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# NAVIGATING AI INVESTMENTS: DIVERSIFICATION AND VALUATION WITHIN THE AI THEME

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As Q2 earnings announcements approach, it's crucial for investors to revisit growth expectations and re-evaluate concentration risk when considering exposure to the [artificial intelligence \(AI\)](#) theme. With the market breadth remaining quite narrow year-to-date, ensuring proper [diversification](#) and being mindful of [valuations](#) are key to building a well-rounded portfolio within the AI industry.

## Avoid Concentration Risk

One standout performer in the [AI industry is Nvidia, which experienced explosive price appreciation since the latest earnings announcement](#) when they forecasted \$11B in sales for the upcoming quarter—more than 50% higher than analyst expectations. Consequently, valuation metrics such as the [price-to-sales ratio](#) soared. If Nvidia seemed expensive six months ago, it has become an even more challenging “buy” to justify for value-oriented investors. Some may even question, is it “growth at a reasonable price” at this point?

However, relying heavily on Nvidia as an AI exposure can lead to concentration risk. Many investors seeking exposure to the AI [megatrend](#) opt for a broad tech approach—sometimes assuming an allocation to the [Nasdaq 100 Index](#) or the [S&P 500 Information Technology](#) sector suffices for AI theme coverage, resulting in mega-cap tech firms comprising a significant percentage of their portfolios. This concentrated and expensive approach may not be ideal for those looking to mitigate [risk](#) and diversify their investments while seeking to gain exposure to the AI theme. Luckily, there are other avenues to gain exposure to this exciting technology.

**Figure 1: Illustrating Possible Concentration Risk within Top 10 Holdings**

Top 10 Constituent Weights			
WisdomTree Artificial Intelligence & Innovation Index	Weight	S&P 500 Information Technology Index	Weight
NVIDIA Corporation	2.5%	Apple Inc.	27.2%
Alchip Technologies Ltd.	2.2%	Microsoft Corporation	24.2%
Meta Platforms Inc. Class A	2.1%	NVIDIA Corporation	9.9%
Taiwan Semiconductor Manufacturing Co., Ltd	2.1%	Broadcom Inc.	3.4%
STMicroelectronics NV	2.0%	Adobe Incorporated	2.1%
Advanced Micro Devices, Inc.	2.0%	Cisco Systems, Inc.	2.0%
Synopsys, Inc.	2.0%	Salesforce, Inc.	2.0%
Cadence Design Systems, Inc.	2.0%	Accenture Plc Class A	1.8%
IonQ, Inc.	2.0%	Oracle Corporation	1.7%
Lattice Semiconductor Corporation	1.9%	Advanced Micro Devices, Inc.	1.7%
<b>Remaining Weight</b>	<b>79.3%</b>		<b>23.8%</b>

Sources: WisdomTree, FactSet, as of 6/28/23. You cannot invest directly within an index. Subject to change.

### Consider Other AI Exposures

Companies like MongoDB and Elastic are creating vector search databases, enabling improved efficiencies in querying large language models (LLMs) like OpenAI’s ChatGPT to be used for inference. These innovations power various use cases—such as similarity search, recommendation engines, Q&A systems, dynamic personalization and long-term memory for language models—enabling businesses to harness proprietary data with LLMs to increase their efficiency.

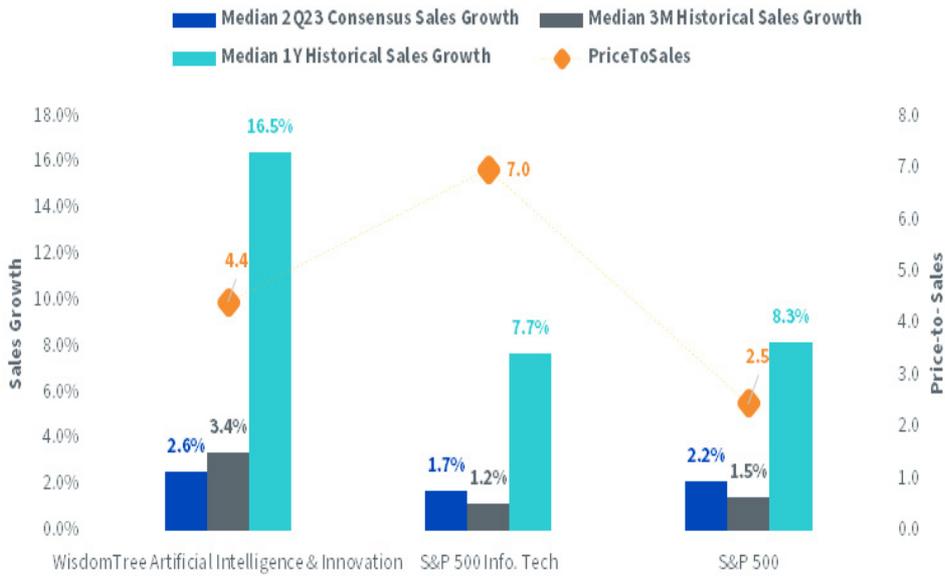
Firms like Autodesk, with its computer-aided design software, stand to benefit from generative learning algorithms—which can be used to increase design efficiency by generating potential solutions tuned to the input parameters of the user. This allows the user to augment their creative abilities, using AI-generated outputs to streamline the process from idea generation to finished product.

At WisdomTree, we take an approach that covers various aspects of the AI [value chain](#), seeking broad exposure to AI. This exposure can be broken down into subgroups such as AI Software, Semiconductors, Other Hardware and Innovation. By diversifying across these subgroups, investors can capture many different aspects of the AI theme. For example, gaining exposure to AI computing chips within the Semiconductor group, generative AI applications within the Software and Innovation groups, and autonomous vehicles and robotics in Other Hardware—allowing for a more comprehensive exposure to the breadth of the AI theme.

### Be Mindful of Growth and Valuations

When seeking exposure to high-[growth](#) companies, valuation often comes at a cost. The significant run-up in prices of [large-cap](#) tech names at the beginning of the year has led to higher valuations and increased concentration within some of the broad market baskets. Through the [fundamentally](#) aware and diversified approach to the [WisdomTree Artificial Intelligence & Innovation Index](#), the strategy seeks to blend strong forward-looking and historical growth with reasonable valuation statistics such as [price-to-sale](#) [S](#).

Figure 2: The Growth vs. Valuation Trade-Off



Sources: WisdomTree, FactSet. Price-to-sales and 2Q23 consensus sales growth as of 6/28/23. Historical growth rates as of 5/31/23. Past performance is not indicative of future results.

Breaking things down further on the growth side, it becomes evident that sales and earnings volatility persists in the AI industry, as demonstrated by Nvidia. When a large company like Nvidia forecasts a 50% growth in sales, the market reaction is significant, and the single stock impact on the broader portfolio can take effect—in terms of both allocation and aggregate statistics like growth rates. At the moment, for the holder, the price appreciation can be great, but as valuations steepen and another quarter nears, investors may anticipate impacts that the next earnings announcement may bring and question trimming the allocation to reduce risk. With each subsequent announcement, it becomes more and more challenging to give market participants a suitable “positive surprise” to keep pushing the share price even higher.

**Figure 3a: The WisdomTree Artificial Intelligence & Innovation Index Sees Broad Contribution to Sales Growth from Many Companies, Limiting “Growth Concentration”**

WisdomTree Artificial Intelligence & Innovation Index	Weight	Median Consensus Sales Growth Q2 2023	Growth Contribution
NVIDIA Corporation	2.5%	53.0%	● 1.3%
BioXcel Therapeutics, Inc.	0.7%	142.7%	● 1.0%
SK hynix Inc.	1.7%	13.6%	● 0.2%
Cognex Corporation	1.0%	18.8%	● 0.2%
Meta Platforms Inc. Class A	2.1%	8.2%	● 0.2%
OMRON Corporation	1.1%	-13.1%	● -0.1%
Apple Inc.	1.1%	-14.4%	● -0.2%
Altair Engineering Inc. Class A	1.1%	-16.2%	● -0.2%
Cerence Inc.	1.9%	-11.1%	● -0.2%
Synaptics Incorporated	1.5%	-31.1%	● -0.5%
<b>Overall Forward Consensus Weighted Average Sales Growth</b>			● <b>2.58%</b>
<i>Percent Reporting (Companies)</i>			94.8%
<i>Weight Reporting (Weight)</i>			97.1%

Sources: WisdomTree, FactSet, as of 6/28/23. Past performance is not indicative of future results. Weight reporting refers to the weight in companies that have reported earnings for the most recent quarter as of June 28, 2023.

**Figure 3b: The S&P 500 Information Technology Index Sees a Very Concentrated Contribution to Sales Growth from a Smaller Subset of Companies, Not Mitigating “Growth Concentration”**

SP500 Information Technology Index	Weight	Median Consensus Sales Growth Q2 2023	Growth Contribution
NVIDIA Corporation	9.9%	53.0%	● 5.2%
Microsoft Corporation	24.2%	4.8%	● 1.2%
International Business Machines	1.2%	9.2%	● 0.1%
Palo Alto Networks, Inc.	0.7%	13.7%	● 0.1%
Cisco Systems, Inc.	2.0%	3.3%	● 0.1%
QUALCOMM Incorporated	1.3%	-8.3%	● -0.1%
Lam Research Corporation	0.8%	-19.7%	● -0.2%
Oracle Corporation	1.7%	-10.0%	● -0.2%
Intuit Inc.	1.3%	-56.1%	● -0.7%
Apple Inc.	27.2%	-14.4%	● -3.9%
<b>Overall Forward Consensus Weighted Average Sales Growth</b>			● <b>1.74%</b>
<i>Percent Reporting (Companies)</i>			100.0%
<i>Weight Reporting (Weight)</i>			100.0%

Sources: WisdomTree, FactSet, as of 6/28/23. Past performance is not indicative of future results. Weight reporting refers to the weight in companies that have reported earnings for the most recent quarter as of June 28, 2023.

As you can see above, the WisdomTree Artificial Intelligence & Innovation Index growth profile is much more diversified than more concentrated alternatives. Those with large weights to mega-cap tech stars may show reasonable numbers but are much more reliant on these heavy allocations. The same can be said for their returns and volatility profile.

Investing in artificial intelligence requires a well-balanced portfolio that prioritizes diversification across the AI ecosystem. The WisdomTree Artificial Intelligence and

Innovation Index provides a promising avenue for investors to tap into the potential of the AI industry while ensuring a balanced approach. By diversifying across different AI subgroups and adopting a strategy that emphasizes use cases as well as growth and valuation considerations, investors can effectively mitigate concentration risk while gaining exposure to artificial intelligence in a portfolio.

For those investors interested to learn more about WisdomTree's approach, they may consider a further look at the [WisdomTree Artificial Intelligence & Innovation Fund \(WTAI\)](#), the Fund designed to track the returns of the WisdomTree Artificial Intelligence & Innovation Index.

#### Important Risks Related to this Article

There are risks associated with investing, including the possible loss of principal. The Fund invests in companies primarily involved in the investment theme of artificial intelligence (AI) and innovation. Companies engaged in AI typically face intense competition and potentially rapid product obsolescence. These companies are also heavily dependent on intellectual property rights and may be adversely affected by loss or impairment of those rights. Additionally, AI companies typically invest significant amounts of spending in research and development, and there is no guarantee that the products or services produced by these companies will be successful. Companies that are capitalizing on innovation and developing technologies to displace older technologies or create new markets may not be successful. The Fund invests in the securities included in, or representative of, its Index regardless of their investment merit, and the Fund does not attempt to outperform its Index or take defensive positions in declining markets. The composition of the Index is governed by an Index Committee, and the Index may not perform as intended. Please read the Fund's prospectus for specific details regarding the Fund's risk profile.

For the top 10 holdings of WTAI please visit the Fund's fund detail page at <https://www.wisdomtree.com/investments/etfs/megatrends/wtai>

For standardized performance and the most recent month-end performance click [here](#) NOTE, this material is intended for electronic use only. Individuals who intend to print and physically deliver to an investor must print the monthly performance report to accompany this blog.

#### Related Blogs

- + [Surprise—An AI Fund where Nvidia Is Not Driving All the 2023 Performance](#)
- + [Is AI Excitement Creating a Stock Market Bubble?](#)
- + [Is the Momentum Running Out of AI-Focused Stocks?](#)

#### Related Funds

- + [WisdomTree Artificial Intelligence and Innovation Fund](#)

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## DEFINITIONS

**Artificial intelligence**: machine analysis and decision-making.

**Diversification**: A risk management strategy that mixes a wide variety of investments within a portfolio.

**Valuation**: Refers to metrics that relate financial statistics for equities to their price levels to determine if certain attributes, such as earnings or dividends, are cheap or expensive.

**Price-to-sales (P/S) ratio**: share price divided by per share revenue.

**Megatrends**: A major movement, pattern or trend emerging in the macroenvironment; an emerging force likely to have a significant impact on the kinds of products consumers will wish to buy in the foreseeable future.

**Nasdaq 100 Index**: Includes 100 of the largest domestic and international non-financial companies listed on The Nasdaq Stock Market based on market capitalization. The Index reflects companies across major industry groups including computer hardware and software, telecommunications, retail/wholesale trade and biotechnology. It does not contain securities of financial companies, including investment companies.

**S&P 500 Information Technology Index**: a market capitalization weighted index that is designed to measure the performance of the Information Technology sector, as defined by the Global Industry Classification Standard.

**Risk**: Also standard deviation, which measures the spread of actual returns around an average return during a specific period. Higher risk indicates greater potential for returns to be farther away from this average.

**Value chain**: A business model that describes the full range of activities needed to create a product or service.

**Growth**: Characterized by higher price levels relative to fundamentals, such as dividends or earnings. Price levels are higher because investors are willing to pay more due to their expectations of future improvements in these fundamentals.

**Large-Capitalization (Large-Cap)**: A term used by the investment community to refer to companies with a market capitalization value of more than \$10 billion. Large cap is an abbreviation of the term "large market capitalization". Market capitalization is calculated by multiplying the number of a company's shares outstanding by its stock price per share.

**Fundamentals**: Attributes related to a company's actual operations and production as opposed to changes in share price.

**Volatility**: A measure of the dispersion of actual returns around a particular average level.