very positive for humanity. But at this point it is much too early to predict that.

Apart from investing directly in the large cap tech names, there are many new ETFs devoted to investing in this new industry. Some of the new ETFs are focused on investing in companies that develop new products and services to advance scientific research. Some ETFs are focused on companies that use AI to enhance their bottom line by substantially lowering their operating costs.

One thing for sure is that AI technology is a disinflationary trend, not an inflationary one. The risk to society as a whole is the negative long- term effects of lower employment as machines, drones and robotics replace humans in the workforce.

I have reviewed many ETFs that are devoted exclusively to AI. While most of these ETFs are indexed to some new AI benchmark index and are thus considered passive funds, the difference between active

and passive ones at this time is marginal at best. This is because the new index benchmarks are so recent, that it blurs the long- term differences between active and passive management.

The real differences I see currently are that some ETFs only focus on the large cap tech and communications stocks, while others include both large cap, mid cap and small cap names. We all know that the real entrepreneurs work for the smaller capitalized companies that usually end up being taken over by the larger ones once the technologies are perfected and they are producing solid revenue and cash flow.

One fund I found particularly interesting was Wisdom Tree's AI and Innovation Fund, WTAI. This fund has a reasonable expense ratio of 0.45% with exposure to large, mid and small cap in the proportions of 66.08%, 21.17% and 12.75% of the fund's investments respectively.

ETF	WTAI	IGPT	BOTZ	ROBO	CHAT		
Total Return-1 year	20.47	34.33	22.67	7.06	N/A		
MER %	0.45	0.60	0.95	0.95	0.75		
Inv. MGT	Passive	Passive	Passive	Passive	Active		
Forward PE	32.82	27.14	31.17	24.45	25.05		
% Large cap	48.44	78.30	54.57	32.00	85.79		
% Mid Cap	31.05	19.06	25.02	43.83	8.87		
% Small Cap	20.51	2.64	20.41	24.17	5.34		

Recommendation

It is still too early to determine which ETF will be the long- term winner. Investing in an ETF that includes both the larger and smaller companies is what I recommend at this time. I also do not think it is an issue currently between active and passive management. The indices that the passive ETFs are trying to emulate are so new that it does not make a difference in performance between the active and passive managers. However, over time I fully intend to add an actively managed ETF in this area.

I am adding Wisdom's Tree WTAI ETF to the Growth Portfolio in the Technology sector. It is very broadly diversified with the largest percentage weight holding is ARM at only 2.68%. The top ten largest holdings only represent 21.58%. It has experienced a solid 1- year total return of 24.78%.