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Neuberger Berman Sustainable Equity Team

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Opportunities for Active Stock Picking in Big Tech

After a tumultuous 2022 (S&P500 declined ~20% as the U.S. Federal Reserve embarked on an interest rate hiking spree), the S&P500 has rallied more than 20% this year.[1] Many market commentators have attributed the rally to an "AI bubble" and have compared the markets to the tech bubble of late 1990's and early 2000s.

We believe it is a mistake to paint all "Big Tech" with the same brush. In our opinion, the current info tech firm landscape is vastly different from that of the dot.com bubble era as these leading tech businesses today have robust earnings, visible cashflows and proven business models. Furthermore, within these big tech companies, there is a diversified set of business models, management philosophies, and valuations. We take a different view than pundits who have bemoaned overextended valuations for big technology companies as a group.

As active fundamental investors, we focus on identifying investment opportunities with deep business and economic moats and sustainable business practices, rather than speculate on a "hail mary" of future potential. We believe our exposure to tech is thoughtful and strategic - we have invested in what we see as differentiated businesses at attractive valuations and that have established business lines that together have the potential to benefit from and leverage distinct AI capabilities over many years.

We believe there are certain big tech companies that are both beneficiaries and enablers of the AI trend through their cloud infrastructure and software for customer use. For example, aside from being the world's dominant desktop operating system, Microsoft's Azure is the global No. 2 in cloud infrastructure service spending. Cloud computing is essential to run the enormous amount of data and train AI models such as LLMs (large language models). Azure cloud supercomputing infrastructure, in partnership with OpenAI, is positioned to play a key role in helping enterprises train, deploy and scale AI products.

Similarly, Amazon not only brings in roughly 40% of all U.S. online retail sales, it is also the parent of leading cloud infrastructure service platform, Amazon Web Services (AWS). We believe the company has been ahead of peers in the AI game with its proprietary semiconductor chips (Inferentia launched in 2019 and Trainium in 2021). With its relentless focus on the customer, we believe Amazon can provide high quality AI services through its cloud (AWS) or training LLMs for integrating AI at more reasonable cost due to their proprietary silicon chips.

Google has accounted for at least 90% of global internet search share since March 2013, while streaming platform YouTube is the world's second most-visited site. AI should be a tailwind for Google's search engine as it has the potential to be vastly improved as it integrates AI with search, making it more relevant for end users and consequently to advertisers. Today, the conversion rate in a Google search for search ads is estimated to be low-single digits. Therefore, even a slight improvement could be extremely material as an improved return on investment (ROI) for advertising customers that could directly benefit Google.

We do not view all companies in the "Magnificent 7" as being equally attractive either due to valuations or business models that do not fit our sustainable investing philosophy. 3Q earnings validated our view that there is opportunity for active management and stock picking within the "Magnificent 7" stocks. Consensus for average annual revenue growth for Microsoft, Amazon and Alphabet over 2023-2025 is

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[1] As of end of 24th Nov 2023.

8.7%, almost triple the rest of S&P 493 at 3%, and robust profitability, with net margins of 29.3% or likewise nearly 3 times for rest of 493 companies in the S&P500.[2] And while these businesses have had a healthy rally this year, we view these companies as the "new stalwarts" with market leading scale and with continued R&D investment which has the potential to lead to structural growth.

[2] Goldman Sachs 2024 Equity Outlook Strategy. November 15 2023.