

MARKET COMMENTARY – June 1, 2024

There's gold in them thar hills. ~ Mark Twain (from M.F. Stephenson)

No slouch when it came to turning an original phrase, Mark Twain could even take the mundane utterance of a humble geologist and spin, well, gold. Literature gold.

Matthew Stephenson was a geologist in Georgia during a small gold mining boom in his state in the 1840's. In 1848-49, when gold strikes in California spurred a massive rush westward for thousands of would-be Miner '49ers, he assembled several hundred men in the town square of Dahlonega, Georgia. Encouraging the men to stay put, Stephenson pointed outside town and said, "In that ridge lies more gold than man ever dreamt of. There's millions in it."

Stephenson's misguided plea fell on deaf ears. Those men who moved to California from Dahlonega later told the story to Mark Twain who reformulated the quotation for one of his characters in his 1892 novel The American Claimant. "There's gold in them thar hills. There's millions in it."

From the gold rush currently running in artificial intelligence circles, it is clear investors believe there to be a mother lode just waiting to be mined. We think they are correct. But we mustn't forget that pinpointing the vein and then extracting the ore is the hard part. As the English proverb goes, there's many a slip 'twixt the cup and the lip.

Early winners of the AI revolution can be placed into the shovel category, thus named after another quotation attributed to Mark Twain. "During the gold rush, it's good to be in the pick and shovel business." Initial leaders in this class include Nvidia & Broadcom (chips), Super Micro (servers), Vertiv (cooling), Eaton (power management), and others. The first four have demonstrated massive sales growth as they build the infrastructure of this new industry from scratch. One rightful concern for this high-multiple group is sustainability. How much is demand getting pulled forward? And will there be an air pocket of empty demand on the other end?

Yet, despite the uncertainty in the shovel group, it pales in comparison to what we face in the creators of and users of AI. The great challenge for investors is predicting just what AI business models will look like at scale. One thing for certain is that unlike traditional software companies, the models underpinning generative AI are radically expensive to build. It is too early to tell what the industry will resemble, let alone who will remain alive. And so, we are left with rampant speculation across a broad swath of established and new companies.

Currently, there can be no simple shovel-like category in which to place this next batch of companies because it is difficult to predict just how they may eventually make their revenues. They consist of chatbots using large language models from providers like OpenAI, Google, Microsoft, Anthropic, and Perplexity. Meta, Amazon, Adobe, ServiceNow, and a hundred other software providers are currently utilizing AI to streamline their offerings, to make them more intuitive, predictive, and efficient. Cybersecurity software providers will employ AI to thwart attacks at the front end. Power companies will need to vastly increase generation and transmission to fuel server farms, but they will also utilize artificial intelligence to secure the grid as well as better time supply to demand.

In addition to the above are the companies that have yet to find their AI niche. This is truly a mixed bag. For example, Imbue, a start-up recently valued at \$1 billion by early investors, is two years old. While it hopes to develop autonomous AI agents (whatever they are), Imbue currently has no product to sell. Inflection AI, funded by Bill Gates, is nearly out of business after key employees left. AI start-ups Jasper and Tome recently laid off staff when growth didn't materialize. Character AI and Magic AI are start-ups that have raised over \$100 million but have no revenues. Cognition AI was founded just this year. It raised \$21 million in March. It, too, has no revenue. Its latest funding round values the company at \$2 billion!

As we wrap up our discussion of this modern-day gold rush, we're reminded of a sage of yore who, though he lacked the wit of Twain, demonstrated ample wisdom during his days in the early Roman Empire. Seneca said, "Fire is the test of gold; adversity, of strong men." Like fire beneath the crucible, the unforgiving marketplace will refine the companies above, start-ups and experienced alike, purifying the ore into a glittering sun. Or else the high temperatures will prove which are dross – to be discarded and forgotten.

And so, pickaxe in hand, let us bravely and circumspectly invest away.

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Sincerely
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