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So Your Clients Want to Invest in AI? Here's What to Know

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What You Need to Know

- Artificial intelligence is a potentially transformative technology, but it's a very young industry.
- Like the dot-com bust, many promising young startups won't have it takes to survive as the industry matures.
- Investors should also be watching companies whose business models will likely benefit from advances in AI technology.

While the tech industry has been excited about innovations in artificial intelligence (AI) for years, the introduction of the consumer-facing ChatGPT has prompted far more interest among the broader public — including investors.

"ChatGPT really struck a chord with the public because it was usable and intriguing in a way that was novel and new," says Ryan Jacob, portfolio manager of the **Jacob Internet Fund**.

But while it's clear that AI applications have the potential to **drastically accelerate** the pace of technological change and disruption in many industries, the best way to invest in the burgeoning AI industry is more nuanced.

If your clients are asking about investing in AI, here's what you need to know to respond intelligently.

Artificial Intelligence: An Overview

Artificial intelligence uses computing power to simulate human thinking to solve problems or complete tasks. ChatGPT is a form of "**generative AI**," which means that it not only analyzes data but uses its predictions about that data to "generate" something. In this case, it uses AI to answer questions using data gleaned from millions of pages on the internet. It does not actually "know" anything, but it can predict the answers to questions using its understanding of the relationships between words.

However, there are many other use cases for AI and deep learning models beyond simple, text-based responses. AI is part of the technology powering innovation in self-driving cars and cloud computing, and machine learning could be used for everything from physicians looking for assistance with a patient diagnosis or treatment plan to uncovering cost savings at a manufacturing plant.

"Four or five years ago, artificial intelligence was seen more of a niche or thematic investment," says **Mike Loukas**, principal and chief executive officer of TrueMark Investments. "Now it's permeating so many levels of business and society and our everyday lives. As it becomes a more useful tool for businesses, I think the B2B application is going to become a more important component of investment portfolios."

Is AI a Good Investment?

Artificial intelligence has the potential to be a good investment, but it's important to understand that it's a very young industry. For that reason, it's difficult to determine with much certainty which stocks might benefit the most from AI capabilities.

That said, most large tech companies are investing in AI, seeing dominance in the category as key to maintaining a competitive advantage. The challenge for investors, of course, is determining which companies will gain (or lose) the most as AI matures.

Why Is AI So Hot Right Now?

The introduction of ChatGPT to the public on Nov. 30, 2022, sparked a rise of interest in AI. But the increased interest may also reflect ongoing volatility in the tech markets, which has many investors looking for the next big innovation that will drive growth in the sector.

Microsoft invested \$1 billion in OpenAI, the creator of ChatGPT, in 2019, and is also **heavily investing** in building AI capabilities and tools into its Bing search engine. And while Google's AI tool, Bard, has gotten off to a more rocky start after generating incorrect answers in a demo, the search giant's focus on AI illustrates the importance of the technology.

What Is the Future of AI?

As more consumers and businesses transact online, there are increasing opportunities to incorporate the technology into our everyday lives. Some 44% of businesses are currently working to incorporate AI into their existing applications and processes, according to the **2022 IBM Global AI Adoption Index**.

As the use cases for artificial intelligence continue to expand, the technology itself will improve as well. While ChatGPT, Bard and others right now are prone to factual errors, it's likely that developers will find ways to make the technology more reliable.

"ChatGPT is just one manifestation of artificial intelligence, but it has the cool factor," Loukas says. "But when you start looking at investments, you have to separate the buzz from the business model."

What Are Some AI Companies to Invest In?

Investing in AI can take a lot of different forms, some more direct than others. In addition to focusing on companies building AI, investors might consider allocating to companies that may not be AI-centric but whose business models will likely benefit from advances in AI technology.

Other ways to invest in the coming AI boom include via adjacent industries, such as companies that specialize in cybersecurity, data processing or chip manufacturing, Loukas says, noting that AI needs all three in order to continue to grow.

To that end, Jacob says that he's looking at companies like Cloudflare, which specializes in edge computing, and MongoDB, a developer database platform, and companies in the Internet of Things (IoT) space as having more upside than pure-play AI companies.

Companies Leading the Way in AI Right Now

There aren't many public companies focused exclusively on artificial intelligence, but investment in any of the largest technology companies right now is a bet on AI. In addition to Microsoft and Google, companies like Amazon, Apple and IBM are all working hard to improve their proprietary AI technology and put it to use improving their products and services.

"Really, any major internet company has put resources behind this, and that's where the most innovation is happening," Jacob says. "But the question is how much is their development of AI going to move the needle in terms of enhancing returns? That's part of the challenge."

Despite the recent turmoil in the industry, such companies also remain flush with cash and are likely to acquire startups if they believe that the smaller firms have intellectual property or tech that could bolster their business. Larger companies also have the human capital and deep pockets necessary to quickly scale the technology.

Investors more interested in small- and mid-cap AI stocks might take a look at companies like **C3.ai**, an enterprise AI development platform; or **BigBear.ai**, an intelligence analysis firm.

Electric and self-driving vehicles may also offer an opportunity for investors to bet on AI. Companies positioned at the intersection of those industries and AI include battery manufacturer **SES AI** and **Argo AI**, which builds the infrastructure necessary for self-driving cars.

AI Startups to Watch

For investors without deep tech expertise, it may be difficult to differentiate among the many AI startups vying for space. Building AI is a cash-intensive business, so it's likely that many startups will either simply go out of business or find themselves acquired by larger firms.

In addition, many AI startups are even open to retail investors. About a third of general AI investments have not yet raised any equity funding, and more than half are still in Series A, according to an **analysis by CBInsights**. Retail investors can't directly purchase OpenAI stock, for example, because it remains a private company.

AI ETFs

For investors who want to maintain diversification while also investing in AI, exchange-traded funds (ETFs) may provide a solution. Experts warn investors to look closely at AI-focused ETF funds to make sure they understand exactly what they're buying. Some supposedly AI-focused funds may be more akin to rebranded tech funds.

It's also important to understand how the manager has constructed the fund, and how its evaluating potential investments. Keep in mind that while there are plenty of ETFs that invest in AI, there are also a growing number of ETFs that use AI to help construct portfolios in other sectors.

How to Start Investing in AI

As with any investment, it's important for investors to do their due diligence to make sure they have researched a company and its competitors before purchasing shares in it. As such, financial advisors should be prepared to field questions from clients in this regard.

While it's not necessary to have the deepest understanding of the technology that powers AI, they should have a basic understanding of the business itself and how it plans to differentiate itself — and ultimately generate profits — in an extremely expensive, crowded and competitive space.

Joe Quinlan, managing director and head of Market Strategy for the Chief Investment Office at Bank of America Private Bank, likens the current investing environment to the early days of dotcom investing. Some young companies, such as Amazon, grew into powerhouses during that era, while many more perished in the subsequent bust.

"[There were] a lot of companies back then with no earnings and a great marketing story, but they never came out the other side," Quinlan says. "We know we are on the cusp of new innovation right now, and venture capitalists are throwing money at it. That is how we create great companies, but if you see a great story with no earnings, be careful."

Quinlan says that while the pace of innovation is fast, it also may not be as fast as some investors expect when it comes to generating returns.

"We are accelerating," he explains. "But we are talking years, not quarters."

What Should Financial Advisors Know About Investing in AI?

When it comes to talking to your clients about investing in AI, it's important to help them understand that, while this is a potentially transformative technology, the industry is also in its very early days. That said, there are many opportunities, especially for those willing to look beyond simple pure-play AI investments.

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