

The Investment Conversation: Innovation's Expanding Reach Across Global Equity Markets

In this podcast, Lord Abbett Director of Equities, Matthew DeCicco explores the investment implications of technological innovation across global markets and sectors and how increasing dispersion can create opportunities for active investors.



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KEY TAKEAWAYS

- The AI buildout has expanded across geographies and industries, broadening the opportunity set in areas such as power, networking, cooling, and industrials.
- Disruption is helping markets differentiate between companies positioned to potentially benefit from AI and those more vulnerable to its effects.
- The opportunity set extends beyond the AI buildout, with attractive investment themes across space, defense technology, commercial aerospace, financials, biotechnology, and diagnostics.
- AI and machine learning may enable less-invasive diagnostics and accelerate parts of drug discovery, but the benefits are unlikely to accrue equally across companies.
- Greater dispersion can create a compelling environment for active security selection, with widening differences between companies helping investors distinguish potential winners from losers.

Andy D'Souza: Welcome back to The Investment Conversation. I'm Andy D'Souza, chief marketing officer here at Lord Abbett. AI's reach is expanding well beyond the initial build-out of all the infrastructure, and now we're seeing it through the economy in different sectors, geographies, and industries. I'm joined today by Matt DeCicco, partner and director of equities, to help us sift through some of the implications that are in store for us in the future. Matt, thanks for being here today.

Matthew DeCicco: Thanks for having me.

D'Souza: But either way you're seeing the diffusion of this technology across, as you mentioned, market caps, across different industries. And as you alluded to a bit ago, it's also not just a U.S. phenomenon by any means. It's global. Could you expand on that a little bit more?

DeCicco: Yeah. So, well, first and foremost, the demand for intelligence is global, right? Who wouldn't want to be working with somebody, an agent or (a lot of people use these), a chatbot with an IQ of 150 to bounce off some of your ideas? So, the demand for intelligence is global. But it's also important that the infrastructure that turns electricity into compute, into intelligence, needs to be located near the users of the technology. So, the infrastructure (both by the hyper-scalers or by the other companies that provide infrastructure like this, often referred to as neoclouds), that has to be built globally as well. So, the infrastructure boom and build that we're seeing in the U.S. is happening really all over the world. Of course, it's happening in China, but it's also happening in parts of Europe. It's happening throughout Asia. This is something where the demand is global and the build-out is global as well.

D'Souza: And if you think about it then from the sector industry lens, what are some other areas, obviously the hyper-scalers, that's a pretty easy one to see, what are some other areas of the market that you're seeing that start to really have some major impacts and see opportunities going forward?

DeCicco: So, let's talk AI and then let's talk outside AI. So, yeah, I think if you think about where the AI investment focus was two years ago or three years ago, it was mostly around the [graphics processing unit] GPU, which is NVIDIA's chip. Now the AI infrastructure is, of course, much broader than that. It's things like memory. It's things like networking. It's the generation of power. It's the transmission of power. It's cooling. It is the electrical equipment that goes into a data center, and it's the industrial companies that are supporting that build-out. And again, that is U.S., that's non-U.S. developed markets, that's emerging markets.

I think the other thing that I would say has changed since we last spoke is the view around software and the AI, quote, disrupted companies. When we last spoke, AI-disrupted companies in software were exhibiting what I would call classic bear market behavior. So, it was like good news

is bad and bad news is awful. And having been through market cycles, this happens and my approach to that is generally to take my ball and go home. I'll just wait for that bear market behavior to subside. Well, that has subsided. And to sort of continue that simple explanation, what we now see is that good news is rewarded and bad news is punished, which is more of a normal reaction.

D'Souza: What changed? Why is that?

DeCicco: So, first off, I think that the narrative around the disruption that would happen with these software companies was overstated.

D'Souza: Meaning like, "This [software as a service] SaaS I'm paying for, I don't need it anymore?"

DeCicco: Exactly.

D'Souza: I can use an agent and build it myself.

DeCicco: Exactly. Now, some of those businesses have a sticky customer base and that software is a system of record for the business and most companies aren't going to vibe code a new system that is that critical. That's not to say that everything about the disruption to software was wrong. I do think there are types of software that are still at risk. However, what we saw was—again, in the beginning of the year and at the end of last year—even companies that were beneficiaries or what we believed to be were beneficiaries of AI were—again, even if they had good news—underperforming. So, think of a company that might be involved in your data infrastructure and would benefit as companies are shifting to use more AI. Well, you have to have your data in order and there's companies in public markets that do that, that even when they put up good results, the market was just broadly selling the software group, throw the baby out, so to speak, with the bathwater.

And that very much has changed. So, I also think even if you go back to, I liked your example, people were saying that cybersecurity would be, quote/unquote, vibe coded using Claude or tools from OpenAI. And in fact, the opposite turned out to be the case, which is the attack surface is increased by generative AI and so companies that are in cyber have seen a real sort of increase, as you might expect, in demand for their software and the stocks have started to respond to that. Again, when we were speaking last time, even though those companies were pretty adamant that they were going to see a benefit from AI, the market was not recognizing it.

So, that has changed a bit and so our portfolios a few months ago were beginning to add to some of those positions. And again, I still think AI disruption is a real risk to software and other kinds of related areas, but there are winners, Andy, and there are losers, just like we were talking about before. A lot of people talk about the K-shaped economy when talking about the consumer, but we're seeing this in our investment opportunities as well. In every industry, including software, there are companies that are

outperforming, winners, the top of the K, and there are companies that are under-performing, the bottom of the K.

D'Souza: Let's go big picture. Last night I took my son to a Star Talk discussion with Neil deGrasse Tyson.

DeCicco: Oh, boy. Okay.

D'Souza: He was talking about space.

DeCicco: That's great!

D'Souza: There are some people that say you could put a data center out [in space]—a sun-seeker in orbit—and you could do all these things that help with the cooling and there's a lot of debate back and forth on the sides of that discussion. But in general, how are you thinking about space, if I can ask that question?

DeCicco: I love the question and I love that your son is interested in space. Look, I think that the space economy is a real investable opportunity, and it's not just about SpaceX. It's around the ecosystem that they've created through innovation.

So, the Falcon Space System reduced the cost of launching by, let's just call it, [approximately] 90%. And so, what you've seen over the last decade-plus is that the number of launches has gone up threefold or fourfold, a lot. Now, the next iteration of SpaceX's technology, Starship, is likely to reduce costs, again, by [approximately] 90%. Now, as you probably know, I think you follow this closely, the Starship has some technical challenges for fuel reusability. If you pay attention to Elon Musk, it's likely that he will get there, maybe not on the timeline that he first lays out. So then if launches were up three or four [times] X over the last decade based upon a prior 90% reduction in launch costs, I think once Starship is successful you can expect a similar increase, exponential increase, in the number of launches in the years ahead.

There's a lot of applications around that. Of course there's defense applications, but there's also communications applications. And so, I think there's a lot more for investments in that space economy that will come out over the next decade. And it's a little bit like what we were talking earlier about when fiber for the internet was first laid, you could see the companies early on like Amazon that were going to benefit but you couldn't imagine what new companies would come after that.

And I think the space economy, just like generative artificial intelligence, I think when we're talking in five years there'll be new industries, new companies that have come into being because of this innovation that perhaps we haven't even thought of or considered or imagined would be that big sitting here today.

D'Souza: Yeah. But it seems like (just to go back to the fiber real quick), the Transocean-like deployment of cables, back then it felt like you weren't seeing the shorter cycle of actual reward on that investment, right?

DeCicco: Yeah. This is the concept of [unused fiber optic cable] dark fiber. That is the big difference, one of the major differences, between the investment in [capital expenditure] CapEx that we were talking about before, now versus then, which is that money was being spent [and] it turned out to be correct because the internet was a big idea and it was going to lead to tremendous gains for the economy in the years ahead. But it was done without those returns being seen nearly as fast as what we're seeing today. And that is one of the biggest differences between this period and the early 2000s. And then marry that with valuation. So, you have that happening, that dark fiber being laid at historically high valuations. Here, we have capital being spent, there being a return on that capital, and your valuations are not extreme.

D'Souza: If I could just touch on one more industry and sector I know you're very familiar with over the years, done a lot of work on, would be biotech and diagnostics. I know that this is something that I feel like we're seeing more and more announcements every day about certain research that's coming through that's very promising on things like cancer and other things. How much of this is being driven or aided by AI?

DeCicco: So, I promised you we'd talk about things, other areas that we're interested in that are not AI, and I had on my list of things that I should talk to you about would be biotechnology and diagnostics. I may need to fill that out too. We talked about this space economy. I'm glad you prompted me on that. I would've talked about that. Related to that is defense tech and cyber. We touched on that a little bit. These are all things that, across our equity platform, we have investments in.

I would say also we talked about space. We didn't talk about commercial aerospace. But commercial aerospace is seeing a [potential] benefit from Boeing's production ramping up, and so that helps the entire ecosystem. I also think the amount of money that's being spent on this AI infrastructure build-out that we're talking about is lifting the economy overall. And so, some of the early cyclical companies (so, think like transportation companies), are doing better. So, early cyclical companies that benefit from a lift in economic growth we're invested in. And then a better economy helps the financial industry as well. Whether it be banks or companies tied to capital markets, these are all areas that are attractive. And again, I would highlight that because of dispersion that we talked about you could find good companies in almost any one of these industries.

I do think biotechnology and diagnostics are two of the most attractive areas. Diagnostics are extremely interesting because the technology today allows for diseases like cancer to be detected in much less invasive ways. So, we're investing in companies that are able to diagnose cancer through a blood draw rather than a biopsy and also monitor people who have had cancer and are in recovery, again,

via a blood draw rather than a biopsy. So, just less invasive and AI is certainly a part of this because what you're doing is you're trying to extract microscopic cellular information from a drop of blood and there's a lot of machine learning and of course artificial intelligence and computation work that goes into that. Biotechnology is an area where I think you're going to see benefits from artificial intelligence over the long run. Google's DeepMind, with their invention AlphaFold, has been used by many of the leading biotechnology companies.

D'Souza: What does that do?

DeCicco: So, effectively, as the name would imply, it predicts the way proteins fold, and that is very beneficial for when you're designing a new drug. A new drug has to fit into a protein like a lock and key. And so, a protein is a building block of your cells. If you can predict the way a protein folds, then you can predict better.

D'Souza: You build the key.

DeCicco: Exactly. You can build a better drug. So, that has been a part of pharmaceutical and biotechnology research for the last several years. And I think the way AI is going to benefit drug discovery will be a lot like the way the genetic breakthroughs of the early 2000s benefited drug discovery, which is it will collapse the amount of time it takes to go from idea to new medicine. And we're already seeing some signs of that. We're investing in some of the companies that do some of this work. So, if you develop an idea for a drug using artificial intelligence tools, you then need to study it in the wet lab, which effectively means you actually have to do the experiments.

And so, that time period of going from, "I have an idea," to, "We have a drug that can be tested in patients," that can

collapse. But again, those benefits will not accrue equally to the industry. I think the industry will be benefited at large, just like the S&P 500® [Index] earnings are benefiting at large, but there are companies that we saw in the aftermath of the genomics breakthroughs that put those tools to use in a more efficient way and saw their return on their research and development improve meaningfully. I believe you can draw the same conclusion that you'll see the companies that used generative AI for drug discovery will see a return on their research and development spend faster than those that don't use it as well.

D'Souza: Got it. So, you painted the picture of a few different areas where it's not just those providing the infrastructure but it's everyone else that can benefit as well across the chain. And you gave a few examples. I made you talk about space. You talked about biotech. But you can see the range is just very far and wide. And then the last thing, kind of takeaway I guess in some sense but you just mentioned it, was that just like any new technology that's disruptive and it's this pervasive, there will be winners and losers and that's okay. That's healthy. Dispersion is good for us as active managers. And you and your team have done a phenomenal job sifting through that process over decades and this is nothing new, per se. Although it is new, you've seen this movie before in some other form. But overall, it's pretty exciting and I just wanted to thank you for coming on today and talking about this with us, Matt.

DeCicco: It's incredibly exciting. Thank you.

D'Souza: And thank you for listening to The Investment Conversation. Find more episodes wherever you get your podcasts or at lordabbett.com. And follow us on LinkedIn, Instagram, and YouTube for more perspectives from across the firm. Thank you.

GLOSSARY OF TERMS USED IN THIS BROADCAST

Artificial Intelligence (AI) is technology that enables computer systems to perform tasks that typically require human intelligence, such as learning, reasoning, problem-solving, and generating content.

Bear market is a period in which securities prices are generally falling or are expected to fall. A bear market is commonly defined as a decline of 20% or more from a recent market high.

Capital expenditures (CapEx) are funds a company uses to acquire, build, upgrade, or maintain long-term assets such as property, equipment, technology, or data centers.

Compute refers to the processing power and computational resources used to run software, analyze data, train models, and perform other computing tasks.

Cyclical companies are companies whose financial performance tends to rise and fall with changes in the economic cycle.

Data center is a facility that houses computing infrastructure, including servers, data storage, and networking equipment, used to process, manage, and store data.

Diagnostics refers to tests, technologies, and processes used to detect, identify, or monitor diseases or other medical conditions.

Dispersion is the degree to which returns or other characteristics differ among individual securities or groups of securities. Higher stock-return dispersion can create greater opportunities for security selection.

Emerging markets are economies and financial markets that are generally less developed than those of advanced economies and may exhibit higher growth potential as well as greater investment risk.

Generative artificial intelligence (Generative AI) refers to artificial intelligence systems designed to create new content, such as text, images, audio, video, or computer code, in response to user inputs.

Genomics is the study of an organism's complete set of genetic material, or genome, including how genes interact and influence biological processes.

Graphics Processing Unit (GPU) is a specialized processor designed to perform many calculations simultaneously and is widely used in artificial intelligence computing.

Hyperscalers are large technology companies that operate extensive cloud-computing and data-center infrastructure capable of providing computing, storage, and networking resources at significant scale.

K-shaped economy describes an environment in which different parts of the economy experience divergent outcomes, with some businesses, industries, or consumers performing well while others struggle.

Machine learning is a form of artificial intelligence in which computer systems use data to identify patterns and improve their performance without being explicitly programmed for every task.

Neoclouds are cloud-computing providers focused on supplying specialized computing infrastructure, often including high-performance computing capacity used for artificial intelligence workloads.

Return on Investment (ROI) is a measure used to evaluate the benefit or return generated relative to the amount invested.

Software as a Service (SaaS) is a software delivery model in which applications are hosted remotely and accessed over the internet, typically through a subscription.

Starship is a fully reusable spacecraft and rocket system being developed by SpaceX for transporting people and cargo,

A **sun-seeker** is often used to describe a satellite that continuously orients itself toward the sun to maximize solar power generation.

System of record is a software system considered the authoritative source for an organization's critical business information or data.

Vibe coding is an approach to software development in which a user describes what they want in natural language and artificial intelligence generates much of the underlying computer code.

Wet lab refers to a laboratory environment in which researchers conduct physical experiments using biological materials, chemicals, or other substances.

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