Morgan Stanley

INVESTMENT MANAGEMENT

Global Equity Observer

The tech takeover: why technology is everyone's business

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We are witnessing a rapid technological revolution. Just 14 months after the launch of ChatGPT, generative AI has moved mainstream, while enthusiasm surrounding agentic AI—systems capable of independent decision-making—and robotics continues to build.

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As our largest sector weight, information technology serves as a cornerstone of our global portfolios, led by the software industry and other select high quality compounders. These well established, highly profitable companies consistently deliver high returns on operating capital, fortified by sticky recurring revenues, robust pricing power and strong free cash flows. We believe they represent the best of both worlds—resilient franchises with solid growth prospects. At the heart of our holdings lie long-held, deeply embedded, market-leading firms, driving transformative change for themselves and their clients.

But the story doesn't stop with the tech sector itself. In today's fast-evolving global economy, technology transcends boundaries and sector classifications; it's everyone's business. Across every industry, from financial services to luxury goods, technological innovation is re-shaping growth trajectories and redefining operational excellence. Such companies showcase how digital integration, AI and cloud computing are now essential engines of competitive advantage. The future belongs to those who embrace this transformation—and we believe our global portfolios hold many of the companies that are leading the way.

From exchange pits to electronic bits

A leading exchange group we own was originally founded to digitise energy markets. Today, its technology underpins global financial infrastructure, enabling real-time data analytics and seamless transactions. Its latest initiative? Automating the real estate lifecycle to create seamless experiences for homeowners, lenders and servicers.

Elsewhere, a digital payments network we hold uses AI-driven fraud detection systems to showcase the intersection of innovation and security. By using machine learning to analyse billions of transactions, the company not only protects its network but fosters trust, driving transaction volumes and customer loyalty.

"Markets may be mesmerised by a clutch of "big tech" names, but it's useful to look beyond them to the digital transformation taking hold across industries."

In the luxury sector, the French luxury goods company we own bridges tradition with innovation. By deploying AI and data analytics, the company delivers hyper-personalised customer experiences, from curated marketing campaigns to optimised inventory. This seamless blend of heritage and technology helps ensure its brands remain aspirational and relevant.

A consumer health provider we hold has collaborated with the largest vendor of computer software in the world (and another of our holdings) to improve the accessibility of its health products for those who have blindness or impaired vision. By integrating AI with the vendor's Seeing AI application, users can scan barcodes of over 1,500 products to receive narrated information about the product including name, ingredients and usage directions.

The dual role of technology: growth and efficiency

Technology's power lies in its dual ability to drive growth while optimising operations. It enables businesses to capture new markets, improve profitability and sustain relevance in an evolving landscape.

Take a U.S.-based provider of financial technology solutions we own, for example. By delivering cloud-based solutions to community banks and credit unions, the company modernises operations, enhances scalability and integrates seamlessly with third-party fintech solutions. Its unified platform helps accelerate decision-making, reduce costs and elevate service quality, demonstrating how technology can empower even smaller players to compete at scale.

The German multinational software company we hold uses AI in predictive maintenance on its in-memory, column oriented, relational database management platform. Using deep learning algorithms to analyse key performance indicators, the system can proactively identify potential system anomalies before they lead to failures. Using predictive insights rather than reactive responses reduces downtime and helps optimise operational efficiency.

Digital reach and operational excellence

The world's largest cosmetics brand exemplifies the opportunities digital reach provides. By leveraging social media, augmented reality and data analytics, the company develops trend-responsive products and hyper-targeted marketing. Its Makeup Genius app allows users to try on products virtually. By scanning the user's face, the app analyses over 60 facial features, enabling the simulation of various makeup looks in real time. Skin Genius and SkinConsult AI provide personalised skincare recommendations, and the company's collaboration with ModiFace extends the virtual "try-on" across the product range including skincare, makeup and hair colour.

Operational efficiency is also transforming industries. In health care, an American life science and clinical research company integrates digital tools to streamline global research collaboration. Elsewhere, a leading consulting firm uses AI and automation to optimise client operations, freeing resources for higher-value tasks.

Lessons from legacy: technology's evolutionary impact

History underscores the transformative power of technology. An American multinational consumer goods company, for example, revolutionised marketing with its brand management system in the early 20th century, streamlined supply chains with electronic data interchange in the 1980s, and now uses AI and robotics to optimise manufacturing and inventory.

But not every success story has been smooth. Even today's tech giants have faced missteps. The computer software vendor mentioned earlier in the article was initially slow to embrace the internet revolution, ceding early ground in web browsers, search engines and e-commerce to rivals like Netscape, Google and Amazon. The company also stumbled in mobile operating systems, where a late and unfocused entry left Apple and Android to claim the market. Chairman and CEO Satya Nadella revitalised the company, prioritising cloud computing with Azure, pivoting to subscription-based software, establishing a leadership position in AI, building out gaming and enterprise services, and driving innovation across business units. The leadership's effective capital allocation through key investments and acquisitions has helped fuel sustained growth and market expansion.

AI is everywhere; looking beyond Nvidia

AI innovation is proceeding at a very rapid clip—as seen by the remarkable progress recently announced by Chinese AI company DeepSeek, which released an AI model with performance metrics on a par with OpenAI's o1, though critically built on a comparatively shoestring hardware budget. This reinforces our belief that in the long term, the implications of AI on the real economy are likely to be profound, as the reduced cost of AI technology services allows the development of more use cases. Clearly much of the market's focus on AI to date has been on a handful of hardware providers (the so-called "picks and shovels"), most notably Nvidia. DeepSeek's progress was a reminder that there is a wide range of potential outcomes in terms of longer-term AI chip demand. This uncertainty, together with the risk of competition (including from its own hyperscaler customers), high cyclicality and rich valuation, is the reason we don't own Nvidia.

We see significant AI-related opportunities for the tech companies we do own. We also own a significant number of data-centred companies (e.g. credit bureaus, information service providers, exchanges). These businesses hold significant levels of proprietary data which, together with their strong pricing power, we believe allows them to be AI beneficiaries since they are able to offer AI additional services and apply technology more efficiently.

The cost of technological complacency

The benefits of embracing technology are undeniable—but the risks of ignoring it are equally stark. Companies that fail to harness technological advancements risk losing market share, falling behind more agile competitors, and tarnishing their reputations. History is replete with cautionary tales. Take an American designer and manufacturer of computer components, for example—a once-dominant innovator that struggled to adapt to shifts in the semiconductor market, from delays in advancing its manufacturing processes to missing the boat on key trends like mobile and GPUs (graphics processing units). Its missteps underscore how even market leaders can falter when they fail to prioritise technological progress.

Being actively selective

At a time when markets are mesmerised by a clutch of U.S. "big tech" names it's useful to look beyond them to the digital transformation taking hold across industries. Whether we're evaluating a leading technology company, or a leader in any other sector, our approach is grounded in identifying the high quality fundamentals that drive long-term compounding. Once we believe the quality foundations are in place, we dive deeper—assessing the strength of the franchise and the ability of the management team. How effectively are they building competitive advantages, particularly through the development and strategic application of technology? This focus on technology also forms a key pillar of our risk assessment. Is a company's technological adoption merely reactive or is it proactively setting the stage to gain market share, improve scalability and achieve superior returns? By staying selective and engaged, we look to ensure we're investing in high quality businesses that are not simply keeping up with the times but leading the way.

Risk Considerations

There is no assurance that a portfolio will achieve its investment objective. Portfolios are subject to market risk, which is the possibility that the market value of securities owned by the portfolio will decline. Market values can change daily due to economic and other events (e.g. natural disasters, health crises, terrorism, conflicts and social unrest) that affect markets, countries, companies or governments. It is difficult to predict the timing, duration, and potential adverse effects (e.g. portfolio liquidity) of events. Accordingly, you can lose money investing in this strategy. Please be aware that this strategy may be subject to certain additional risks. Changes in the worldwide economy, consumer spending, competition, demographics and consumer preferences, government regulation and economic conditions may adversely affect global franchise companies and may negatively impact the strategy to a greater extent than if the strategy's assets were invested in a wider variety of companies. In general, **equity securities'** values also fluctuate in response to activities specific to a company. Investments in **foreign markets** entail special risks such as currency, political, economic, and market risks. **Stocks of small- and mid-capitalisation companies** carry special risks, such as limited product lines, markets and financial resources, and greater market volatility than securities of larger, more established companies. The risks of investing in **emerging market countries** are greater than risks associated with investments in foreign developed markets. **Derivative instruments** may disproportionately increase losses and have a significant impact on performance. They also may be subject to counterparty, liquidity, valuation, correlation and market risks. **Illiquid securities** may be more difficult to sell and value than publicly traded securities (liquidity risk). Non-diversified portfolios often invest in a more limited number of issuers. As such, changes in the financial condition or market value of a single issuer may cause greater volatility. **ESG strategies** that incorporate impact investing and/or Environmental, Social and Governance (ESG) factors could result in relative investment performance deviating from other strategies or broad market benchmarks, depending on whether such sectors or investments are in or out of favor in the market. As a result, there is no assurance ESG strategies could result in more favorable investment performance.

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The **S&P 500® Index (USD)** measures the performance of the large cap segment of the U.S. equities market, covering approximately 75% of the U.S. equities market.

The **MSCI EAFE Index (Europe, Australasia, Far East)** is a free float-adjusted market capitalization index that is designed to measure the international equity market performance of developed markets, excluding the US & Canada.

The **Chicago Board Options Exchange (CBOE) Market Volatility (VIX) Index** shows the market's expectation of 30-day volatility.

Earnings per share (EPS) is the portion of a company's profit allocated to each outstanding share of common stock.

Gross Domestic Product (GDP) is the monetary value of all the finished goods and services produced within a country's borders in a specific time period. It includes all private and public consumption, government outlays, investments and net exports.

The **Purchasing Managers Index (PMI)** is an indicator of the economic health of the manufacturing sector. The PMI index is based on five major indicators: new orders, inventory levels, production, supplier deliveries and the employment environment.

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