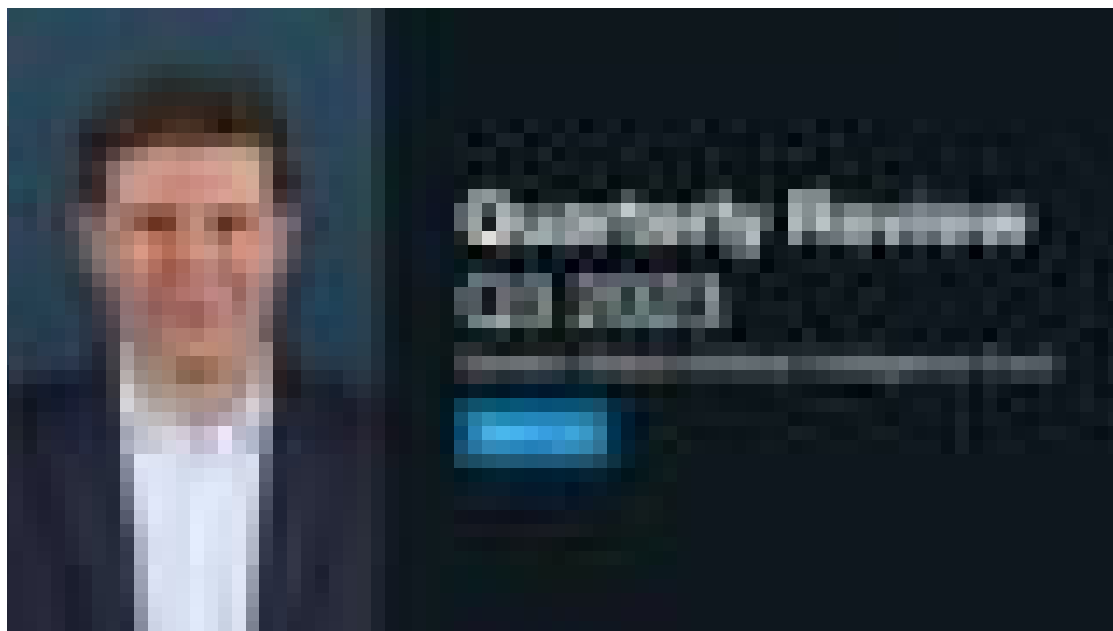


Sanlam Global Artificial Intelligence Fund Quarterly Review - Q3 2023

Chris Rodgers is joined by Head of Growth Equities, **Chris Ford**, who provides an overview of the Sanlam Global Artificial Intelligence Fund's performance, current market trends, and an outlook for the future.



You can also read our [quarterly investment update here](#).

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Read the transcript

Chris Rodgers

Good morning. My name is Chris Rodgers. I'm head of investments here at Sanlam Investments UK, based in London. And with me this morning is Chris Ford. Chris is the head of our growth equities team and the lead manager on the Sanlam Global Artificial Intelligence Fund. And we're going to talk this morning about the third quarter of 2023. Good morning, Chris.

It's been exciting times in the world of AI, but I suspect things have calmed down a little bit from the first excitement in the early part of the year. So how have you found the third quarter? I mean, what have been the main trends in the background for that?

Chris Ford

So you're right, third quarter has been a little bit less frothy perhaps, than what we heard at the beginning of the year.

Chris Rodgers

But healthy

Chris Ford

Yeah, absolutely. I think, you know, there were certainly things at the beginning of the year that you know, went off like a firecracker, really. Partly because the spring had been coiled so tightly through the fourth quarter of last year and things were in an extremely oversold position at that time.

So we saw that spring back at the beginning of the year, which I think surprised some people. But that was then, of course, compounded in the second quarter by the fairly extraordinary fundamental news flow that we heard through that period building on Chat GPT at the end of the first quarter and then with NVIDIA's extraordinary quarter in Q2. So Q3 was characterized by perhaps a little less of that kind of news flow, which I think is healthy, allowed everybody maybe to take a little bit of stock.

And that was reflected in the performance of the of the publicly quoted equities through the third quarter. So the market was down a little bit in the third quarter. The MSCI World Fund was down a little bit, broadly speaking, in line with the MSCI World during the third quarter, but actually nicely ahead of the technology sector, which was good.

Chris Rodgers

You're talking in dollars here? Giving things a little boost because of dollars being strong, so many investors have benefited from that.

Chris Ford

Correct. But broadly speaking, the fund did kind of what we might have expected it to do over the quarter. If anything, I think the quarter was characterized by kind of more of the same. So we did get another extraordinary quarter from NVIDIA. And if it wasn't for the fact that it was coming against the backdrop of the most extraordinary quarter of the quarter before then, I think it and of itself would have would be would have been taken very well.

So from an operational perspective that the theme in which we're looking to invest is developing very much as we would have expected. And the companies that are most in the zeitgeist and perhaps the most familiar to the fund holders and the public are continuing to lead the charge in the way that they have been.

Chris Rodgers

In addition to the obvious excitement around AI the only other thing that the market seems to obsess about at the moment is Fed policy and are we there yet in terms of tightening. Is that something that troubles you?

Chris Ford

Doesn't really trouble me too much, but it's something that obviously we don't invest in a vacuum. So we have to be aware of what's going on around us. And Fed policy is part of that process. I think we need to reflect on the position that with the Fed rate where it is at the moment, a 50 basis point increase or decrease is a much smaller issue than a 50 basis point increase or decrease when you're starting from 50 basis points.

You know, we're not looking at a doubling of rates. We're looking at a kind of 10% increase in the rate to where we are and it is more nuanced now. Of course that means that there is less egregious impact on the discounting mechanism on longer and longer duration securities than was the case when we were coming from such a low level a couple of years ago.

So it concerns me from that perspective less than it did. I think something which is observable, however, over the course of the last, shall we say, two years now since we've been through this kind of post-COVID unwind, is that the operational performance of many of the companies in which we invest in the AI space has been really exceptional.

And so companies which had maybe not been expecting to break even until 2024, 2025, 2026 have in many cases being able to bring forward the point at which they've achieved cash flow, break even, P&L break even. And so you have the duration that you thought you were owning in 2004, the perspective of 2020, 20, 21 actually ended up being significantly shorter than one might have expected at that point.

And that's a measure of, you know, the competitive positioning and the optionality that sits inside these businesses. But also it's a measure of good management, you know, management responding and reflecting the changed environment that they're operating within.

Chris Rodgers

As the markets become more settled and less frenzied, a bit of consolidation in some share prices have you being able to find some entry points for stocks that had got too frothy previously.

Chris Ford

A bit less so in the last three months, frankly. You know, we historically over the life of the fund over the last six, seven years now, you know, turnover hasn't been very high. It was elevated a little bit as a result of the much more rapidly evolving market context through the 2021, 2022 period. But with things a little bit more stable and and less flighty over the course of the last three months, there hasn't been a significant amount of turnover in the fund.

And yet a much more so, you know, kind of more normal levels or a couple of things that we finally ended up exiting, having begun that process earlier in the year. Some that have done extraordinarily well for us for a very long period of time. A company like Advantest for example, which is a Japanese testing stock, which has just been an amazing investment for us over that period that's just on the way out.

Some where unfortunately, things didn't develop in the way we'd hoped, so we exited that position in Zoominfo earlier in the quarter and a few new things which I'm not going to talk about for the moment in detail because we're still in the process of building those up, but the bench at the moment in respect of those that are kind of waiting to come into the portfolio, if you like, and providing competition for capital in the fund, which is very important, keeping those things that are already in the fund on their toes and earning their positions in the fund on a day by day, week by week basis.

That bench is as strong as it's ever been and I've actually come straight into this session with you, Chris, straight from the process of looking through that bench with my colleagues on the team. And it's a very strong picture.

Chris Rodgers

Okay. We've touched on performance of headline levels and what's been going on underneath the bonnet. What are the highlights and lowlights that have been driving the portfolio?

Chris Ford

So let's start with the bad stuff first. So, you know, we've had a few things that have been going on. It's been more difficult in the automation world, in places in the course of the last 3 to 6 months. That's partly been a function of interest rates actually coming back to fund the financing costs.

And for some of those in the automation world have had the impact of large infrastructure projects, particularly the logistics space or else were being pushed back. And the upshot of that has been the demand for some of the stuff. Some of the equipment sold into that space has been weaker than had been previously expected, and that's been seen particularly in some of the Japanese automation names over the course of the last three months.

We also had the impact of the GLP-1s. We had a position in the fund, a longstanding position of the fund where we've made a lot of money over the years, in Dexcom, which is a manufacturer of continuous glucose monitoring equipment and of course the assumption that we regard to be a rather knee jerk assumption at the moment is that the presence of the new diabetes drugs will lessen the demand for continuous glucose monitoring equipment for diabetics.

We take a different view in the long run, but the market for the moment is shooting first and asking questions later. We still own that position. On the other side there's been some really interesting developments across the portfolio, so we are very pleased to see that Darktrace here in the UK is now beginning to come out of the other side of what's been a very difficult period for distraction with the Mike Lynch situation.

And so that positions them very well for us. In the quarter we saw a great performance from a company called Arista, which we own in the networking space. This is a company that we think is going to benefit significantly from the requirement to use its equipment to facilitate the movement of the enormous quantities of data in and out of the central processing facilities inside hyper computing centres, and ever greater speed with lower latency and on a greater scale.

So that stocks done very well and in the middle of the quarter, we heard what we fully expected to hear from Activision and Microsoft that the CMA here in the UK had decided that it wasn't going to pursue its position any longer. And the acquisition of Activision by Microsoft is looking to conclude imminently. So that's a position that we've had in the fund for a very long period of time.

We're going to get taken out there and that obviously gives us some incremental capital to redeploy into that bench.

Chris Rodgers

I noticed that the top performing stock was called PDD Holdings, which is the Chinese e-commerce company. What's been going on there?

Chris Ford

So PDD is a stock that we've held at points on and off in the fund for about five or six years now. It first came to prominence in the extraordinary growth it was able to achieve in its market domestically in China, operating kind of at the lower end in the e-commerce space beneath the traditional part of the market where you would find Alibaba, for example, as being the obvious incumbent.

And more recently, PDD has looked to enter foreign markets. It's entered over the course of the last 12 to 15 months, the US has entered the UK, Germany, a number of other markets as well, really looking to offer very, very low priced goods to those markets. We've seen the lower price point consumers really hanging around in the e-commerce space, post-COVID in a way that they were kind of largely absent from before and they addressed that market very successfully.

So really what we're seeing here, I suppose with PDD and that team rebrand is the disruption of the very low end of the consumer market that might be associated in North America, for example, with the dollar stores in the same way that we saw Amazon over a couple of decades disrupt the more mainstream retail market in the States.

There's debate around what the profitability of that business looks like over time. But for the moment it's been all about the revenue growth has been very, very significant.

Chris Rodgers

I know you're very much a bottom up stock picking portfolio, but what about sector positioning? You're very quick to remind people that you're not a technology fund, but just remind us what is the technology exposure?

Chris Ford

We're still not a technology fund, we're still in the mid-forties.

Chris Rodgers

Which is not high by comparison with the indices.

Chris Ford

No not at all, but on the other hand, it is towards the upper end of the range that we've occupied since the fund has been available over the course of the last 6 to 7 years. And that's a function of the performance that we've seen in many of the stocks. I referenced Advantest earlier. Obviously, we've got a fairly big position in NVIDIA that's done very well for us.

Chris Ford

Companies like Microsoft and so on have done very well for us so far over the last 12 months or so. So it's not that we've been particularly allocating actively more capital into the technology sector, but rather the growth of the technology sector within the fund has been a function of the performance of the stocks that we've held. So I don't really make any apology for that.

But it's not a change in strategy. It's just a function of where we happen to be investing. Broadly speaking, I would say if you stand back and squint a little bit, the shape of the portfolio really hasn't changed very significantly. We're kind of 60% in North America, mid 40% in technology. And that's, broadly speaking, been where we've been over the course of the life of the fund.

Chris Rodgers

What about exposure to Asia, which has become, in China's case, quite topical?

Chris Ford

Again, hasn't really changed significantly over the course of the last we've got a 20% interest in Asia. I mentioned earlier that we've suffered some less than strong performance from a couple of our Japanese stocks, which hasn't been particularly helpful over the course of the last three months. On the other hand things like semiconductor capital equipment companies in Japan have continued to perform for us over the period.

So there've been puts and takes on both sides. China has been less one way or the other over the course of the last three months than it has been at other points over the last couple of years. No real change.

Chris Rodgers

Okay, crystal ball gazing time. Obviously the markets are in the middle of a bit of a correction, I would have said, and obviously rising bond yields has been a factor which reads across directly to valuations of highly rated growth stocks. What do you see in store for the next quarter and beyond? I mean, I know a lot of the positions are very long term anyway, but do you have this kind of a road map?

Chris Ford

Well, of course, that road map is first and foremost a road map around the theme that we're looking to target and specifically AI, obviously, that's burnished rather than diminished over the course of the last three months. As a result of the incremental newsflow that we've heard from Google and Microsoft and specifically NVIDIA, again, in this quarter and Microsoft launching its own, investing in its own AI chips, amongst other salient news points, we have yet still greater conviction that we're in the right place and we're investing behind the right things.

Now, one of the things that's obviously caught the eye over the course of the last few months has been NVIDIA's numbers. And of course, you know, if you ordered some of NVIDIA's stuff earlier this year, you really only took delivery of it relatively recently. So until this stuff is in datacentres and powered up, wired up, ready to go, it's not possible to imagine that until that those conditions have been met, Those products and services that rely upon those things would have been able to be delivered.

So what stands ahead of us now is we see NVIDIA delivering these extraordinary and larger shipments we might have expected previously is going to be that delivery of product and service over the top of that infrastructure. So we think NVIDIA's in that process of making deliveries, what we're likely to see over the near term is going to be some

incremental demand for the equipment that's required around those NVIDIA chips inside the datacentre to make sure that they work.

You can't just buy an NVIDIA chip and just put it on the table, that's not how it works. You've got to wire it in, put it in a rack. You've got to turn it on, you've got to provide it with power and data. So all of that requires adjunctive equipment from companies like Arista and Monolithic Power, for example. And then you will get the opportunity for the software services, software providers in particular, but also others to start accessing that infrastructure in there.

And that's, I think, the roadmap that we're looking to observe over the course of the next one through four quarters.

Chris Rodgers

So it's still very early days in this.

Chris Ford

We've hardly started.

Chris Rodgers

Okay, good. I think we'll wrap it up there Chris. Thank you very much for listening. I hope you found that interesting. If you have any questions that you'd like to put to Chris, perhaps in the first instance, could you please contact your Sanlam representative, we'll relay them to Chris and we'll get back to you that way. Thanks very much.