Refining AI exposure: WisdomTree's strategy enhancements for the AI megatrend

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Baoqi Zhu
Associate Director, Quantitative Research & Multi Asset Solutions

Key Takeaways

- The ETF's latest rebalancing introduced an enhanced methodology to adapt to the evolving AI landscape.
- The enhanced index methodology maintains key principles of purity, expertise, diversification across the AI value chain, and differentiation from the broader market.
- Reclassification of key players, such as Alphabet, Microsoft, and Amazon, highlights the growing role of AI infrastructure.
- The fund remains focused on capturing emerging AI opportunities, particularly in cloud services and AI-driven platforms.

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Our flagship thematic ETF, the WisdomTree Artificial Intelligence UCITS ETF, underwent rebalancing in late September. Unlike the previous regular rebalancings, we implemented an enhanced index methodology this time to maintain key principles of purity, expertise, diversification across the Artificial Intelligence (AI) value chain, and differentiation from the broader market.

The fund was launched in 2018, before ChatGPT's release and before companies like Nvidia became as central to AI discussions as they are today. The competitive landscape has shifted as the AI ecosystem has evolved over the past few years, making strategy enhancements necessary. Furthermore, with the continued development of AI technology, we have noticed new potential opportunities we aim to leverage. In collaboration with our expert partners, Nasdaq and CTA, the strategy has been enhanced to ensure it keeps delivering a refined exposure to current and future opportunities.

A recap of the AI value chain

In our strategy, AI companies within the AI value chain are classified into three categories:

- **Enabler:** a company that develops the building block components for artificial intelligence, such as advanced machinery, autonomous systems/self-driving vehicles, semiconductors, or databases used for machine learning.

- **Engager:** a company that designs, creates, integrates, or delivers artificial intelligence in the form of products, software, or systems.
- **Enhancer:** a company that provides its own value-added services within the Artificial Intelligence ecosystem that are not core to their product or service offering.

How was the index enhanced?

- With the growing focus on AI, funding for early-stage AI companies is abundant. Private AI firms can now remain private at higher valuations, and breaking into the space requires large infrastructure investments. Consequently, the minimum market cap has risen from $250M to $2bn, with added liquidity restrictions.
- In the early stages of AI, the unpredictable emergence of "theme winners" led us to initially equal-weight companies across the Engager, Enabler, and Enhancer categories. However, as competition within the AI space has solidified, we now weight companies based on their CTA intensity scores, with a 4% cap on individual stock weights.
- As more firms enter the AI space, our strategy must focus on those with the most significant involvement. To achieve this, we have reduced the number of Enhancers by applying a minimum intensity score of 0.8. This selective approach not only increases the weights of the remaining companies but also minimises major shifts in weighting when firms transition between categories.
- The weightings of Enablers (40%) and Engagers (50%) have shifted to 50% and 40%, respectively. This change reflects the current AI cycle, where Enablers, particularly in hardware and semiconductors, are generating more revenue. CTA's assessment suggests that the AI space is entering an "arms race" for data centre infrastructure and rapid AI device development, which benefits the Enablers category. Moreover, this category expands beyond semiconductors to include a broader range of foundational companies.

Please refer to the index rulebook for more detailed information on the index changes.

How did the portfolio change in the rebalancing?

In the most recent rebalancing, five companies were reclassified from Enhancers to either Engagers or Enablers, and one company was added to the portfolio after meeting the necessary criteria. Additionally, 23 companies were removed, primarily due to the updated index methodology.

Reclassification

Alphabet, **Microsoft**, and **Amazon** were all reclassified from Enhancers to Enablers, reflecting their increasing roles as hyper-scalers providing AI compute capabilities and development platforms. These companies offer cloud services that enable enterprises to develop and deploy AI models. Alphabet's reclassification highlights its integration of Gemini into the Google Cloud platform, its Tensor Processing Unit (TPU) for AI model training and deployment. Microsoft's reclassification is also driven by its integration of OpenAI into the Azure cloud platform, supporting generative AI development, alongside its suite of AI products, such as the Copilot productivity tool and Copilot+ hardware. Amazon’s reclassification reflects its strategic investment in Anthropic, integrating Claude into its AI cloud services, along with its Trainium chips that aid AI model training and deployment.

Meta was reclassified from an Enhancer to an Engager due to its extensive delivery of AI services through its Llama large language model (LLM) and, more significantly, its advertising-supported social media platforms. The company uses advanced AI algorithms to efficiently and accurately match brand advertisements with their targeted audiences.

Symbotic was also reclassified from an Enhancer to an Engager as it strengthens its role in AI-powered warehouse automation. Its software showcases advanced self-learning capabilities, while its fulfilment robots fully automate operations using state-of-the-art vision and sensing technologies. Symbotic’s solutions, adopted by major retailers like Walmart, highlight its impact and growing importance in AI-driven warehouse innovation.

Addition

Astera Labs was added to the portfolio as an Enabler. Specialising in semiconductor-based connectivity solutions for cloud and AI infrastructure, Astera Labs’ products are critical for ensuring high-speed, reliable data transfer essential to AI workloads as models grow in complexity and size.

Deletions

Most of the portfolio deletions resulted from changes to the index methodology, with companies failing to meet revised market cap and intensity score thresholds. Five semiconductor enablers were removed due to low AI intensity scoring, highlighting the strategy's focus on more relevant and leading AI innovators. This ensures the index targets the most impactful semiconductor companies in the AI space.

Figure 1: Deletions due to the portfolio rebalancing in September 2024

Source: WisdomTree, Nasdaq, CTA, as of 23 September 2024.

Conclusion

The recent rebalancing of the WisdomTree Artificial Intelligence UCITS ETF reflects the evolving AI landscape and strategic updates to the index methodology. By refining company classifications and adjusting weightings, the index maintains diversified exposure to key players in the AI ecosystem. The reclassification of major companies like Alphabet, Microsoft, and Amazon highlights the growing significance of AI compute capabilities and cloud platforms. Additionally, the inclusion of companies like Astera Labs emphasises the rising need for advanced infrastructure to support AI growth. These changes position the ETF to capture future opportunities as the AI megatrend continues to unfold.

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