

Xuesong Zhao, Lead Fund Manager and Partner
Polar Capital Artificial Intelligence Fund



A: Vik Heerah, Chief Marketing Officer: Xuesong, we are in a period of geopolitical instability at the moment, but the AI trade has remained intact. What has driven that?

A: Xuesong Zhao (XZ), Manager of the Polar Capital Artificial Intelligence Fund: Model development last year had a profound impact on the demand side. Leading-edge model developers improved the architecture of the model, so that the hallucination rate declined quite meaningfully. As a result of this improvement, from Q3 last year enterprise adoption hit an inflection point, increasing significantly, which provided a very strong backdrop for CapEx investment. That, perhaps, is a key reason why you have seen the hyperscalers revise up CapEx quite meaningfully, and the capacity-related trade has been doing very well. At the same time, more and more enterprises embracing AI tells investors how great the technology is, but more importantly how it is starting to show some P&L impact. That perhaps is the reason why you have seen the AI-related trade been isolated from the macro noise.

Q: VH: You have been managing an artificial intelligence fund for a number of years now. Has the model progress and its rate of change surprised you?

A: XZ: Yes, definitely, particularly from Q3 last year. The model development improvement means it actually costs less for you to use the model. Even though the model may occasionally still give you mistakes, you do not need to hire dedicated people to cross-check the results.

That is why enterprise adoption has increased quite significantly, and the pace of adoption has surprised us on the upside. At the same time, the pace of development for agentic AI actually surprised us most. This means now quite a lot of workloads can run with large language models without human intervention, and that is going to have an impact across whole sectors.

Q: VH: A misconception about your Fund is that it is a tech fund. It is not – it's a global equity fund and you invest across a number of sectors. How has business adoption of AI been so far, and how is that pace of change?

A: XZ: Last year, for Q3, when companies reported their results close to the end of the year, around 15% of S&P 500 companies were talking about tangible evidence to show they were adopting AI. This was right after the new model launches, so we expect this number to increase more significantly because we have been talking about AI being a discontinuous technology breakthrough for a very long time. One of the unique features of this technology is that once it hits inflection point, you should expect a very steep adoption curve and we believe that is what is happening now.

Q: VH: Looking ahead on the horizon, are there any other events coming up that you have got an eye on? NVIDIA Blackwell for example, I don't think we have yet seen the impact of that. What are you thinking about at the moment?

A: XZ: New models coming out of the developers using Blackwell is something we look very closely at, as you alluded to.

We have not really seen any models that have been trained with the most advanced GPU yet, i.e. the Blackwell generation. We hope both Meta and OpenAI can launch this model quite soon, and we think performance should improve quite significantly – that is the first thing. The second thing is, at the moment, all these leading edge models are built on something called the transformer model, which was invented by Google back in 2017 and we want to make sure that the architecture of this model will not change significantly. That is something we look at very closely as well.

Q: VH: In terms of the non-tech areas in the Fund, can you give us a feel for the sectors that you are exposed to and the opportunities that you are finding?

A: XZ: One of the interesting philosophical ideas we have is that we think physical asset owners can benefit more from adopting AI. We look at industrial companies including airlines, airports, manufacturing, chemicals, and also transportation companies. We see quite a significant AI adoption in these areas. More importantly, some of the companies have demonstrated tangible evidence of benefits from AI and that is why they have had a very strong rerating in the past few quarters.

Q: VH: As you are running a global equity fund, a key part of it, particularly with a disruptive technology like AI, is avoiding the losers. How much do you think about that?

A: XZ: That is actually quite important. I can give you one example: the entire model architecture was changed or redesigned, so the hallucination rate declined very dramatically. As a result of that, enterprises started using AI to do things very differently. One example is that they can replicate quite a lot of the functionality from existing packaged software, and that is why, once we realised that was the case, we thought unique data points may not be the advantage anymore. As a result, we significantly reduced our exposure to application software and also the business analytics segment, which helped us avoid some of the multiple compression that happened after we sold those stocks.

Q: VH: I am sure you get a lot of questions about valuations, as technology has had a strong run. What do you say to investors concerned about these levels?

A: XZ: We should look at whether this is multiple driven or earnings driven. Since ChatGPT was launched, the super majority of the returns specific for tech (Nasdaq) has been driven by earning revisions – slightly over 80%. Less than 20% of the returns came from valuation multiples rerating. When you look at non-tech sectors for companies who can demonstrate they benefited from AI by changing business models, for example Walmart, who have enjoyed a very significant rerating. We think the rerating is fair because they permanently changed their business model. For certain companies which use AI and benefit from it, but are still in the early stage of demonstrating the return you see the multiple move up a little bit but not significantly, which is why we still see the potential.

If we split tech versus non-tech, we think tech has been doing very well in terms of returns, but it is earnings driven. We think it is more interesting to find opportunities outside the tech sector for companies which use AI to do things differently and we think you should see a very meaningful rerating happening. That is the reason why we feel quite excited about opportunity there.

Q: VH: Finally, looking ahead, how have you positioned the portfolio? What does it look like at the moment?

A: XZ: At the moment, slightly over 40% in the technology sector, mainly investing in enabling technology. Around 60% is invested outside the tech sector. Industrial is one of the sectors we look at very closely and also the consumer sector, that is mainly offline merchants. Lastly, the chemical and energy sector, where we think can benefit from AI-related demand. So the portfolio is quite well balanced and we have a bias towards growth.



Find out more



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Polar Capital Artificial Intelligence Fund

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