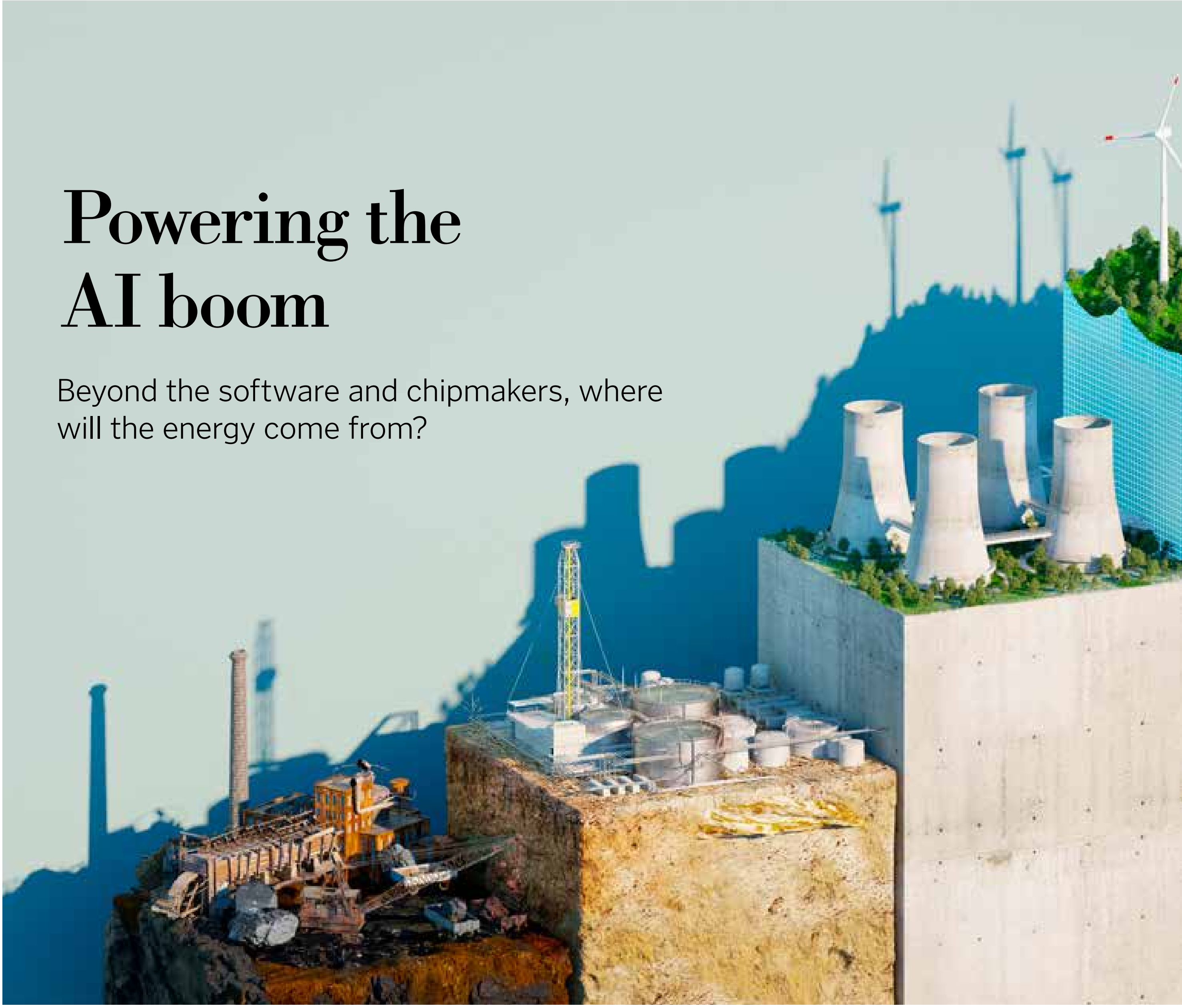


Powering the AI boom

Beyond the software and chipmakers, where will the energy come from?

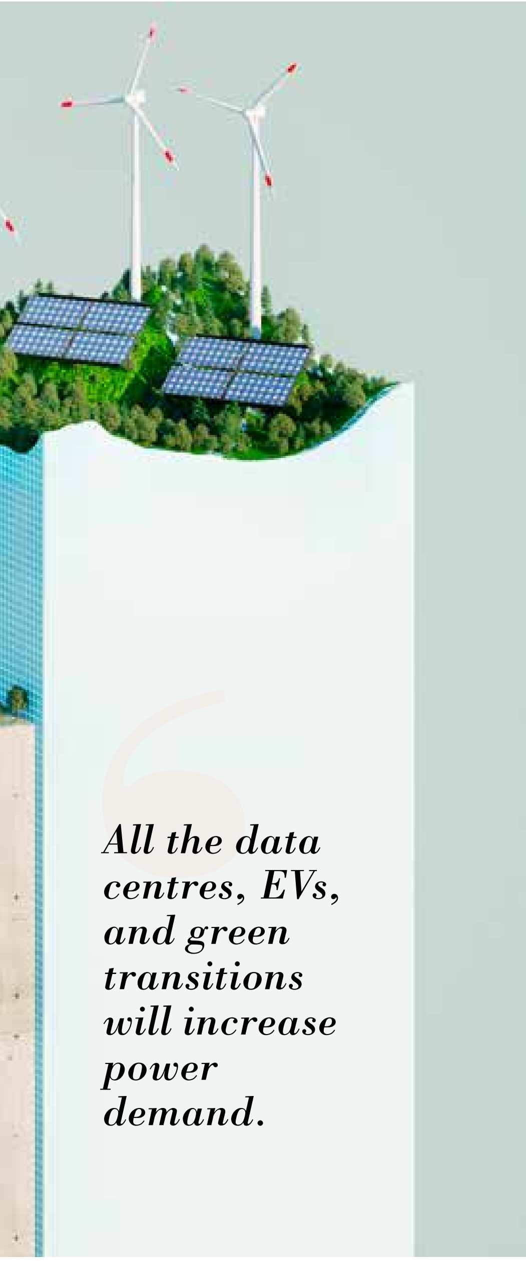
It appears global investors are waking up and suddenly realising – who is going to power the artificial intelligence (AI) demand boom? We know the software and chipmaker companies who will benefit from the AI boom, as reflected in their share prices. However, attention has, rightly, also turned to how we are going to provide the electricity to power this structural growth story given how energy-intensive AI is. The utilities sector is now catching investors' attention and we believe it will be an important theme over the medium term.

Utilities find a new life

The usually uneventful and boring utilities sector is getting some attention of late because of these types of questions. So much so that even rising long-term bond yields in the US have not disrupted the recent rally in utilities companies. Historically, there is a negative correlation between the two – that is, when bond yields rise, the share price of utilities falls. At the time of writing, the US Utilities Select Sector SPDR ETF was up 21.3% from its low in February this year, despite the US 10-year Treasury rate also rising over the same period. The Australian utilities companies have also caught the bug, with the share price of ASX-listed merchant retailers AGL Energy (ASX: AGL) and Origin Energy (ORG) up 22.6% and 21.8%, respectively, over the same period.

AI-boom thematic broadening

First, it is worth pointing out that the recent performance of utilities is not just about the AI theme broadening to the utilities sector. It also has to do with the recent quarterly earnings update



> *All the data centres, EVs, and green transitions will increase power demand.*

provided by the utilities companies listed on the S&P 500 Index – it was a standout performance with respect to earnings. However, the AI boom has also made its way to utilities, and this is where the future earnings growth potential for merchant utilities could see a material change.

At the end of the day, all the data centres, EVs, and green transitions will significantly increase power demand and, in fact, could materially accelerate it. Let's take the power required for data centres. AI is driving growth in global demand for data centre capacity. According to a recent presentation by Nextdc (NXT) – an Australian data centre operator – historically the global data centre market has grown at a +15% CAGR (compound annual growth rate) between FY17 to FY23, supported by digitisation and cloud migration megatrends. However, with the emergence of AI megatrend and the pace of adoption, the market growth rate is expected to accelerate to a +19% CAGR over 2024-27.

Ageing power grids

In a recent earnings call with the chief executive of US-listed Generac Holdings Inc (GNRC) – a manufacturer of automatic, stationary standby and portable generators – the chief executive noted: "The amount of power that will be drawn from those data centres will triple from the current levels that we're at today. It's almost the equivalent to adding 40 million households to the grid … the ageing power grid in the US is clearly not prepared for the future trajectory of power consumption needed to satisfy these converging trends."

Paying a premium

Recently we have seen global companies, such as Amazon, move to secure energy supply. Amazon recently agreed to purchase a data centre campus attached to the sixth largest nuclear power facility in the US and will reportedly take up 40% of the output of the nuclear facility.

Interestingly, this then reduces the amount of power that would otherwise be going into the grid for other consumers, which means that power will need to be sourced from other energy sources – that is, solar panels, wind turbines and so on. We see the potential for a capital expenditure boom in the utilities sector. ■

3 FUNDS TO WATCH

Munro Climate Change Leaders Fund

The fund is focused on creating a portfolio of climate winners that help enable the decarbonisation of the planet – those companies that are best positioned to champion and win from this structural change. The investment return objective of the fund is to maximise long-term capital appreciation, by investing primarily in a concentrated long-only portfolio of companies focused on decarbonisation and climate change located anywhere in the world.

T Rowe Price Global Equity Fund

The strategy aims to deliver long-term capital growth by investing primarily in a portfolio of companies that are traded, listed or due to be listed on recognised exchanges and/or markets globally. We believe the fund's approach to global equities (core, quality growth) is likely to yield solid absolute and relative performance over the investment horizon.

Utilities Select Sector SPDR Fund

The fund seeks to provide investment results that, before expenses, correspond generally to the price and yield performance of the Utilities Select Sector Index. The index aims to provide an effective representation of the utilities sector of the S&P 500 Index. It also seeks to provide precise exposure to companies from the electric utility, gas utility, multi-utility, and independent power and renewable electricity producers industries.

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