ACG Insights: Artificial Intelligence – Fad or Panacea?

Executive Summary – AI Generated in Dr. Seuss Style

Oh, the wonders of corporate AI,
In its infancy, it does lie.
Investors seek its potential bright,
Appraising with all their might.

Generative AI, oh what a treat,
Efficiency advantages it does greet.
Questions aplenty about adoption pace,
And future profits, a thrilling chase.

But what opportunities and
challenges await,
When AI enters the financial gate?
Oh, the possibilities that lie ahead,
In the industry where money is bred.

Background

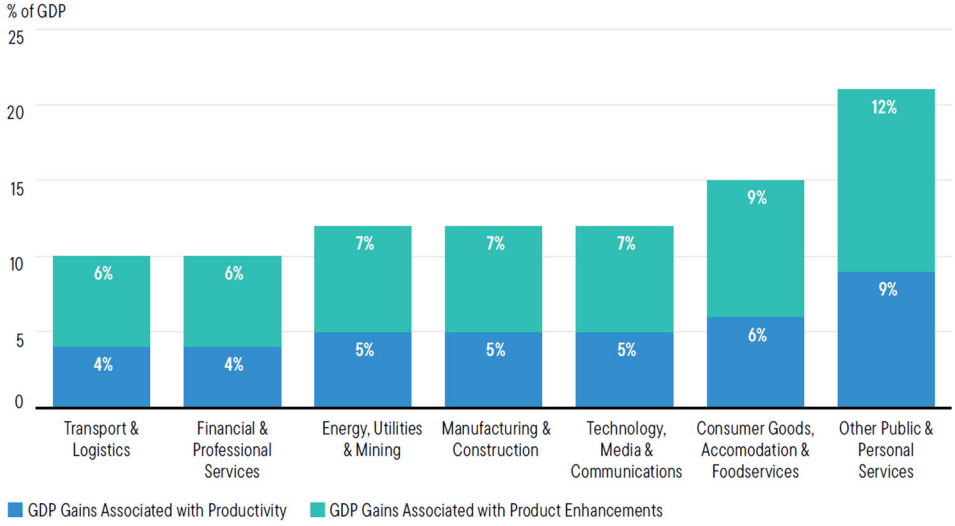
Artificial intelligence (AI) as a discipline dates back to the 1950's and encompasses a variety of technologies, predominantly merging computer science with extensive datasets to facilitate complex problem-solving. The long-term goal and subject of numerous science-fiction portrayals has been the development of artificial "general" intelligence where a machine would have an intelligence equaled to humans, i.e., a self-aware consciousness that can solve problems, learn, and plan for the future.

Exhibit 1: Investment Consultant Solving the World's Problems – AI Generated [1]

[1] Source: DALL·E 2

While we may not be there yet, a great leap forward arrived in late 2022 with the OpenAI release of ChatGPT (GPT stands for Generative Pre-Trained Transformer). As a natural language model, ChatGPT has undergone extensive training on a vast array of data encompassing conversations, books, and online resources. It can execute a variety of natural language processing (NLP) tasks such as generating text, providing summaries, answering questions, and translating languages. While NLP techniques have been used for years, the explosion in ChatGPT's popularity, one million users in five days, has increased awareness of potential advancements in generative AI right around the corner. Although the implementation of AI in corporate settings is still in its nascent phase, market participants are already evaluating the investment potential.

Exhibit 2: Projected Gains in Global GDP in 2030 Resulting from AI by Industry Sector [2]



Investment Opportunities

The potential for efficiency gains through innovative technologies like ChatGPT are easily conceivable, however, the precise timing and amount of growth in corporate earnings stemming from these advancements are yet to be determined. Semiconductor companies have emerged as prominent early beneficiaries, owing to the substantial computational power required by generative AI. A "picks and shovels" approach, greater and more powerful chips will be required regardless of the success of AI applications. In May, leading semiconductor company NVIDIA released Q2 guidance, projecting estimated revenue of $11 billion, far surpassing the consensus estimate of $7 billion. This optimistic outlook was attributed to a significant surge in demand driven by the burgeoning fields of generative AI and large language models (LLM)[3]. The stock has experienced an increase of over +40.0% since the announcement, and impressive growth of nearly +200.0% during the first half of the year.

According to Goldman Sachs Research, large incumbent technology companies may stand to gain the most due to the costly nature of developing AI chatbots and similar tools. According to industry estimates, hardware expenses can amount to $500 million, while an additional $500 million is needed for model training[4]. Both significant engineering talent and the availability of capital are essential in constructing these fundamental models, quite different from the software startups of yesteryear. Investors with exposure to U.S. large caps need not fret about missing out, but should they be concerned about Dot Com Bubble 2.0-style unbridled optimism? Based on broader index level data, the answer is not yet. While growth stocks have certainly regained their prior luster to start 2023, the S&P 500 index's equity risk premium and long-term EPS growth expectations are roughly in line with historical averages. Zooming out, how can recent advancements in artificial intelligence inform investment decision making and shape financial markets at large?

[2] Source: BofA Global Research, PwC Analysis. There can be no assurance that any estimate, forecast or projection will be realized.
[3] Source: NVIDIA
[4] Source: Goldman Sachs

Implications for Asset Management and Advisory Services

AI has the potential to have a significant impact on financial markets and investing, through its capacity to enable the analysis of vast amounts of data quickly and accurately. Financial data, news articles, and social media feeds can be analyzed in real-time to identify investment opportunities and signal potential risks. It can be expected that greater model specificity through enhanced pattern recognition, algorithmic trading, risk management, and sentiment analysis would improve overall market efficiency. I.e., more data will be analyzed, incorporated into models, and acted upon more quickly.

However, AI could also introduce challenges and risks, such as increased market volatility and flash crashes if not properly regulated. Given the profound implications of this emerging technology, discussions surrounding suitable regulatory measures and diligent oversight have already commenced.

A word of caution before releasing your very own AI generated trading strategy. Financial markets are complex adaptive systems meaning participants change their behavior to adapt to other market participants. AI algorithms are all built on data from the same place…the past. So, with markets in a constant state of flux, historically successful trading strategies may only work for a short time or not at all. How would an AI model adapt to a novel economic scandal or geopolitical crisis? In essence, it is important to acknowledge the truth behind the adage "past performance is not indicative of future results."

Exhibit 3: Top AI Use Cases in Financial Services[5]

Natural language processing (NLP) / large language models (LLMs)	**26%**
Recommender systems / next-best action	**23%**
Portfolio optimization	**23%**
Fraud detection: transactions/payments	**22%**
Fraud detection: anti-money laundering / know your customer	**22%**
Algorithmic trading	**21%**
Conversational AI	**20%**
Marketing optimization	**20%**
Creating synthetic data for model creation/optimization	**20%**
Synthetic data generation	**18%**
Document management	**18%**
Compliance	**17%**
Default prediction	**15%**
Environmental, social, and governance (ESG)	**12%**
Metaverse / virtual worlds	**12%**
Claims processing	**12%**
Geospatial AI	**10%**

Conclusion

The economic potential for AI is vast given that most industries, not just technology, could benefit from automating tasks, supplementing their existing work force with AI, and/or increasing their output through enhanced products or services. Again, it is very early days, but OpenAI, the creators of ChatGPT, have conducted some preliminary research on how the American labor market will be impacted by large language models. It is estimated that around 15% of all worker's tasks in the U.S. could be completed significantly faster at the same

[5] Source: NVIDIA "State of AI in Financial Services" report based on a survey of ~500 global financial professionals

level of quality with the help of LLM[6]. OpenAI does not speculate on a potential adoption timeline, but ACG is excited about the opportunities AI will bring to improve our business operations and deliver more value to our clients.

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[6] Source: OpenAI