# CIO Academy

## AI-related opportunities go well beyond the usual suspects

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Authored by

Kevin Lyne-Smith

Global Head of Equities, HSBC Global Private Banking and Wealth

Willem Sels

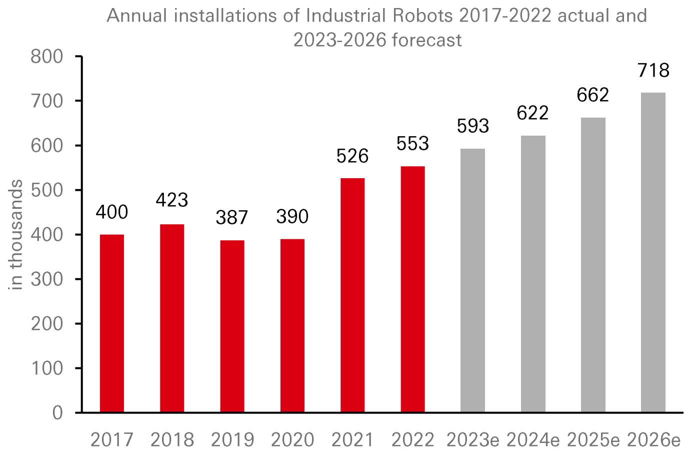
Global Chief Investment Officer, HSBC Global Private Banking and Wealth

- Technological advancements are designed to make our lives easier. When used correctly, they should automate simple tasks to allow us to focus on the higher value items. One area experiencing significant growth is the integration of generative AI and robotics – which is becoming more democratised, with broader use cases than ever before. Because of this, the landscape of high-volume tasks, such as content production and software development, is being redefined by AI's ability to generate text, images, and even code based on simple prompts.
- But where do the opportunities lie? As more intelligent, automated products and services become available, their expanded capabilities mean they can take on a broader array of tasks. For example, vast quantities of companies in the service industries are using chatbots to answer consumer inquiries, either via online chat or by telephone.
- We are also seeing a lot of industries – from the energy sector to food production – rapidly automating certain processes to avoid tedious and labour-intensive manual inspections. This will provide both a boost to productivity and services, whilst improving consistency and quality.
- In this piece, we argue that advances in AI, automation and semiconductor technology will generate innovation and earnings growth across the value chain and across sectors. This generates opportunities in tech-related stocks, which our Generative AI and Robots high conviction theme touches on, but it can also drive growth in the US and global equity markets in general.

## Our thinking process behind our Generative AI and Robots high conviction theme

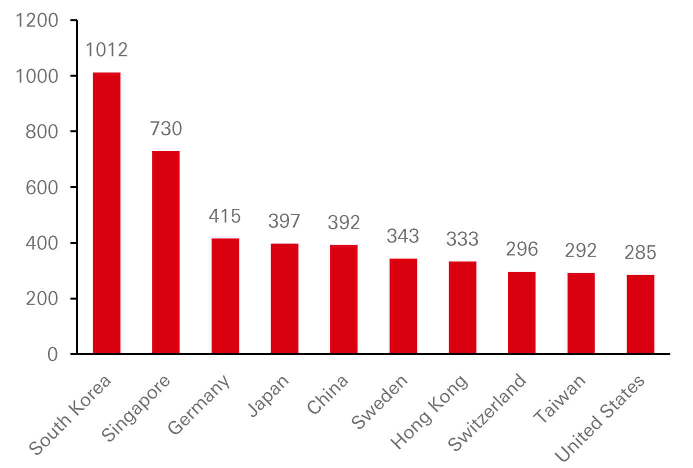
Robotics, the linchpin of an automated future, is experiencing an unprecedented upswing. With the operational count of industrial robots touching 3.5 million units in 2022, valued at a whooping USD 15.7 billion, the automation landscape is ripe for exploration and expansion. This is particularly pronounced in Asia, which saw 381,000 installations of industrial robots in 2021, up from 89,000 a decade before.

### Global annual installations of industrial robots




Source: World Robotics 2023 report, IFR, HSBC Global Private Banking as at February 2024. Forecasts are subject to change.

### Robots installed per 100,000 employees




Source: International Federation of Robotics, HSBC Global Private Banking as at March 2024.

So far, the focus of AI has been on the enablers – principally in the chip industry and the cloud; you could think of this as the infrastructure around AI. But there will also be huge growth in software, which will provide the solutions to use AI in real-life applications. Smart users of AI will enhance their productivity and their innovation, with rapid gains in areas like sales administration, marketing, operations, coding and research.

There are applications and nuances across sectors. For example, in healthcare, the integration of AI and robotics can revolutionise monitoring, tracking, data and image analysis, and sample testing. And as the financial sector gravitates towards online consumption, AI can streamline processes, such as identity verification and application processes for insurance, bank accounts, and cards. Moreover, the deployment of large language model AI software in online chat functions can enhance customer service experiences while concurrently reducing corporate costs.

At a time when labour markets are tight and high wage growth is putting pressure on costs, efficiency gains will be welcomed by companies. But we don't think of AI as a job killer. New jobs will be created as a new industry kicks off. And for most people, AI can be seen as a 'copilot' which does not replace them but makes them more efficient.

The agricultural industry, especially in developed markets, is witnessing a sea change with the advent of AI-driven automation. From GPS-controlled tractors and harvesters to sophisticated soil and crop management using drones and AI, the face of modern agriculture is changing swiftly. In fact, over 60 per cent of the agriculture and F&B industries plan to use AI by 2025.

AI and automation can play a pivotal role in helping farmers adapt to changing climate conditions as they rethink the way they farm to minimise impact on both the environment and biodiversity.

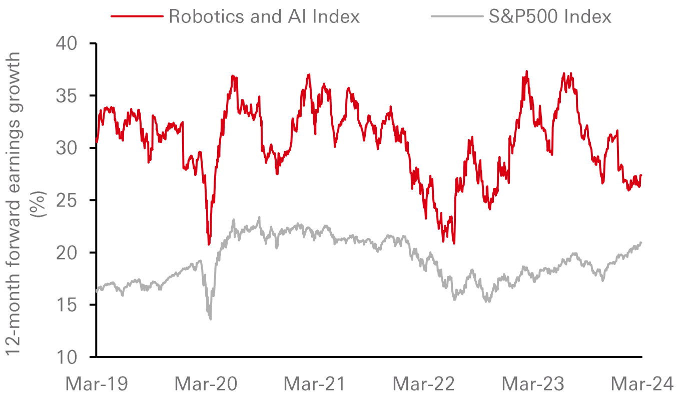
Many farmers are embracing new technologies, including drought and pest-resistant seeds; micro-irrigation that reduces water usage; methane-reducing feedstock. AI is helping traditional farms at all stages of the agriculture process, from initial livestock or crop selection, monitoring and husbandry to treatments – and much more. Sensors, tags and cameras, all facilitate the optimisation of the processes and raise productivity. These same technologies are also being applied in vertical farms in cities to grow high-value crops for restaurants and consumers in warehouses or disused underground spaces.

Incorporating sensors, cameras, batteries, and antennas into a wider array of products and locations is a growth area opening up new avenues. This development significantly augments the data flow into AI programs, thereby enhancing their efficiency and effectiveness.

Miniaturisation—the process of making something smaller using technology—has been a theme in the tech sector since the 1970s as the semiconductor industry crammed evermore onto its silicon chips. As products and services have digitalised, often their physical dimensions have shrunk sometimes to nothing. Miniaturisation and digitalisation of products have facilitated greater integration of technologies that enable AI to fully exploit its potential. AI programs are able to use a smartphone sensor, cameras, microphone, speaker, positioning data and internet connection to fully interact with the user and their situation.

The intertwining of AI with other technological advancements has broadened the scope and applicability of automated products and services. Simultaneously, the pressure of labour shortages and escalating costs is spurring a renewed wave of investment in robotic automation, rendering potential investment returns increasingly attractive. The growth of 5G, cable, and low-earth orbit satellite networks has expanded data capacity dramatically while reducing latency, thereby setting the stage for an AI and robotics-led industrial revolution.

**Earnings growth in Robotics and AI has been consistently above that of the S&P500, and this should continue**




Source: Bloomberg, HSBC Global Private Banking as at 4 March 2024. Past performance is not a reliable indicator of future performance.

As these new applications are embraced, the workforce will need to adapt as new jobs are created and existing roles evolve. The infrastructure will also need to be built to deal with the rapid acceleration of data use, including data centres, for example, which continues to be a major growth area in our view (supporting another theme of ours – Infrastructure and future cities).

For businesses, the potential for productivity improvements and enhanced products and services is clear. But the gains for consumers are evident too, as services can be offered efficiently 24/7 and product quality continually improves. The opportunity now lies in broadening the use cases for these technologies, in order to reduce cost to serve and increase efficiency. And for investors, this means that when thinking about AI, we need to think beyond the usual suspects.

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**Risks of investment in fixed income**
There are several key issues that one should consider before making an investment into fixed income. The risk specific to this type of investment may include, but are not limited to:

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Investor is subject to the credit risk of the issuer. Investor is also subject to the credit risk of the government and/or the appointed trustee for debts that are guaranteed by the government.

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High yield fixed income instruments are typically rated below investment grade or are unrated and as such are often subject to a higher risk of issuer default. The net asset value of a high-yield bond fund may decline or be negatively affected if there is a default of any of the high yield bonds that it invests in or if interest rates change. The special features and risks of high-yield bond funds may also include the following:

- Capital growth risk - some high-yield bond funds may have fees and/ or dividends paid out of capital. As a result, the capital that the fund has available for investment in the future and capital growth may be reduced; and
- Dividend distributions - some high-yield bond funds may not distribute dividends, but instead reinvest the dividends into the fund or alternatively, the investment manager may have discretion on whether or not to make any distribution out of income and/ or capital of the fund. Also, a high distribution yield does not imply a positive or high return on the total investment.
- Vulnerability to economic cycles - during economic downturns such instruments may typically fall more in value than investment grade bonds as (i) investors become more risk averse and (ii) default risk rises.

**Risks associated with subordinated debentures, perpetual debentures, and contingent convertible or bail-in debentures**

- Subordinated debentures - subordinated debentures will bear higher risks than holders of senior debentures of the issuer due to a lower priority of claim in the event of the issuer's liquidation.
- Perpetual debentures - perpetual debentures often are callable, do not have maturity dates and are subordinated. Investors may incur reinvestment and subordination risks. Investors may lose all their invested principal in certain circumstances. Interest payments may be variable, deferred or cancelled. Investors may face uncertainties over when and how much they can receive such payments.
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**Contingent convertible securities (CoCos) or bail-in debentures are highly complex, high risk hybrid capital instruments with unusual loss-absorbency features written into their contractual terms.**
Investors should note that their capital is at risk and they may lose some or all of their capital.

**Changes in legislation and/or regulation**
Changes in legislation and/or regulation could affect the performance, prices and mark-to-market valuation on the investment.

**Nationalisation risk**
The uncertainty as to the coupons and principal will be paid on schedule and/or that the risk on the ranking of the bond seniority would be compromised following nationalisation.

**Reinvestment risk**
A decline in interest rate would affect investors as coupons received and any return of principal may be reinvested at a lower rate. Changes in interest rate, volatility, credit spread, rating agencies actions, liquidity and market conditions may have a negative effect on the prices, mark-to-market valuations and your overall investment.

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There may not be active secondary market available even if a renminbi bond is listed. Therefore, you need to face a certain degree of liquidity risk.
Renminbi is subject to foreign exchange control. Renminbi is not freely convertible in Hong Kong. Should the China Central Government tighten the control, the liquidity of renminbi or even renminbi bonds in Hong Kong will be affected and you may be exposed to higher liquidity risks. Investors should be prepared that you may need to hold a renminbi bond until maturity.

**Alternative Investments**
**Hedge Fund** - Please note Hedge Funds often engage in leveraging and other speculative investment practices that may increase the risk of investment loss. They can also be highly illiquid, are not required to provide periodic pricing or valuation information to investors, and may involve complex tax structures and delays in distributing important information. Alternative investments are often not subject to the same regulatory requirements as, say, mutual funds, and often charge high fees that may potentially offset trading profits when they occur.
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Leveraged FX trading carry a high degree of risk and the Customer may suffer losses exceeding their initial margin funds. Market conditions may make it impossible to square/close-out FX contracts/options. Customers could face substantial margin calls and therefore liquidity problems if the relevant price of the currency goes against them.
The leverage of a product can work against you and losses can exceed those of a direct investment. If the market value of a portfolio falls by a certain amount, this could result in a situation where the value of collateral no longer covers all outstanding loan amounts. This means that investors might have to respond promptly to margin calls. If a portfolio's return is lower than its financing cost then leverage would reduce a portfolio's overall performance and even generate a negative return.

**Currency risk – where product relates to other currencies**
When an investment is denominated in a currency other than your local or reporting currency, changes in exchange rates may have a negative effect on your investment.

**Chinese Yuan ("CNY") risks**
There is a liquidity risk associated with CNY products, especially if such investments do not have an active secondary market and their prices have large bid/offer spreads.
CNY is currently not freely convertible and conversion of CNY through banks in Hong Kong and Singapore is subject to certain restrictions. CNY products are denominated and settled in CNY deliverable in Hong Kong and Singapore, which represents a market which is different from that of CNY deliverable in Mainland China.
There is a possibility of not receiving the full amount in CNY upon settlement, if the Bank is not able to obtain sufficient amount of CNY in a timely manner due to the exchange controls and restrictions applicable to the currency.
**Illiquid markets/products**
In the case of investments for which there is no recognised market,
it may be difficult for investors to sell their investments or to obtain reliable information about their value or the extent of the risk to which they are exposed.

**Environmental, Social and Governance ("ESG") Customer Disclosure**
In broad terms "ESG and sustainable investing" products include investment approaches or instruments which consider environmental, social, governance ('ESG') and/or other sustainability factors to varying degrees. Certain instruments we classify as sustainable may be in the process of changing to deliver sustainability outcomes. There is no guarantee that ESG and sustainable investing products will produce returns similar to those which don't consider these factors. ESG and Sustainable investing products may diverge from traditional market benchmarks. In addition, there is no standard definition of, or measurement criteria for, ESG and sustainable investing or the impact of ESG and sustainable investing products. ESG and Sustainable investing and related impact measurement criteria are (a) highly subjective and (b) may vary significantly across and within sectors. HSBC may rely on measurement criteria devised and reported by third party providers or issuers. HSBC does not always conduct its own specific due diligence in relation to measurement criteria. There is no guarantee: (a) that the nature of the ESG / sustainability impact or measurement criteria of an investment will be aligned with any particular investor's sustainability goals; or (b) that the stated level or target level of ESG / sustainability impact will be achieved. ESG and Sustainable investing is an evolving area and new regulations are being developed which will affect how investments can be categorised or labelled. An investment which is considered to fulfil sustainable criteria today may not meet those criteria at some point in the future.

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