RESEARCH NOTE

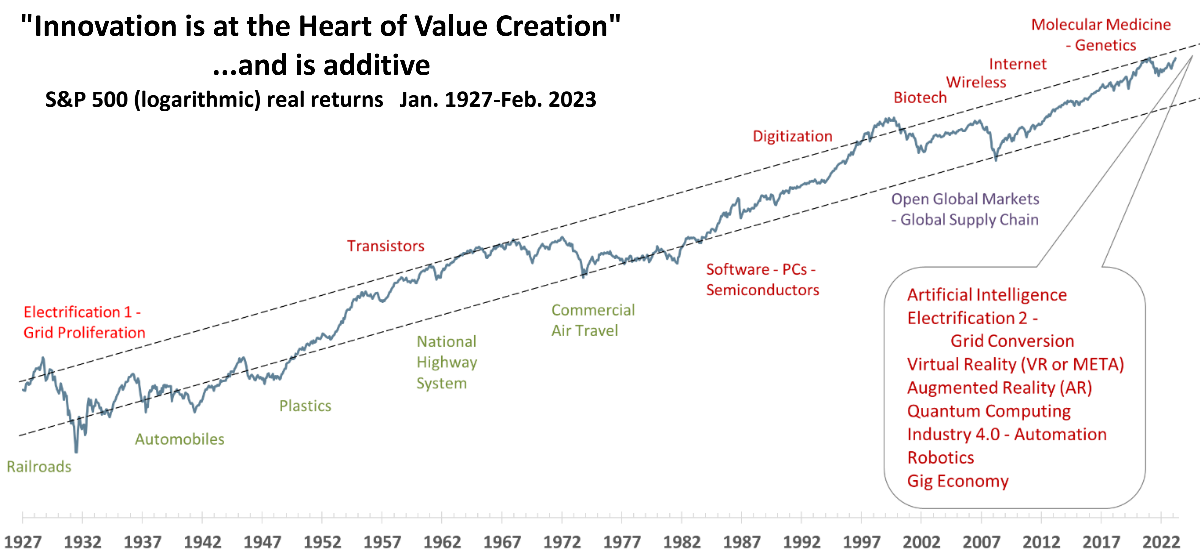
JUNE 18, 2024

CAPITAL ADVISORS

Enabling Innovation Investment Strategy

Enabling Innovations

Innovation is the heart of value creation, and we believe there is currently a historic cluster of "enabling" innovations. We define the term as innovations that drive significant value creation across the entire economy. The chart below illustrates such an enabling innovation map.



Our primary goal is to identify companies that can help shape the development of each innovation with excellent management teams, strong balance sheets, and uniquely valuable business models. For example, **NVIDIA (NVDA ~$130)** remains uniquely positioned to shape artificial intelligence's (AI) development curve from a technological perspective. Companies with major platform business models, such as **Microsoft (MSFT ~$448)** and **Apple (AAPL ~$216)**, can influence how companies and consumers use AI.

If we own these types of companies early enough, their value can increase significantly. In such cases, we balance realizing the value of these trends while controlling risk and meeting each strategy's objectives. For instance, in *Managed Equity Growth*, the primary consideration would be overconcentration. In *Managed Equity Dividend*, we also heavily consider the position's cash distribution and yield.

AI is only one of the major enabling innovations we believe are coming online within the global economic system. There are potentially major enabling innovations in the chart above that are in the visible window but are not yet in the initial, universal acceptance phase; for example, robotics, augmented and virtual reality, and quantum computing.

AI Investment Strategy

We segment AI's value creation pie into four slices and expect the stock market could realize value in very roughly the following order. The Managed Equity Strategies have material concentrations in the first three; our present new addition focus is the fourth.

1) Technology Pioneers can shape the development of AI by controlling its core technology. NVIDIA's visionary, near-dominant AI chip technology is an example, as are **Broadcom**'s **(AVGO ~$1806)** chips, which control AI data center information flows.
2) Activity Hubs own the technology platforms that capture the value of many companies' AI investments and innovations. Microsoft's *Azure Cloud* and *OpenAI* ownership are examples, as is Apple's phone, computer, software, and cloud service ecosystem.
3) Infrastructure Enablers provide the technologies and equipment necessary to build out the AI infrastructure. For instance, the International Energy Agency (IEA) expects data center energy demand to more than double from 2022 to 2026, roughly reaching the electricity consumption of Japan.[1] A few of the *Managed Equity* examples include **Eaton (ETN ~$325)**, a leading power management company for the entire energy grid and a major player within data centers; **Constellation Energy (CEG ~$212)** which has contracts to provide power to data center clusters; and **GE Vernova (GEV ~$169)**, which supplies a variety of equipment and services to support the energy grid.
4) Power Users significantly enhance their business models by incorporating AI uniquely well. We expect current holdings like **Intuitive Surgical (ISRG ~$430)** and **Medtronic (MDT ~$80)** to be standout beneficiaries in the long term. We also expect corporate spending to re-orient in favor of consultants, such as **Accenture (ACN ~$286)**, that help companies invest in AI more wisely and use it more effectively.

When enabling innovation stocks appreciate significantly, we may de-risk by trimming them to a core position as long as the fundamental outlook remains strong. With dividend stocks, strong price appreciation means the yield could decrease significantly. One example is **Broadcom**, which had a 4.7% yield when we added it to *the Managed Equity Dividend Strategy* and now yields 1.2% despite strong annual dividend increases. A typical account that acquired Broadcom with the *Strategy* in 2021 has made back the initial investment plus 50% through such trims and still owns a position worth nearly double the original investment. The position also returned another 10% of the initial investment in dividends. Similarly, **Eaton** had a 3.5% yield when it entered the *Managed Equity Dividend Strategy* and now sports a 1.2% yield. Portfolio management trims covered the initial investment plus 20%, and the remaining core position is currently valued at 70% of the initial investment. The holding also returned nearly 10% of the initial investment in dividend cash.[2]

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[1] International Energy Agency. (2024). Executive Summary – Electricity 2024 – Analysis, https://www.iea.org/reports/electricity-2024/executive-summary

[2] Source: Orion & Charles Schwab Advisor Center representative account. *Managed Equity Dividend* added $2,827 of AVGO in the representative account on June 11, 2021. Trims on May 31, 2023 and June 17, 2024 returned $4,220; since June 11, 2021, the position generated $296 in dividend cash. The remaining holding was valued at $5,440 on June 17, 2024. Similarly,

Disclosure

Managed Equity Dividend added ETN $3,140 of ETN in the representative account on February 19, 2019 and added $589 on August 2, 2022. Trims on June 9, 2020, October 19, 2021, and September 12, 2023 generated $4,510; since February 18, 2019, the position generated $327 in dividend cash. The remaining holding was valued to $2600 on June 17, 2024.