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# Let's Talk Evolution: AI's Evolution

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## Let's Talk Evolution: AI's Evolution

The evolution of AI mirrors the growth of cloud computing, progressing through three distinct waves: (1) foundational infrastructure; (2) the shift to software; and (3) widespread, real-world applications across industries like defense, automation, and energy.

While semiconductor companies drove initial AI growth, market trends show a shift toward software and practical AI applications. The second wave is marked by increased adoption of AI-driven software, while the third wave focuses on integrating AI into diverse industries, creating opportunities for new market players.

As AI evolves rapidly, active portfolio management is crucial. Unlike mature sectors where passive strategies might work, the dynamic nature of AI requires investors to identify emerging companies early. The key to capturing AI's potential lies in anticipating industry shifts and adapting investment strategies accordingly.

Think of a city being built from the ground up. The first things that must be built are roads, bridges, and power grids – the foundational infrastructure. Once these are in place, businesses start emerging and before you know it, an entire skyline takes shape atop the original infrastructure. The evolution of artificial intelligence (AI) follows a similar pattern. It began with the foundational infrastructure, hardware and semiconductors, which powered initial breakthroughs, followed by the second wave: software, cloud-based AI models and enterprise adoption. Now, the world is starting to experience the third wave, where AI shifts from being “just a new technology” to having widespread application in different industries and embodying new opportunities. Each stage unlocks new layers of economic potential, and for investors, this shift is not just about recognizing AI's growth, but also about understanding where value is being created at each stage.

**It is interesting to see how the adoption of AI mirrors the one seen by cloud computing in the early 2000's.** In the first stages of cloud computing's adoption, there were four big tech giants that laid the groundwork for the cloud: Amazon with AWS, Microsoft with Azure, Google with Google Cloud, and IBM

with IBM Cloud. These companies became the dominant forces which created the infrastructure on which an entirely new industry would emerge. Once the foundation was established, software developers capitalized on it by creating cloud-based applications that rapidly transformed sectors like finance, healthcare, and logistics.

AI is now experiencing a similar evolution. The first wave established the infrastructure, with large semiconductor companies providing the raw computational power needed for AI breakthroughs. **But as with cloud computing, the initial infrastructure boom is giving way to a more complex and layered economy. The real value is shifting from pure hardware to software and, eventually, to real-world applications.**

The first wave of AI took over the world in late 2022, when OpenAI launched ChatGPT and caused the demand for AI-specific hardware to rise. Semiconductor and GPU companies became the backbone of AI's expansion. Markets rallied and semiconductor companies such as NVIDIA and ASML experienced exponential growth in their market caps. NVIDIA's stock alone surged over 239% in 2023, as demand for AI chips outpaced supply. **The industry saw billions in capital inflows, and even though global startup investment declined 38% from 2022 to 2023, AI related venture funding increased 9% reaching USD 50bn.**

This phase was essential, but much like the cloud computing infrastructure-driven wave 25 years ago, the market eventually started plateauing. AI hardware is now reaching a similar point. Companies such as Micron Technologies, ASML, and Advanced Micro Devices have experienced volatile downtrends in their stock prices since mid-2024, confirming that the fast gains of semiconductor companies are not indefinitely sustainable, and that the market is shifting its focus to a new phase, exploring what can potentially be built on top of these foundations. Also, it

is important to keep in mind that the companies that dominated the first wave will not necessarily lead the next one. **Investors who focus exclusively on semiconductors run the risk of missing the broader evolution of AI-driven industries.**

Once the foundation needed to run AI was in place, the second wave has emerged, shifting the focus from hardware to software. With this, the world has started to view AI not just as a research tool but as something that businesses can integrate into their operations and capitalize on. Software companies like Snowflake, Palantir, and Cloudflare are important players that have been able to ride and adapt. **They are refining the way AI processes and manages information by building platforms, models, and tools to adopt AI across industries. In other words, they are using AI models to extract useful and insightful information from data.**

Furthermore, Palantir is a prime example of how the demand for these AI software models is increasing. Specifically, the company has seen a sharp rise in demand for AI-driven data analytics in the defense sector. For instance, according to Palantir's Q4 2024 earnings call, management stated that the revenue stemming from doing business with the US government grew 45% YoY. Even if the U.S. government cuts its defense spending, this gap may be quickly filled by Europe, as it attempts to ramp up its own defense spending.

Software is a sector in technology that is gaining steam, and it is important for investors to keep an eye on potential AI software companies that may emerge and eventually become great competitors. However, while these AI software companies structure the data and make sense of it, it does not apply AI directly to build autonomous military technology. That is where the third wave begins, and it is important to understand that **there is an overlap between the second and third waves; they are not mutually ex-**

clusive, instead, we are seeing them co-evolve.

The third wave is the moment where the tangible AI application becomes a key factor across many industries. This stage is about the market application of AI, as well as those industries and companies that will benefit from the adoption and growth of this technology. Companies in defense, automation, and energy, among others, will begin to leverage AI to develop new products and enhance efficiency and productivity. This in turn will increase market competition and open a space for smaller names to flourish.

In defense, for instance, AI is shifting from intelligence-gathering to real-world applications in military hardware. Companies like Lockheed Martin, Rockwell Collins, and Anduril are developing AI-driven fighter jets and autonomous systems that will fundamentally change how modern warfare is conducted. This is a significant leap from the second wave, where AI was primarily used for data analysis. Automation is another key area of transformation. AI is advancing industrial robotics, with companies like Honeywell leading the way. These developments are set to redefine manufacturing, logistics, and even consumer technology.

The energy sector is also being reshaped. AI's power demands are immense, and existing infrastructure is struggling to keep up. This is driving a renewed focus on nuclear energy, which offers a stable, long-term solution. Next-generation nuclear reactors are gaining momentum, with AI-driven energy management systems making them more viable.

Infrastructure development is another critical piece of this wave. Data centers, essential for AI's continued growth, are reaching capacity. Companies like Meta, Google, and Microsoft have acknowledged that server shortages are limiting AI expansion. The construction of new data centers is becoming a high-priority investment area.

This third wave is broader than just AI companies. It is expanding into industries that will integrate AI into their operations and widen the competitive landscape. Unlike the first wave, where a few dominant players like NVIDIA controlled much of the market, this phase will most likely see a wider range of winners.

With AI evolving at such a fast pace, active portfolio management of a technology strategy is essential. Unlike more developed sectors, where passive investing strategies can be effective, the AI sector is defined by constant disruption and innovation. **It is very likely that the companies leading today will not be the leaders of tomorrow, and as AI expands into different industries, investors must anticipate those shifts.**

We have seen ecosystems evolve before. It happened with cloud computing; it is happening now with the waves of AI that ebb and flow. The market does not necessarily have every outcome priced in, but what we do know is that being ahead of the curve, looking for those potential bloomers that are yet to flourish in the industry, is what can create value for investors' portfolios.

Consider how NVIDIA went from a gaming GPU company to an AI powerhouse, or how Palantir evolved from a defense contractor to a major player in AI-driven analytics. These companies succeeded not because AI was growing, but because they adapted at the right time. The next phase of AI should follow a similar pattern. **Having a dynamic strategy managed by a team of professionals who are actively looking for these new emerging players is an attractive alternative to capture AI's full potential. ■**



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