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Pacific Ring of Fire: Fault Lines & Silicon

Dan Rohinton, Vice-President, Portfolio Manager, Global Dividend

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Throughout the centuries, the island of Taiwan has a rich history of being an exceptionally well-positioned island in the heart of Asia. However, there's one big catch: Taiwan is also right in what is known by geologists as the "Ring of Fire". Without delving into plate tectonics, it's an unfortunate reality that residents of Taiwan have to plan for natural disasters, such as strong earthquakes, exactly like the one experienced this week - the largest earthquake of the last 25 years, measuring 7.4 on the Richter scale. In our technology-enabled world, any disruption to semiconductor supply chains will have tangible impacts on the global economy, especially when a major earthquake occurs near the factories of the most important company you've never heard of.

Island of Semiconductors: Over the last three decades, Taiwan has built a commanding lead in the semiconductor fabrication industry, through Taiwan Semiconductor Manufacturing ("TSMC"). As we move to transistor geometries that are approaching the atomic level (we're talking protons and electrons!), there are only a few facilities building these cutting-edge chips, and they're all in Taiwan. Specifically, the 2-nanometer plant in Hsinchu city in the north of the island is the only one of its kind in the world. This cutting-edge facility has the most sensitive instruments humanity has ever developed to manufacture chips that are going into the 2026 generation iPhone and Nvidia GPU.

Phew!: After experiencing several past major earthquakes, there has been a significant effort at TSMC to reinforce their facilities from the earthquake and follow-on aftershocks. We can all take comfort that the impact on the manufacturing plants was minimal, with the majority of the production back at over 80% capacity in just three days. In addition, there was no damage to the most sensitive equipment in the assembly process, the extreme ultraviolet lithography ("EUV") tools, which can cost C$300-400 million each. The most advanced engineering company in the world was clearly planning for this type of risk, and so far, we can all collectively breathe a sigh of relief.

There is a local proverb "yùfáng shèngyú zhìliáo" (prevention is better than cure) that carries even more significance today. The local earthquake and its unfortunate consequences have mostly disappeared from the international news cycle largely because there was extensive planning by the government and TSMC to minimize the damage. However, it's worth appreciating the counterfactual: if there was major damage to these facilities, this could have caused untold damage to the mobile computing and artificial intelligence companies, as the essential semiconductor wafers they need would have suffered long bottlenecks and shortages.

We live in a world characterized by the power law function, especially in these cutting-edge technologies propelling humanity forward.

Have a great weekend!

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From Google To Alphabet: Finally The Name Fits

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In 2015, Google made a monumental decision to change its name to Alphabet, a clever play on words to excite the investment community. This was a significant announcement that revealed the highly profitable "Core Google". It also unveiled the multi-billion annual losses in "Other Bets", a category for high-cost science projects without clear paths to commercial profitability.

Since that day in July 2015, "Alphabet" has disappointed investors time and again across various aspects. It's a company with great potential, but the management's reluctance to make difficult decisions has been discouraging.

However, change is here!

The sudden success of OpenAI has challenged Google's long-held lead in search and artificial intelligence. These twin setbacks within a year have made their mark, and we see Google making better strategic decisions to leverage its full breadth of capabilities.

The significant shifts have been in the commercialization and cost control in the company. The AI divisions have been restructured to focus on practical tools that enhance its dominant search engine. This crucial yet underrecognized transition has pushed Google to actually exploit its extensive AI capabilities for the benefit of customers. Alongside, there's a noticeable shift towards containing costs. This is evident in the decrease in employees to 181,900, down by almost 10,000 from the peak in Q1 of the last year, thanks to careful expense management. These changes could have occurred sooner after the 2015 rebranding, but as the saying goes, better late than never.

As a final step management made a strong commitment to return almost $80 billion back to shareholders through a share buyback program and its first ever dividend. I see this as a critical final step in the long journey at Google, they have finally graduated to becoming a dividend aristocrat and matured in their philosophy as a management team. We now have a line of sight for greater income back to shareholders and a more focused strategy to expand and entrench their incredible business .

Today as the best opportunity in the Magnificent 7 we can finally say, Google is absolutely an "Alpha-bet".

Have a great weekend!

P.S. Sorry Meta, we'll see you on the flip side of the Llama 3 & 4 investment cycle. It's an expensive move but the right one.

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The Costly Game Of AI: A $212 Billion Eye-Opener

Dan Rohinton, Vice-President, Portfolio Manager, Global Dividend

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This past Friday, Nvidia stock experienced a market value decline of $212 billion. To frame it differently, the entire GDP of Greece was lost on a typical Friday in the markets due to the volatility of one single stock.

I use this comparison to underscore the incredible level of volatility we are currently witnessing in the AI trade. This drastic fluctuation is far removed from the circumstances in April last year when this topic started entering mainstream discussions.

So, where do we stand today in the dialogue about "AI being the future"?

Phase Shift In Expectations: The narrative among investors has significantly evolved over the past year. Instead of merely seeking a proof of concept for AI-related products, investors are now concerned with the size of the potential market and the hundreds of millions, if not billions, of dollars each AI-related stock could generate. The valuations of most companies involved in the hardware build-out have skyrocketed in anticipation of an unending surge of demand for their services.

Consider liquid cooling leader Vertiv Holdings, who benefitted from the datacenter buildout championed by Nvidia across its clients. Vertiv's valuation has climbed from a modest 8x price-to-earnings ratio to a staggering 29x, marking a 365% increase over the past year. Moreover, it's crucial to note that earnings forecasts also indirectly incorporate a higher level of optimism through their financial statements.

Analysts for Vertiv previously projected that the EPS in 2025 would be $1.63/share last year; that number has now risen to $2.95/share, a remarkable 180% increase. This surge in expectations leaves a great deal of room for disappointment if demand falters or data points around AI adoption are lacking. This is a textbook recipe for greater volatility, both favorably and unfavorably, as investors grapple with new data points.

Utilizing industry leader Nvidia, I highlight this surge in volatility and the massive shifts in value to underscore how rapidly expectations have evolved. We remain optimistic about the positive changes this technological breakthrough can induce over the long term. However, we firmly believe that 2024 should be marked as the year for diversification.

For those investors intent on heavily investing in the AI trade, yesterday served as a critical reminder: the cost of joining the AI bandwagon is now gauged in the hundreds of billions, and the expectations are sky high. Any outcome short of perfection could trigger disappointment.

Enjoy your weekend!

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About iA Global Asset Management (iAGAM)

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A magnet for top investment talent, iA Global Asset Management is one of Canada's largest asset managers, with over $100 billion under management across institutional and retail mandates. We help investors achieve their long-term wealth creation goals through innovative investment solutions designed for today's complex markets. We are building upon our historic success, supporting the growth of our core strengths, and exploring innovative ways to meet investor needs. We are rooted in history and innovating for the future. Our experienced portfolio managers use a proprietary investment methodology, rooted in iAGAM's unifying commitment to strong risk management, analytical rigor and a disciplined, process-driven approach to asset allocation and security selection.

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