What is Artificial Intelligence (AI)?

Academics do not agree on a definition of AI - it is a hugely complex and rapidly-evolving area. However, for our purposes, we would define AI as follows:

*Artificial Intelligence seeks to synthesise, automate and optimise the process of converting information into useful and actionable knowledge.*

Why have you launched the fund now?

The world is changing rapidly - self-driving cars may have seemed a very unlikely prospect just a few years ago, but they are here now and their development will have a profound impact on industries well beyond autos. For example, if your business relies on charging hefty insurance premiums to human drivers who are prone to expensive prangs when parking at the supermarket, you may find that such drivers switch to self-driving cars - which are much safer than the average human driver and which cannot therefore be subject to the same hefty insurance premiums. Self-driving cars don't have to be perfect, they just need to be better than humans - and because they don't get drunk at the wheel or sleepy or involved in road rage incidents, they already are. Self-driving cars could also help older citizens stay mobile and maintain their independence - a huge benefit in the many societies where populations are ageing. When cars become fully autonomous, there are likely to be meaningful productivity benefits, as humans will be free to perform other tasks - or simply relax and enjoy that very precious commodity - free time.

Why does any of this matter? We believe that we’re at a turning point in respect of the adoption of artificially intelligent systems, and the implementation of these systems within the economy will have a meaningful and substantial impact on the way in which we live our lives. They will also change the way in which we think about growth rates within the global economy and where that growth is to be found. There will be AI winners but there will be losers too. That is why we think an active approach will be important.

There are a handful of robotics and AI ETFs (primarily focusing on robotics), and there is also an actively-managed AI fund run by a competitor. What makes your fund different?

The point of our Fund is to provide clients with purity of revenue exposure to what we believe to be one of - if not the - fastest growing element within the global economy. This isn’t a dressed up tech fund, and neither are we investing solely in very narrowly defined areas of AI, such as robotics.

A further crucial differentiator of our Fund is that we have AI embedded in our research process - in essence, rather than employ an army of analysts to grind their way through company reports; we use AI to help us find artificial intelligence applications within companies. AI is faster and more thorough than any human could be, and unlike human analysts, AI never gets tired and the quality of the output is always improving.

Could you outline the differences between this Fund and a tech or a robotics fund?

A traditional technology fund will be somewhat hidebound within the specific sector that it is designed to address. By contrast, the very nature of the broad application of artificially intelligent systems presents a huge breadth of opportunity right across the economy, much of which will be out the purview of a traditional technology fund. There are opportunities to be found in the consumer discretionary sector, in consumer services, healthcare, industrials, energy and within financial services in particular. Companies in these sectors will be investible in only small scale for a traditional tech fund, because they are not classified as technology stocks.

Robotics is an interesting expression of artificial intelligence. You can think of a robot as an embodiment of an artificial intelligence. AI is the enabling technology that sits behind the robots in which a robotics fund would look to invest. Robotics is, of course, only one slim vertical of the broader opportunity to apply artificially intelligent systems across the economy. Other examples might be cyber security or automated driving or automated triage for healthcare services. Many of these sit firmly outside of the scope of a robotics fund. For a robotics fund, the bread and butter tends to be industrial robotics companies, such as those that one would typically find in Japan and in Germany. The result of this is that a robotics fund can provide very targeted exposure to one of the more economically cyclical spaces enabled by artificially intelligence, but it would be highly unlikely a robotics fund could capture the full breadth of the opportunity that the artificially intelligent economy could provide.
What type of companies will you invest in? Is this really just a dressed up global themes Fund?

The type of companies that we would look to invest in will be those that can offer highly targeted and pure revenue exposure to artificial intelligence. We believe that artificial intelligence is very likely to be a persistent and rapidly-growing theme within the global economy, and we think that those growth characteristics are something that we can express within our portfolio by targeting purity of revenue exposure to that theme. So yes, it is at some level thematic stock picking, but very purely targeted to give exposure to pure AI revenues. We use a number of tools to allow us to find those companies, and we believe we are currently unique in employing AI in the research element of our investment process.

Does the Fund have a particular style orientation, e.g. growth or value?

The Fund is growth oriented. This perhaps isn’t surprising given the growth characteristics that we think will accrue to the theme and could persist for a number of years. However, given the breadth of the theme and the richness of the opportunity set, we would hope the fund is able to display significantly more resilience than a focused thematic fund (e.g. a robotics fund) in the event of a market downturn.

Investors with long memories will remember the hype around ‘new economy’ stocks in the late 1990s and early noughties, how will you avoid the fate that befell tech funds?

We are cognisant of the valuations afforded to the FAANG (Facebook, Apple, Amazon, Netflix and Google) stocks but would reiterate that this is not a tech fund - the Artificial Intelligence Fund (AI) is diversified by sector and by geography. AI is, in our view, likely to have profound impacts on sectors such as healthcare which typically the market regards as defensive. The impact of AI will also be found in traditionally cyclical (and traditionally lower growth) sectors such as consumer cyclicals and financials. The tech bubble was burst by the collapse of ‘TMT’ (technology, media and telecom) stocks and the recent market rally has been led by a fairly narrow group of the leading online names (Facebook, Amazon, Netflix and Google) and Apple. Our investment universe is much wider than this - and it has to be, because we think AI is going to be transformative across a range of industries and sectors. Also, unlike the TMT boom, we think that AI will persist and continue to evolve over time - indeed you could argue that AI has been with us in one form or another ever since Charles Babbage invented the computer. Tech booms have been much more transitory, with formerly household names such as Nokia enjoying a meteoric rise but then disappearing almost as quickly.

An AI Fund is not what we would expect from Smith & Williamson, why do you think you can be credible in launching and running such a Fund?

My colleague Tim Day and I joined Smith & Williamson from Pictet. Pictet is a market leader in the management of thematic equity products. We managed the global equities business for Pictet in London before joining Smith & Williamson a couple of years ago, and there we innovated a couple of global funds which had a sort of thematic bent to them; most recently a global ‘major players’ fund.

For Smith & Williamson this is a very interesting opportunity. Smith & Williamson’s business has for 100 years been characterised by the entrepreneurial environment within which it sits, and as the entrepreneurial environment in London has become increasingly characterised by companies and entrepreneurs involved with artificially intelligent systems, so our business has become more inflected by AI in our interactions with counterparties, clients and so on.

You are running the Fund from London; given the dominance of US names in your portfolio, do you see that as an advantage or a disadvantage?

In our view, London has a key role to play in the adoption of artificial intelligence. DeepMind is based in London and they are owned by Google. We have Europe’s largest biotechnology research lab recently opened in the Crick Institute. We have the Turing Institute at the British Library which looks to bring together the universities of Oxford, Cambridge, London, Bristol, Edinburgh and Warwick in one place in a large research hub, adjacent - not coincidentally - to Google’s DeepMind campus. Amazon and Microsoft have very large AI teams based in Cambridge. The network effects that one might traditionally associate with Silicon Valley in respect of traditional technologies are now beginning to accrue in London within the artificial intelligence space.
Why do you think AI justifies the launch of a dedicated fund? Don’t tech funds and global equity funds invest in AI (or users of AI) already?

The value of a specific AI fund is the robustness of the theme that lies behind it. AI is in its infancy but could be applied to a very wide range of applications - this means that there is a potentially very long runway for AI, and as such we think it could be a source of attractive structural (as opposed to cyclical) growth opportunities. Technology and robotics funds tend to be quite cyclical because demand for technology and capital goods in general tends to ebb and flow with the business cycle. With AI, there are opportunities that cut across a broad range of sectors, and we think this could allow investors to capture attractive rates of earnings growth without the cyclicality that is inherent in a tech fund or a robotics or an automation fund.

You have talked about the theme a lot. Please could you outline the valuation measures/screens that you use when selecting stocks?

We employ a wide range of valuation measures, including Price/Earnings to Growth ratios, Enterprise Value/Sales and Enterprise Value/EBITDA.

How does the Fund differ from an ETF?

The fund is actively managed; most ETFs simply invest in a basket of stocks or replicate an index, which is difficult in the case of AI as there is no meaningful AI index (as far as we are aware). We believe that our Fund allows investors to achieve purity of exposure to AI revenues; given there is no requirement for companies to disclose the percentage of their revenues that come from AI, it is hard to see how a passive or rules-based ETF could ever claim to have purity of exposure to the theme. As we have discussed above, we also have AI embedded within the Fund’s research process, which we believe is unusual.

How do you select stocks for the fund?

The selection process begins by screening for companies globally that meet the managers’ liquidity criteria, creating a universe of around c.17,500 stocks with a market capitalisation above c.$250m.

A proprietary AI-enabled platform then reviews data from online sources to search these companies for the key markers of artificial intelligence, as defined by the investment managers. This rapidly and efficiently reduces the initial 17,500 companies to a universe of around 500 which we know are worthy of consideration for the AI portfolio, spread across a range of sectors and geographical regions.

The managers then apply their expertise, intuition and judgement to filter these companies further by assessing their breadth and depth of involvement in AI. The managers analyse and score each company’s ability to sense, gather and process data, employ algorithms and deliver a service using AI in one form or another.

The stocks are assessed for their degree of AI purity. This is based on an estimation of the proportion of a company’s revenue reliant upon AI and the overall importance of the AI platform to the underlying business. The impact of AI to the company’s overall growth rate is also an important factor.

The stocks that pass the ‘purity test’ are then considered for inclusion within the portfolio, once an assessment of the valuation has been concluded.

Are there maximum or minimum sector or country weightings?

No. The Fund is unconstrained but does have to comply with the UCITS rules on portfolio diversification.

What is your benchmark and how will you measure success?

The Fund does not have a benchmark. We will invest globally, so some investors may wish to compare us to the MSCI World, but we would not regard that as a formal benchmark and will not be constrained versus the MSCI.

We believe we could have been successful if we deliver similar returns to other AI sub themes such as robotics, but with lower volatility and less cyclical, as would be expected given our wider opportunity set.

How frequently will the portfolio change?

Given the strength and duration of the theme, and the high-conviction nature of our portfolio, we would expect turnover to be low.
Why are you running such a concentrated portfolio?
Our focus is on providing purity of exposure to AI and to back our best ideas with conviction. Portfolio theory would suggest that a portfolio of around 30-35 stocks should be sufficient to mitigate non-systemic risks.

Will there be any yield?
We would expect the Fund’s yield to be close to zero.

What are the fees?
Retail share classes are available in dollars and sterling with an annual management charge (AMC) of 80bps and an ongoing charges figure (OCF) of 0.95%.

Institutional share classes are available in dollars and sterling with an investment minimum of $10m or £10m, respectively, with an AMC of 50bps and an OCF of 0.65%. We are waiving the investment minimums on the institutional share classes for an initial three-month period* and this is available to all investors.

Where is the Fund domiciled?
It is a Dublin-based UCITS and will form part of the existing S&W Dublin range.

Will the Fund have HMRC reporting status?
Yes, we have applied for reporting status.

What is the minimum investment amount?
For the retail share classes (‘B’ and ‘C’ share classes), the minimum initial investment is £100,000 or $100,000, respectively.

What is the base currency of the Fund?
Sterling.

Will you currency hedge the non-sterling share classes back to GBP?
No.

* The offer period runs from 17.07.17 for an initial period of three months; for further information, please speak to your Smith & Williamson representative.
If you have any questions on the Fund, please do not hesitate to contact your usual Smith & Williamson representative or you can email us at funds@smithandwilliamson.com.

**Key risks:**

- Investment does involve risk. The value of investments can go down as well as up and investors may not receive back the original amount invested.
- Equity (stocks & shares) investment is subject to specific risks relating to the performance of the individual companies held, the market’s perception of them and systematic risks such as general economic conditions, interest rates, foreign exchange rates and industry sector risks. In general terms, equities tend to be more volatile than bonds.
- When investments are made in overseas securities, movements in exchange rates may have an effect on the value of that investment. The effect may be favourable or unfavourable.
- Investments in emerging markets may involve a higher element of risk due to political and economic instability and underdeveloped markets and systems.
- Investments in smaller companies may involve a higher degree of risk as markets are usually more sensitive to price movements.
- From time to time the Fund may invest in initial public offerings (IPOs) which frequently are smaller companies. Such securities may be subject to greater price volatility than more established securities and are therefore higher risk.
- The Fund is usually well diversified although it may from time to time hold relatively few investments. A Fund which holds a relatively small number of stocks or holds a large position in a particular investment, may be subject to greater volatility and therefore more significant declines in value than a more diversified (a larger number of stocks) portfolio.
- Past performance is not a guide to future performance.
- Investment is subject to documentation (Prospectus, Key Investor Information Document (KIID) and Terms & Conditions), copies of which can be obtained free of charge in English online at www.smithandwilliamson.com

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