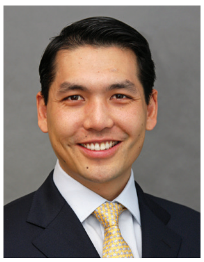
Exploring the Commercial Application of Artificial Intelligence

Authors



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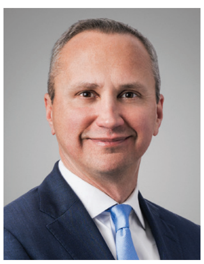

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How are companies talking about AI? How will this new technology impact companies? How are you and other investors at MFS® thinking about AI in portfolios?

Looking at AI from about 30,000 feet, the consensus appears to be that it represents a tectonic shift in technology. It's akin to the invention of the Internet or the mobile phone. Any time there's a pivot in a technology platform, there are always more questions than answers, and right now, there is a bit of a frenzy. It feels similar to 1999–2000, when every company portrayed itself as a dot-com company, or the early 2010s, when every company was a cloud company. Now, every company is talking about how AI will help them.

Our job is to tune out the noise and instead understand how AI will impact companies and industries over the next three to five years. Which companies and industries will likely win? Which will proceed as usual? Which might see their business model, margins or profits at risk?

Let's talk about that third category and the effects of creative destruction. Are there any insights you can share with us?

Companies formed over the past 10 to 20 years have incumbent profit pools they need to defend. They will likely look for ways to use AI to help protect and then augment those pools. As with the Internet era and the mobile era, there will be hundreds, if not thousands, of new companies funded. Most probably won't scale, but a handful probably will. We're not thinking about them today.

We know AI is a set of computer programs that helps makes workflows or performing repetitive tasks more efficient, and we know it's getting more intelligent. But exactly how will it be used? Thinking about businesses that charge per seat or rely on labor as their business model, will there be fewer seats to sell with a software-based business model if there is deflationary pressure on labor? If your business is hiring people to implement outsourcing services, if some of that gets automated, what does that mean for your business? How are you going to pivot? What's your rate of growth and duration of growth? Your rate of growth is obviously a function of your value proposition. If that value proposition is duplicated by AI, that revenue stream goes away.

Take a generic enterprise software company that sells software to automate a workflow. If it introduces AI features and functionalities, it'll want to charge more for that. How much will customers be willing to pay for that productivity enhancement? On the flip side, if a Fortune 500 company cuts 5% of headcount, that's a headwind offsetting a potential tailwind. Is that neutral, positive or negative? We're asking these questions company by company within each industry to better understand the implications of the new technology.

Coming out of the global financial crisis, many businesses were fungible because capital costs were so low. Now rates are no longer zero and companies might not be fungible. If AI can possibly duplicate their revenue streams, how will that impact growth drivers?

Onshoring is necessary to build supply chain resiliency. That's important for national security and geographic diversity. It needs to happen just as AI needs to happen. If a company is facing a potential disruption, and it doesn't invest in an AI roadmap, it will eventually be disintermediated. It's table stakes. The last decade had low rates and free money. Many fintech and biotech businesses were funded. Much of that funding has disappeared, but there's still a lot of dry powder sitting at the venture capital and private equity firms that are funding the next wave of AI companies.

How are you thinking about the other buckets, the neutral or positive companies?

Those are broad buckets that are constantly evolving — week to week, month to month. As investors, we historically have leaned on the suppliers — we think of them as the picks and shovels — that provide the capital, computers and hardware or semiconductor tools required. That's where we start with the neutral-to-positive. As we move up the stack, there's a broader set of questions. You can't just say this is always good or that is always bad; it's company-specific. This is active management; it's where our global research platform comes in. Interviewing companies, making comparisons across geographies to figure out which companies have the right roadmap. Which companies will likely win and which are just issuing press releases with no substance.

All these tech companies are talking about AI and delivering a value proposition. How do you channel- check to determine who has competitive technology that will be commercially successful?

We've analyzed companies that are perceived as winners; it's all in the numbers. But it's the category three companies where we have questions about. What are they doing? How are they thinking about AI? How will it benefit them? We are talking through industry channel checks. We're talking to old line companies that historically might not have participated in this technology shift and asking them, "What is your AI roadmap? How will it be executed? Will it change how you run customer service or product development if it's in health care and life sciences? Who are the vendors that you want to work with?" The answers to these questions creates a mosaic of information that helps us understand the duration and rate across sectors at a deeper level than we would by just going to conferences or reading company press releases.

You're not just a technology investor. You're also a generalist. How are you and your team thinking about AI from a real economic standpoint as well as across your portfolios?

We believe that outside traditional technology, AI will be net neutral to beneficial. It's going to drive greater efficiency in every organization. It could be labor, or it could be time spent. We're already seeing innovation, and the pace should continue to accelerate. I have a couple of examples: Life science and pharmaceutical companies are using AI to help reduce the time needed for drug discovery and molecules. That takes costs out of the system and improves speed to market.

Content creation, whether it's images, video or creative, will see something similar. Employees will spend less time doing mundane tasks and more time thinking critically and adding value to services and products, which will drive revenues. As we look sector by sector, this is more likely to be a tailwind than a headwind.

Looking back, companies have been able to chug along because they offshored labor and benefited from low interest rates. Now labor and capital costs are elevated. Will AI be able to help struggling companies in a recessionary time?

In the short term, companies can cut costs faster and maybe survive a little longer. If we think innovation will move faster, it will exacerbate any weakness in their structural positioning. That's my guess.

So selectivity is important. Not only in tech and when looking at companies in one of the three categories we've discussed, but also at a much broader level, whether it's across the S&P, Russell 1000® Growth or other indices. I think the questions we've asked will take five to 10 years to get answered in tangible ways outside of the technology sector. We're still in early innings. The news and capital flows are concentrated in larger-cap technology companies. It's an arms race right now in terms of spending and investing to improve the technology's accuracy and reliability; plus you have to add in the regulatory framework. In many cases, change may be incremental instead of transformational.

It's been a crazy couple of years. First there was COVID, and there were winners. Then there was a COVID hangover. Companies participated and extrapolated all the trends and are now taking stock. Many have likely thought that the technology shifts of the past 10 years — e-commerce, payments or digital advertising —have been in their later innings. But now there's AI. It's happened so fast — in the span of six months. Everyone can touch and feel it through ChatGPT. It's creating another leg of growth for the economy and companies that wasn't here, or at least apparent, 6 to 12 months ago.

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