Investment Focus: Navigating global equity: Combining AI precision with human expertise

September 2024

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In 2024, global equities have exceeded expectations, outperforming across various regions and sectors. Unlike the US technology stock dominance of 2023, this year's performance has shown diverse strength, with significant returns from consumer staples, financials, industrials, and utilities. The disparity in investment returns among the top 100 performers on the MSCI All Country World Index highlights the potential for substantial gains, with the highest performer achieving 170% and the lowest 43%. Notably, only 22 of these top 100 are US-listed companies, underscoring the global breadth of this performance.

In light of the recent US market performance dominated by the "Magnificent 7" stocks, concerns about a potential market correction are increasingly prevalent. For investors, this scenario poses a significant challenge: how to balance the risks of overexposure to these high-flying stocks with the need to avoid substantial tracking error.

The "Magnificent 7" constitute about 20% of the MSCI All Country World Index (ACWI), creating a concentration risk if a large portion of the portfolio is allocated to these names. We address this by adopting a balanced approach, holding reduced weights in these stocks. This strategy enables us to benefit from the tech sector's strength while maintaining flexibility to explore other market opportunities, particularly as the rally broadens.

Globally, risk premia appear narrow, reflecting a market complacency about earnings growth risks—a stark contrast to early 2023 when recession fears were predominant. Central bank interest rates need to decrease to justify current asset valuations. A benign disinflation trend would support fair valuations and potentially strong equity performance, while a reactionary cut due to weakening demand could reveal inadequate risk compensation. Opportunities include a broadening market trend that favours stock-picking strategies and emerging markets (EM) with attractive valuations.

Harnessing AI for superior stock selection

In the realm of global equity investing, distinguishing stocks that will outperform the market is a significant challenge. M&G Investments employs a cutting-edge artificial intelligence (AI) model, as used in the the M&G (Lux) Global Maxima Strategy, to navigate this complex landscape. This model, which supports the M&G Global Equity Fund, M&G Global Property Fund, and the equity components of the M&G Global Balanced and M&G Global Inflation Plus Funds, provides an edge by analysing a vast dataset—spanning 30 years and over 5 billion data points—to identify companies likely to deliver above-market returns.

The AI model's ability to detect patterns and relationships at an unprecedented scale and speed offers a critical advantage in portfolio construction. Its continuous updates and unemotional, rules-based process ensure that investment strategies remain relevant and effective.

Combining AI precision with human expertise

M&G's strategy integrates AI-driven insights with the nuanced understanding of human fund managers. The team

scrutinizes the model's recommendations, addressing potential risks and incorporating qualitative factors such as management quality and regulatory changes. This collaboration ensures that the portfolio is well-rounded and responsive to evolving market conditions.

The Global Maxima Strategy, focusing on stock-picking alpha, minimizes active bets on countries, currencies, and industries. The strategy leverages a proprietary AI system to evaluate nearly 10,000 companies daily, guiding stock selection based on extensive machine learning techniques. This AI system, combined with our investment professionals' expertise, allows us to deliver superior stock recommendations while maintaining minimal active allocation risks. This human-machine collaboration ensures precise and informed investment decisions.

Focusing on smaller to mid-cap companies for maximum impact

The M&G Global Equity Fund and other portfolios employing the Global Maxima strategy has strategically favoured small- and medium-cap stocks over global mega-caps. This approach leverages the AI model's strength in less-covered segments of the market, where mispricing is more likely. The fund's performance reflects this strategy's success, showcasing its ability to harness extensive data to identify high-potential investments.

Although it has not been a good period in which to be underweight the global mega-cap stocks, astute stock picking has been the primary driver of performance over its history. This attests to the power of M&G's AI model and the management team's ability to harness this power and apply it successfully to generate solid long-term returns for our clients. It shows that we are able to get robustness and consistency out of these models in a way that improves tricky in other strategies.