POLAR CAPITAL

Polar Capital Global Technology Fund

The Magnificent 7 and positioning for a market broadening

Q: GC: Nick, you've got the advent of the Magnificent Seven, or possibly the Fab Four or Five with Apple and Tesla struggling. Do you expect the market to broaden? What do you expect for the rest of the S&P 493? Do you expect them to all wait until the market normalises?

A: NE: The Magnificent Seven needs to be viewed in the context of the underlying growth of those stocks, not over one year, but over a multi-year period. They were exceptionally weak in 2022, down about 40% as a group, resulting in very cheap valuations coming in with low expectations last year, which led to strong performance across the group. As you said, this year it's not so even, with Apple and Tesla really struggling. I think what's happening is part macro, and that's probably the bigger issue for Tesla. The electric vehicle market is tough, highly competitive, and growth is slower. At the same time, Apple looks like they've missed the boat a bit on generative AI. Also, if things play out the way we think, with infrastructure spend coming before devices, AI laptops will come before AI smartphones. That replacement cycle for smartphones is probably further down the line. So even though it gives Apple time to catch up, it means it's not the focus of where the action is near term. The market is differentiating based on growth prospects and how well-positioned companies are from an AI perspective. We have minimal position sizes in Apple and Tesla right now, less than a percent of the fund. Although we have temporarily supplemented Apple with a small call option positioned around their developer conference in case they make some groundbreaking AI announcements, including a potential partnership with either Google on the Gemini model or OpenAI, embedding more into Apple devices. So, there's potential for a bit of a bounce there, but really, I think that smartphone story is further down the line.

The other big names, Fab Four/Five, all look pretty well-positioned here, and the valuations look reasonable too. So, where I would agree is we do expect a broadening, and the fact that those companies aren't delivering the sort of growth they did last year is a good thing because it means there are a lot of other companies we're looking at that are delivering at least the same, if not considerably stronger growth. So, we're broadening the portfolio; the number of stocks has gone up because of that. If a broadening happens, and we think it will, it won't be all about NVIDIA. That should play to our strengths as a big team, travelling a lot, diving deeper. As will the experience we've gained with our AI Fund where we've built up a big base of knowledge around AI which others just don't have yet. We do expect broadening, and we hope it'll happen, but we've not really seen it yet.

Q: GC: How have you actively repositioned the fund? Are there key changes that you can talk us through?

A: NE: Yes, the most important point is there's been a lot of change because it's needed at times like this. You need to pivot towards new technologies and generative AI. The compute stack is very different, with the bill of materials 25 times higher. Most components need changing, with way more memory and graphics processing rather than CPU at the core. So different companies win. That has resulted in significant turnover in the portfolio. We've applied an AI lens to our process, which means we look at every stock in the portfolio and say, is it an enabler of AI? Is it a beneficiary of AI? Or is it an adopter? Which is typically someone who's used old AI machine learning, has a lot of data, and has the potential to embrace generative AI but hasn't yet. Actually, that's where Apple would probably fall, along with Uber, DoorDash, and The Trade Desk; companies that could get there but haven't demonstrated it yet. They're good companies that we still like but for now have smaller positions in because we're not sure if they're going to make that leap. So, we're moving towards companies that we think are key enablers and key beneficiaries and away from companies that are potentially losers. I mentioned Adobe earlier; they were a potential beneficiary of generative AI but right now, since the release of the Sora product, they're looking increasingly like a loser.

We've also reduced exposure to broader consumer spending because we feel the macro backdrop is unhelpful. You can see that in Amazon's results, Disney's results, Starbucks' results. They're all talking about makeshift or softer outlooks; consumers are feeling the pinch a little bit, so reduced exposure there. We've reduced exposure to China where increasing geopolitical tension is unhelpful, and the economy is probably struggling a bit more. I mentioned earlier, we've reduced exposure to electric vehicles and clean green energy transition stuff, largely because of the macro backdrop. So, we've pivoted the portfolio to fully embrace AI, and I think you have to at a time like this. If we're right and we get broadening and more participation of smaller stocks, it will benefit us, having an active growth-centric approach off-benchmark. I think ETF-based investing in tech will be much more challenging, it usually is at turning points like this. If you don't change the portfolio at these key technology turning points, you're going to have a portfolio full of legacy incumbents that are going to go ex-growth. So yes, I think change is critical.

Nick Evans, Partner, Polar Capital Global Technology Team

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