



Morningstar Global Next Generation Artificial Intelligence Index Frequently Asked Questions

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Index Overview

What is the objective of this index?

The Morningstar Global Next Generation Artificial Intelligence Index is designed to deliver unparalleled, thematically pure exposure to companies involved with leading-edge artificial intelligence (AI) technologies, including generative artificial intelligence and adjacent products and services, by drawing on the in-depth knowledge and forward-looking insights of Morningstar's equity research team.

How does Morningstar define “next generation AI”?

Morningstar uses the term “Next Generation AI” to capture innovative technologies that transcend traditional AI use cases. Generative AI, the use of AI to create original content, is currently the AI-related technology with the most potential to be transformational. As artificial intelligence evolves, the exposures targeted by the index may also evolve with the emergence of new subthemes.

How does this differ from a traditional technology sector index?

While firms involved with artificial intelligence products and services disproportionately come from the technology sector, Morningstar applies a high bar

for thematic relevance that most technology stocks do not meet. So, although the index tends to have heavy exposure to the technology sector, its composition and performance tend to be quite different from a traditional market cap-weighted technology sector index. The Morningstar Global Next Generation Artificial Intelligence Index does not reference traditional sector classifications and may include stocks in other sectors as well.

Investment Case

What is the investment case for investing in producers and suppliers of AI products and supporting infrastructure?

Artificial Intelligence (and subsets of AI, such as Machine Learning and Deep Learning using Neural Networks) is one of the most exciting opportunities across the investment landscape. It has the potential to transform many businesses and change how consumers interact with the world. AI can automate repetitive tasks, making employees more efficient and productive. AI may also provide insights and detect patterns across vast amounts of data, more so than what humans have been able to detect in the past. This creates inroads for downstream users to improve operating efficiency and product quality. In turn, this

may provide attractive opportunities to invest in companies involved in producing these technologies as well as the supporting infrastructure.

With rapid advances in technology, should investors be concerned about today's AI leaders losing their leadership position over time?

While the AI landscape is rapidly evolving, some companies are better positioned to benefit than others. Nvidia is closest to being a “pure play” AI company across the large-cap technology space. A wide variety of companies are investing in models, software, and infrastructure to support Large Language Models (LLMs). However, all LLMs require cutting-edge semiconductors called accelerators to handle the parallel processing needed to make billions of calculations per inquiry. Nvidia's graphics processing units (GPUs) are by far the industry's best and most viable accelerators today.

But even leaders, like Nvidia, are not immune from competitive threats. GPU competitors (AMD, Intel), startups (Cerebras), and even Nvidia's customers (Google, Amazon, Meta Platforms, Microsoft) aspire to build accelerators to handle at least a portion of LLM workloads dominated by Nvidia today. In software, Generative AI breakthroughs are occurring rapidly, so it is very likely that today's trailblazers may not sustain their leads in the years ahead. This underscores the importance of a forward-looking approach when assessing thematic exposure.

How can companies involved with AI build durable competitive advantages?

Generative AI requires massive computing power and significant software and infrastructure design expertise. Companies that carve out durable competitive advantages, or economic moats, should have intangible assets via their considerable design expertise in these areas, which start-ups would struggle to match.

We will also likely see cost advantages for large cloud companies that are able to outspend others to buy AI servers and rent this computing capacity out to its customers.

Finally, once customers have built their LLMs or integrated AI software, we expect to see some companies benefit from high customer switching costs. In these cases, software customers should be very unwilling to incur the time, effort, and/or financial cost to move away from existing software and tools to other platforms.

Index Construction

How does Morningstar assess each company's exposure to the AI theme?

Morningstar equity analysts consider four criteria when determining a company's thematic exposure to a given theme: current % of companywide revenue, projected % of companywide revenue five years forward, probability of the thematic exposure driving a material net profit increase over the next five years, and the company's role in the supply chain for related products/services. These analyst inputs are routed through a decision tree to determine a company's thematic exposure to each sub-theme within the index, with sub-theme exposure scores ranging from zero to four. Ultimately, the higher the company's exposure to the selected sub-themes, the more likely it will be included in the index.

How does this approach differ from others?

The Morningstar Global Next Generation Artificial Intelligence Index leverages forward-looking insights from Morningstar equity analysts in order to provide a high degree of thematic purity. This differs from lower-touch thematic index construction approaches, such as relying on historical revenue figures or keyword searches across public filings. However, due to the index's objective rules-based construction methodology, it also differs from strategies that employ

more “active” approaches to stock selection by bringing transparency and discipline to the portfolio construction process.

What determines eligibility for inclusion in the index?

Constituents are derived from the Morningstar Global Markets Index, which covers developed and emerging market stocks representing the top 97% of the global investable market by market capitalization. To be eligible for inclusion in the Morningstar Global Next Generation Artificial Intelligence Index, companies must have a thematic exposure score of 1 or higher on at least one of the four subthemes, indicating that they will likely be net beneficiaries with at least 10% revenue exposure to the theme five years forward.

What subthemes does this index target?

The index targets four subthemes:

Generative AI: This involves the creation of original content. Large Language Models (LLMs), such as ChatGPT, are a type of Generative AI model that focuses on producing human-like text.

AI Data and Infrastructure: This encompasses the various technological components needed to manufacture, design, maintain, host, support, and improve AI models. These include semiconductors and data center infrastructure.

AI Software: This includes enterprise and consumer software that incorporate AI models to enhance the user experience and/or improve efficiency.

AI Services: This includes consultancies and outsourced business process companies, which may aid businesses in implementing AI.

How are stocks ranked for inclusion in the index?

Consistent with its emphasis on next generation AI, the index is designed to favor the generative AI subtheme, which has the potential to be more transformational than traditional AI models that solve specific tasks or

make predictions based on existing data. Companies that receive a score of 1 or higher on the generative AI subtheme are assigned to tier 1. Those that receive a score of 0 on generative AI, but a score of 1 or higher on at least one of the remaining three subthemes are assigned to tier 2. Tier 1 stocks are targeted for inclusion before tier 2 stocks. Eligible stocks are ranked on their thematic exposure scores within each tier and the top-ranked 50 are included in the index. Where there is a tie, current index constituents and smaller-cap stocks are favored.

Do analysts have discretion to select stocks for the index?

The insights of Morningstar equity analysts determine the company-level thematic exposure scores and, in turn, these scores determine which stocks are eligible for index membership. However, beyond the thematic scoring process, equity analysts have no discretion regarding stock selection. Analyst-driven thematic exposure scores are implemented through a transparent, rules-based index construction methodology that aims to maximize thematic purity.

How is the index weighted?

The index constituents are weighted by float-adjusted market capitalization. However, the weightings are adjusted, if necessary, to ensure at least 80% of the index is allocated to stocks with meaningful exposure to generative AI (tier 1 stocks). Additionally, the top constituent weighting is capped at 10%, while constituents with weightings above 5% may not sum to more than 40%.

Are there any sector or regional constraints?

Thematic purity is the primary objective of this index. As such, there are no constraints on sector or regional weightings.

How often is the index updated?

The index is reconstituted once per year, in December, and rebalanced quarterly, after the close of the market on the third Friday of the last month of each quarter.

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