

AI: The Game-Changer of everything Including Investments

November 2023



Antonio Cavarero

Head of Investments at Generali Insurance Asset Management (GIAM)

Artificial Intelligence is able to handle an incredible amount of data and solve complex problems in a short amount of time: this will change the world in the same way electricity changed our society somewhere in the late 19th century. As its marginal cost decreases over time and given that it can be delivered virtually anywhere, it can be applied in an extremely wide variety of situations.

Like with the mass adoption of electricity, there is a “before” and there is an “after”: once people learned about the advantages of electricity coming into homes, shops and workplaces, there was no going back. There are several analogies suggesting that once artificial intelligence is widely adopted, it will change the world as we know it. And investments will be no exception.

Maybe this industry has been lagging behind, but there are all the elements for an acceleration of the adoption of AI in our business.

I ask myself three questions:

1. How will AI influence the investment process?
2. How will AI influence the assets where we invest?
3. What to do when investments meet AI?

AI as a tool within the investment process

AI can read the macro scenario...

AI-based tools can read into the fundamentals of the economy simply by being able to go through a gigantic amount of data and make hypotheses about the incoming scenarios, spotting, for instance, the early symptoms of a new macro trend or an underlying tension. This is something that we are already doing at GIAM and that we want to make even better by enlarging the set of data we look at.

...help to design the investments strategy...

The use of artificial intelligence can go beyond the mere design of the investment environment. We can also build and monitor the portfolio. AI can define the asset allocation that best fits into the

needs of that specific client, designing the optimized portfolio that offers the best decorrelation between asset classes, the desired expected drawdown and volatility and that can respect several additional constraints. This means being able to manage risk closer to the client’s perspective. Humans will still be the last decision makers, but their actions will be based on suggestions derived from a much wider and deeper set of data.

...build the portfolios...

There’s more: AI can build the portfolios, not only design them. We can analyze legal, ESG or credit documents en masse, we can check the newsflow and spot changes in market sentiment on a specific name, we can get very granular information about single companies, adding therefore a detailed and updated bottom-up view to the macro picture. AI

can also define the specific instruments that best fit into the wider strategy and that offer the best expected return, even tactically. GIAM is already working on this, looking at a very large set of data to extrapolate the desired credit portfolio.

... and monitor them.

Besides the investment activity, there is also the monitoring phase. AI-supported risk management can analyze the risk profile along the whole investment process, being able to connect different metrics and look for known patterns to apply and possibly provide for mitigation suggestions.

Artificial Intelligence is a tool, probably the most powerful we ever had, that will strengthen Human Intelligence: as such, the whole investment process is open to AI intervention, it will make it more solid and will offer a wider set of information and suggestions to the human decision maker.

AI as investment

Artificial intelligence is, obviously, an investment theme, the hottest and most fascinating on the street right now, but impossible to cover properly here. If I have to focus on something, I would look at the discussion about winners and losers.

The winners – the real winners are not born yet.

As the real winners of internet were not born 20+ years ago when it became popular, Airbnb or Facebook were simply not there. Today, the real winners of AI are probably a bunch of people somewhere in a garage, scratching their heads and thinking, “OK, what can we make out of this?”.

While waiting for these new names to emerge, we can try to extrapolate some conclusions. First of all, AI will make us more efficient and productive, it will allow savings and better allocation of scarce resources like energy, hence it will create wealth per se.

Then, among the many possible angles, I want to highlight those occasions where **exponential technologies are crossing and feeding each other,**

leading to results of a higher order of magnitude. Think about **biotech** or **pharma meeting with AI**: this will lead to the creation of new molecules in shorter time, cutting research costs, developing, for instance, new and better drugs or new tools to handle environmental problems. This is simply breathtaking.

The losers

On the other hand, **knowledge-based activities and media** are among the first in the line of fire. If knowledge, actually “all-knowledge”, is easily accessible via Chat GPT et similia, then all those businesses relying on an exclusive access to a specific knowledge will be put at risk as they can be bypassed, at least partially.

The same goes for media, because the access to content might be different, because content can be automatically built (AI can shoot a film) and, more worryingly, because AI-generated fake content might seriously undermine their credibility and disengage readers and viewers.

And do not underestimate an “**intelligent Siri**”, best example of an AI agent, i.e. a software able to interact with the environment and other machine learning based models to execute actions and achieve goals following your orders.

Imagine Siri sitting in your phone, able to book your holidays. “Hey Siri, I want to go on holiday in Greece, 3 weeks from August 15th. I want to go to this and that place, you know my taste about hotels because you know everything about me. Please find something and, if you think I like it, book planes and hotels and also rent a nice convertible car”.

This means **changing consumption behavior** and cutting out some players. You can also ask your Siri to continuously check for the best phone contract or the best return for your bank account and, as soon as a better option emerges, simply switch into the new one. Mechanically, higher and continuous competition will take its toll on some players because of more efficient, automated and intelligent tools

sitting in our phones. By the way, in the medium-long run higher competition and the already mentioned productivity increase will have **disinflationary effects**.

The "winners in any case"

There are, however, those who will win in any case, with some of them clearly successful.

Think of a world where hundreds of millions of users, maybe via a simple smartphone, interact countless times each day with AI-based processes for a wide range of activities: the networks, the data centers, the calculation capabilities needed to serve that gigantic number of requests will need massive investments up to an extent that is difficult to anticipate. This explains Nvidia & Co.; this explains the focus on chips and the geopolitical tensions about them.

Not only are "chips are the new oil", but also better computational capabilities will be crucial, like quantum computing: expanding from here, introducing IoT and a wide usage of sensors to link with the physical world, we can see widely connected networks of artificial intelligence agents. It's a brand new world that needs lots of investments. It will take some time, but not as much as you think. So, **focus on the infrastructure**.

Investments meet AI

It is important to deal with some "managerial" aspects of AI as we need to insert it into our processes and make it work with our people.

AI is moving from a "nice to have" to a "must have". It is an historic opportunity for the believers, it is an existential threat for the others. You cannot stay out of it. We should take the low hanging fruit to accelerate the implementation of AI. The more you use it, the more you will use it.

Cooperation and calibrated trust. AI will provide suggestions to human decisions but, especially for the bigger ones, won't be allowed to take them. AI can easily take over smaller tasks and, in order to increase confidence and to allow some supervision, it will provide the human user with the context and the logic behind the action that is being taken. No black box.

The integration of artificial intelligence tools. We need to use AI as much as we can in all processes without taboos. We need to learn how to integrate the current offering of AI tools in our processes. Chat GPT has changed the scenario as now we have cheaper alternatives to some instruments that we were building on our own. **Widely accessible AI tools have shifted the "make-or-buy" frontier**, forcing everybody to reevaluate more frequently what are the initiatives, where to invest time and money to build, and where we simply buy the product outside. And this frontier is moving fast. This has important consequences on planning activity: on the one hand, it cannot be erratic but, on the other, it needs to quickly recognize the changes in the tech landscape to **focus resources where they can really create corporate value**. Integration also means that we need to solve some obvious **confidentiality** issues: sharing information with a platform that we don't fully control implies problems that everybody needs to be aware of. However, as staying out of AI is simply not an option, there are and there will be tools and policies providing the adequate solution.

I am really excited by the introduction of AI, a tool that will help (but not substitute) humans in the most important decisions, that will open new scenarios inside and outside the asset management industry. The age of Artificial Intelligence & Human Intelligence is in front of us.