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Why active management matters in the AI era

Every major technological shift creates winners and losers. The challenge for investors is that passive indexes can often own both.



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AI Is Creating a Different Type of Investment Cycle

Artificial intelligence (AI) has become one of the most important investment themes in global equity markets, but the opportunity is unlikely to be distributed evenly. As with prior technological shifts, some companies may emerge as beneficiaries of disruption while others may face pressure to their business models, competitive positioning, or pricing power.

That distinction is one reason active management may be especially critical in the AI era. Passive indexes can provide broad market exposure, but they can also include companies that may be vulnerable to technological disruption alongside those driving it. In our view, identifying the companies best positioned for this environment requires more than recognizing that AI demand is growing. It requires understanding where that demand is most durable, where bottlenecks are forming, and which companies can convert those forces into sustainable earnings growth.

Why Broad Exposure May Miss Key Differences

Fundamental research can help investors identify not only potential beneficiaries of AI adoption, but also businesses whose competitive positions may weaken as AI changes industry economics. In periods of rapid technological change, markets can struggle to separate long-term compounders from companies that are merely attached to a powerful theme. Passive strategies that provide exposure to companies impacted by AI do not distinguish between those companies benefiting from disruption and those potentially vulnerable to it. Active management can be used by investors to identify companies with strong fundamentals, pricing power, capital discipline, and multi-year growth potential.

During prior technological transitions, broad market exposure often included both the disruptors and the disrupted. As an example, many traditional retailers and legacy media businesses struggled as digital platforms reshaped their industries. AI may create similar divergence across sectors, where some companies benefit from changing industry economics while others face pressure to existing business models or competitive positions.

For investors, active managers may provide value by not only seeking innovative beneficiaries but also by eliminating exposure to potentially underperforming industries that are included in broad benchmarks. Some of the companies benefiting most from AI adoption may exist deeper within the infrastructure and supply chain ecosystem, where market positioning and earnings potential may not yet be fully reflected in index weightings. On the other hand, some of the losers of innovation may have significant weightings in passive indexes that are not warranted.

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Hidden Risks and Opportunities Across the Stack

Compute infrastructure remains one of the largest areas of AI investment, as advanced models require increasingly powerful processing capabilities. But not all compute exposure is equal. Some companies may benefit from sustained demand and strong competitive positioning, while others could face increasing competition or pressure on margins over time. The key question is whether AI demand can translate into durable earnings growth and attractive long-term economics.

Memory is another area where AI may be reshaping industry dynamics. AI workloads require significantly more advanced memory capacity, increasing demand in areas where supply may remain constrained. Historically, memory has often behaved like a cyclical commodity business, but AI could create more durable demand for certain advanced products. The main question for investors is whether these changes represent a temporary cycle or a more lasting shift in industry structure.

Power is also becoming an increasingly important part of the AI investment story. Data centers require large and reliable electricity supplies, and access to power may become a constraint on future AI deployment in some regions. That could expand the opportunity set beyond traditional technology companies to include utilities, electrical equipment providers, and infrastructure firms. But not every company will benefit equally, reinforcing the importance of selectivity and fundamental research.

AI Infrastructure is Deeply Interconnected

Because each layer of the AI stack depends on the others, a bottleneck in one area can cascade through the broader ecosystem. Scarce memory can reduce compute efficiency. Limited power availability can delay data center deployment. Delayed data centers can affect demand for chips, equipment, and services. These dependencies can create both risks and opportunities. It also makes generalized thematic exposure less precise, because the most attractive investments may not always be the most obvious AI winners. In some cases, they may be found deeper in the supply chain, where constraints are emerging, demand is improving, and investor attention remains limited.

AI may also reshape competitive dynamics across industries in ways that are not yet fully reflected in passive indexes. Some enterprise software vendors, IT services firms, ride-hailing providers, and other incumbents could face pressure if AI reduces barriers to entry, changes customer behavior, or compresses pricing power. For investors, avoiding businesses vulnerable to disruption may become just as important as identifying the companies enabling AI adoption.

Identifying AI Winners Through Fundamental Research

For advisors building long-term growth allocations, the challenge may not simply be gaining AI exposure, but determining which businesses are positioned to sustain earnings power as industry structures evolve. That requires separating signal from noise: distinguishing real demand from hype, sustainable pricing power from temporary shortages, and disciplined capital investment from spending that may not generate adequate returns. It also requires recognizing that some companies may be disrupted by AI even as others benefit from it.

At Alger, our investment philosophy has long centered on positive dynamic change, which means identifying companies benefiting from meaningful shifts before they are fully reflected in market expectations. AI is a powerful example of that kind of change. It is reshaping demand across industries, creating new constraints in critical parts of the infrastructure stack, and expanding the opportunity set beyond the companies most commonly associated with the theme.

Because the AI opportunity is substantial but could be unevenly distributed, we believe active management, grounded in deep fundamental research and high-conviction positioning, can help investors navigate this environment and identify companies with long-term compounding potential. Broad exposure can capture part of the AI opportunity, but selectivity may be essential in finding businesses with durable earnings power and sustainable competitive advantages.

For advisors and investors seeking actively managed exposure to companies benefiting from AI-driven change, Alger's ETF lineup provides access to the firm's bottom-up growth investing approach. Visit **Alger.com/ETFs** for more information.

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Companies involved in, or exposed to, AI-related businesses may have limited product lines, markets, financial resources or personnel as they face intense competition and potentially rapid product obsolescence, and many depend significantly on retaining and growing their consumer base. These companies may be substantially exposed to the market and business risks of other industries or sectors, and may be adversely affected by negative developments impacting those companies, industries or sectors, as well as by loss or impairment of intellectual property rights or misappropriation of their technology. Companies that utilize AI could face reputational harm, competitive harm, and legal liability, and/or an adverse effect on business operations as content, analyses, or recommendations that AI applications produce may be deficient, inaccurate, biased, misleading or incomplete, may lead to errors, and may be used in negligent or criminal ways. AI companies, especially smaller companies, tend to be more volatile than companies that do not rely heavily on technology.

Investing in innovation is not without risk and there is no guarantee that investments in research and development will result in a company gaining market share or achieving enhanced revenue. Companies exploring new technologies may face regulatory, political or legal challenges that may adversely impact their competitive positioning and financial prospects. Developing technologies to displace older technologies or create new markets may not in fact do so, and there may be sector-specific risks. There will be winners and losers that emerge, and investors need to conduct a significant amount of due diligence on individual companies to assess these risks and opportunities.

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