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Barrow Hanley: How to find AI winners outside big tech

By Perpetual Asset Management

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The global AI boom is creating investment opportunities in unexpected places. Barrow Hanley portfolio manager DAVID GANUCHEAU explains where to look

- Industrials seeing AI growth
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TAKING a value-investing approach to artificial intelligence can help protect investors from overexposure to highly priced companies that risk disappointing, says Barrow Hanley's David Ganucheau.

AI is creating investment opportunities beyond America's big tech leaders and is driving growth in the traditional industrials that supply electricity, cooling equipment and components for robotics.

But the challenge for investors is finding opportunities that do not already price in the potential upside.

"What we're trying to do is buy companies that have truly dislocated from their intrinsic value. Cheap is not an investment thesis," says Ganucheau, who co-manages the Barrow Hanley Global Share Fund.

"We love growth. We just don't want to pay for it."

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Picks and shovels

Ganucheau says traditional industrial companies across the market are generating strong growth from AI investment.

“The cool thing is it’s not just the hyperscalers and Nvidia. There are a lot of different companies – suppliers to the suppliers to the suppliers – that benefit from this growth.”

The first wave of growth was in electricity utilities like Entergy Corporation (NYSE:ETR) and data centre power and cooling providers like Vertiv Holdings (NYSE: VRT).

But the next opportunities look like coming from suppliers to the so-called physical AI sector – robotics, self-driving and industrial automation.

“We’re not just thinking about AI – we’re thinking about the follow-on effects. What about physical AI, what about robotics?

“Aptiv (NYSE:APTV) we’re buying at seven times earnings – with a huge robotics opportunity. This suite of products inside your car that tells your car where it is, enables full self-driving and … all the safety features.

“Aptiv has a huge call option on robotics.”

He also points to Sunny Optical (HKG: 2382), which makes cameras for smartphones, and gears and bearings maker Regal Rexnord Corp (NYSE:RRX).

“Regal Rexnord is a boring gear and bearing company – but those gears and bearings are going to be used in humanoid robotics.

“Elon Musk says there’s going to be 10 million humanoid robotics a year at some point. That is so crazy – but it’s definitely coming.

“And the key is we’re just not paying for it. These are cheap companies. It’s not in the price.”

Increasing index concentration

Ganucheau says investors need to look beyond the biggest technology names because an increasing concentration of global markets in a very small number of large companies poses risk.

“You have to think about these seven to 10 companies that make up such a huge portion of the index now and a huge portion of managers portfolios. People may think they have diversification when they don’t.”

He says investors should make sure their managers are also looking outside big tech.

“At some point the market is going to broaden out. It’s extremely narrow right now.

“There’s no law that says the AI companies have to keep growing.”

Duration risk in growth stocks

Ganucheau says investors should think about the risks of holding highly-valued growth stocks as similar to holding very long-term bonds – small changes in interest rates or growth forecasts can have an outsize effect on today's price.

"When you're buying growth companies with high multiples – when that growth slows, or if interest rates go up, those cash flows aren't worth as much."

He says many investors have already forgotten the market turmoil in 2022, when the prospect of rising interest rates and inflation from Russia's invasion of Ukraine sent growth stocks plummeting.

"Growth was down 30 per cent that year – value was down single digits.

"You've got to think about the downside, and I don't think a lot of people are thinking about the downside right now."

Growth risk

"The obvious risk of a high-growth company is that you get a growth miss – it's one of the pitfalls of growth investing.

"As that multiple contracts, it's brutal. Now that hasn't come to fruition yet – the advent of AI has really lit a match under the growth of a lot of these companies.

"But we can see that it's going to get harder and harder to fund going forward."

About Barrow Hanley

Barrow Hanley is a global leader in value investing, managing assets on behalf of clients for more than 40 years.

Barrow Hanley Global Share Fund and its ASX-quoted asset class aim to provide investors with long-term capital growth through investment in quality global shares.

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