

Beware what you can't know

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Artificial Intelligence (AI) has gone from a concept in most people's minds to a reality in just over a year. This new technology has very quickly become seamlessly embedded into our everyday lives. If you use WhatsApp you may have noticed the new 'Meta AI' functionality over the past month for example, powered by the proprietary Meta Llama 4 AI model, and imbedding AI into your day-to-day messaging application.

To us, this rapid development is not unusual as all major technological advances of the past century have been met with scepticism initially, followed by rapid engagement by users as they make life easier.

Something that does get missed by investors in the West is that the leading AI companies are not only domiciled and listed in the US.

In fact, Asian competitors to US AI businesses primarily come from China, with notable companies including DeepSeek, Alibaba, ByteDance, Baidu, Tencent, and a group dubbed the "Six Tigers" (Stepfun, Zhipu, Minimax, Moonshot, 01.AI, and Baichuan).

When comparing these businesses, certain differences become very apparent.

Innovation and Scale: US firms like OpenAI, Microsoft, and Google lead in R&D spending and capital expenditure, investing hundreds of billions annually to develop cutting-edge AI models and infrastructure. Chinese companies spend less in absolute terms but are rapidly increasing investment, focusing on efficient, cost-effective AI development under chip export restrictions.

Model Development: DeepSeek claims AI models competitive with US equivalents such as OpenAI's GPT-4, developed at a fraction of the cost and using less advanced chips due to US export controls. This again reflects China's ability to innovate despite technological constraints.

Business Strategy: US companies often monetise AI through enterprise services (software licenses) and paywalled models, yielding higher profitability. Chinese firms tend to distribute AI models freely and prioritise rapid integration into consumer applications like e-commerce and gaming, aiming for broad market penetration rather than immediate profit. Think of this as Apple's IOS operating system on an iPhone versus the Android technology on all other devices: one is driven purely by scale (Android) whilst the other is driven by a premium experience (IOS).

In summary, while US AI businesses maintain a lead in scale, R&D, and monetisation in the short term, Chinese AI competitors are rapidly closing the gap through cost-efficient innovation, aggressive deployment, and consumer-focused AI integration, signalling a shifting balance in global AI leadership.

These considerations illustrate the importance of having an edge in the sector and, perhaps more importantly, the need to maintain such an edge into the future. Our analysis of this evolving landscape leads us to question the valuation anomaly between the US technology sector and its peers in Asia, as history shows that only the best companies maintain their dominant position over decades whilst most fall by the wayside. This valuation gap seems too wide to us.

Asian AI leaders generally have lower valuations compared to top US AI companies. For example, major US AI firms like Nvidia trade at price/earnings (P/E) ratios around 35x projected earnings, reflecting strong investor confidence and growth

expectations. In contrast, leading Asian AI companies typically have P/E ratios ranging from 12x to 19x, indicating more conservative valuations by comparison.

Tacit strategies have exposure to both the largest, most well managed US companies as well as positions in the Asian peers which are currently trading at significantly lower valuations. This seems to us to be a sensible 'barbell' when investing in this transformative theme.

Please be advised that the AJ Bell / our client portfolio portal will be undergoing scheduled maintenance on **Sunday, 11th May 2025**. As a result, the portal will be **unavailable between 18:00 and 21:00** that evening. We apologise for any inconvenience this may cause and appreciate your understanding.

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