Intelligence, Raccoons & Shiny Things

We can imagine the warbling music of an old black-and-white film in a seventh-grade classroom in 1968. As it rachets and skips through the intro music, the voice-over begins, “Mr. Raccoon’s predilection for shiny things is well known. His insatiable fascination with reflective things is not fully understood by scientists. Mr. Raccoon is not alone in his obsession with shiny things, though. Mr. and Mrs. Jones have a brand-new Buick and a shiny new toaster here in Suburbia, Illinois.” Turns out, people, like raccoons and monkeys can’t help but be intrigued with the new and the shiny.

The acclaimed economist and thinker John Kenneth Galbraith often implied that few things are as dangerous as the human attraction to and fascination with new, novel (*shiny*) things, asserting that:

> “The public is captured by the attraction of the new, by the seeming brilliance of what has not been tried before.”
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> “Each new era is invested with the belief that its innovations are exceptional, unprecedented, and uniquely wise.”
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> “This time, as so many times before, is declared different because of the new instruments, the new institutions, the new men.”
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> “Past experience, to the extent that it is part of memory at all, is dismissed as the primitive refuge of those who do not have the insight to appreciate the incredible wonders of the present.”

This general tendency, while relatively easy to understand and comprehend, is less easy to evaluate in terms of its relative constructive or destructive implications for investors. To be sure, in science, astronomy, exploration, entrepreneurship and many other fields, curiosity is the fuel of endeavor. New worlds, vaccines and planets owe their existence to the curious. In all the promise of today’s world, it is hard to imagine the hope and excitement that must have accompanied the European discovery of a literal New World in the Americas. No idea in technology today could compare to the idea that virtually half of the undiscovered planet awaited - rich with life and alive with riches. A new world did, in fact, come into being and, as it did so, the East India Company, the West India Company and the South Sea Company alone are said to have lost somewhere in the vicinity of $24T in today’s dollars in the process. In due

time, the whole of the European powers' investments in the colonial system and the great foray West was largely lost.

It would be reasonable to question how so much capital was attracted and deployed to such endeavors given their substantial, inherent riskiness. Just as we are witnessing today, beyond the spectacle of grand gestures and promises, there was legitimation. If some hapless sailor had happened upon the idea and tried to solicit investors in such an ambitious enterprise, he would likely, of course, have been laughed off the dock. If, however, some certain sailors and adventurers were able to gain the support of the royal court, a prominent merchant or two, might his effort be deemed to have some legitimacy? Today, we have no less than world leaders and the scions of tech thrusting their support behind the AI frontier. It is a pattern as old as time - investors seeking the implicit endorsement of the smart, the wealthy and the powerful to validate their hopes.

Five hundred years after the Europeans sought to reap the riches of a new world, we are assured that there is, yet, another new world of vast riches, health and prosperity for all. It is ours for the taking. AI, we are told, will more than justify investments in the trillions. It will make good on the enormous amounts of natural gas, coal, uranium and fresh water we must feed our power plants to keep the thriving dream machine alive. Yet, an apparently inadequately moderated ChatGPT (which apparently lacks a self-preservation instinct) has told me that, based on the quit rate of users and pricing models extant today, the business model is unsustainable. This as we are told by the leaders of the field that it must simply be built in order for us to truly understand how it may be used and monetized. And, as often been the case with new technologies, if we cannot understand the promise, we are told that we must be hapless dolts destined to dwell in antiquity who simply cannot understand the technology nor its promise. If only we were smarter and more hip to technology, we could see the promise and appreciate their vision. This is not a critique of the technology. It is a critique of the venture. It is an appeal to caution and prudence. After all, had the Spanish crown known that all their conquests would eventually destroy vast wealth, they most probably would have put their money into more windmills, now all the rage in Europe.

The questions frequently arise: What is AI really? Should we be invested in it? One has to ask, if I were a queen would I bet my throne? If I were a supplier to Westbound vessels, would I require payment in advance or rely upon the possible return of a treasure laden vessel? Society very often does benefit in the long run from many such endeavors, but, as an investor, the question to consider is if and how you will benefit. If I am to finance this endeavor, what is my payback period? How liquid will my investment be? May I sell it to another investor later at more or less? What is my IRR versus what I could make selling my wares here in Amsterdam relative to selling them in New Amsterdam? It is the very same endeavor sold in the bright, shiny wrapping of the overarching tech narrative.

Will some things change due to AI? Yes. Will the world tilt on its axis as promised? Doubt it. Investors naively smitten by the cultural narrative that radical technological innovation itself has been the driver of great wealth generation should ask themselves if they can name the

companies in 'actual' technological innovation which have: A) been incredibly profitable; B) done so through the development and introduction of truly new technology within the computing space; and, C) earned consistent reliable profits over time. Timekeepers, start the clock. I dare say that most cited AMZN, GOOG, META, NFLX, AAPL, MSFT, NVDA. Now, strike the first five. AMZN, GOOG, META, NFLX are not even categorized as tech in the widely cited indices, as they are recognized as companies whose value is derived through activities that are consumer discretionary, communication services and the like. AAPL, while still categorized as tech, is effectively a mobile phone company. The point is not to quibble with sector alignment or whether technology, as commonly defined, is present in their businesses, but to point out that their success, in most instances, has been the product of branding and marketing rather than the development of radically new technology. Some might also say that monopolistic tendencies also play a role, but that can be left to another discussion in another European court proceeding. These companies, collectively, owe a lot of their capital formation to the fascination with newness and their cultural and brand association with the tech narrative which grants them excess rents. This is similar to Soros' contention of reflexivity, wherein he suggested that things believed can effectively cause outcomes.

Another short exercise will help highlight our misperception about technology companies per se. Consider, for example, that Yellow taxis were long hailed on the street or by phone, after which Uber drew your ride on your phone. Same service, different delivery. Freight carriers, specifically Yellow Freight and Dial-A-Truck are credited with first using electronic dispatch long before Uber. So, Uber hardly invented the tech. Same with the NFLX which did not invent streaming. Real Networks is widely considered to have been the first in the field. The earliest commercial browsers were from Mosaic and Netscape. First gas-powered car? Duryea. First electric car? Tesla? Nope, William Morrison, Iowa 1890. First commercial satellite, Hughes Aircraft. First telegraph, Western Telegraph. The objective lesson is that our fascination with tech and innovators dominates decision making. It must be remembered, however, that pioneers and innovators die at a merciless rate.

Let's have another quiz. Match the company on the left with the company on the right:

Sears Roebuck Catalog	Blockbuster
Apple	Yellow Taxi
Netflix	Amazon
Rand McNally Atlas	Google Maps
Uber	AT&T

Today, we are fascinated with AI. The list above highlighted tremendously powerful businesses which did not deliver the bleeding edge of technological innovation. They simply capitalized largely on a delivery channel based on new, but existing technologies. If you really wanted to

delve into the bleeding edge of tech development, we could produce a list of hundreds of companies about which you have never heard. Real technologic innovation development is very difficult and profoundly expensive to create and even harder to defend in many instances.

Today, the AI narrative is running on the notion that it creates a fantastic, unbelievable world of possibilities. Like the merchant at the port of Lisbon, you would do well to wish to be paid in advance. Paying a very high price to stake your claim against the future abundant treasures to be culled from the new world like the queen could risk leaving you scouring the castle for what is left of your royal treasure. Frontiers are intriguing places about which to read, but somewhat less endearing places in which to reside or scratch out a living. I have often imagined what it must have been like on a dusty wagon train with the family incessantly asking, "Are we there, yet?" And, later, "No, I mean this is not really it, is it?"

Unlike early colonists or settlers of the West, with AI, we neither know precisely where we are going or roughly how long it will take. The whomevers who promoted train rides out West in the 1880s or to Florida's promised land in the 1920s made grand promises to investors/speculators that ended in some of the most spectacular real estate busts in young America. AI promoters are now squeezed into a difficult dilemma between expectations and reality. Consider for an instant that throughout your life you have been admonished that computers do not make mistakes. And, that has a substantial amount of truth to it, because, heretofore, we have asked computers to spit out facts based on other facts. Now, we are endeavoring to do something else. We are asking it to think. Conclusions and decisions are based on assumptions and inputs, but also require inferences and deductions based on those facts, presumed associations and relationships among facts and, sometimes, even speculation.

So, we benchmark our future expectations for artificial intelligence based on our experience of having had nearly flawless outputs. All intelligence, however, must, necessarily, assume correlations, associations and relationships that may or may not be persistent or even true in any specific instance. As such, anything that 'thinks' is prone to mistakes. And, so it happens, AI makes mistakes and plenty of them. They can be anywhere from irrelevant and innocent to catastrophic or potentially malevolent. Consider the implications of that. An AI system could, for example, find that every human taken off their cancer drug for a three-year period survives. That very well could be true. Does it make it a reasonable decision for your new AI doctor? Each time a president has been inaugurated in brown shoes, it could be found, the market performed in a certain way. An AI financial decision system could conclude that investors should be all-in in such during an administration of a president inaugurated in brown shoes. An AI loan officer could even conclude that people of a certain height present better or worse credit risks. In all such cases, it would be hard to adjudicate such decisions as logically flawed

on the basis of the associations and interrelationships of all the premises and factors within the systems' respective purview. Yet, they all could present catastrophic, unforeseen outcomes. So, we must either cast blind faith in such systems or heavily moderate and gate them. We are left to ask what roles they have and what expectations are realistic for modern computing. Most certainly, our past faith and reliance is no longer founded in the same way that it was when we fed the rules of mathematics into machines and had them kick out the perfect and expected results in excel, for example. No, this is a brave new frontier. We should remind ourselves that everything that sparkles is not gold and intelligence in all its forms, mechanical, biomechanical, human or machine is going to be prone to failure. Accordingly, we may have to dial down our expectations and/or be prepared to deal with very unexpected outcomes and consequences.

As we moderate our expectations and await news of our intrepid explorers' great discoveries of vast treasures, we should also practically consider the timing of cash flows and payback periods, the costliness of errors of 'judgment' to our enterprises, the likely internal rate of return of allocated capital, the future value of our investments and the like. This is particularly so when there are real questions about circular financing, valuations, depreciation schedules that do not adequately reflect the true-life span of AI chips, the heavy demands of data centers, as well as questions about technological obsolescence. Now, too, many months after we reasonably questioned whether so many data centers (and, the power grid upgrades necessary to support them) can or actually will be built, we begin to get analysts' commentary that, perhaps, as much as 30% of announced deals will not actually come to fruition. Growth and innovation are welcome news, but investors are required to ask, "At what price?"

None of the foregoing should lead one to conclude that AI is not an intriguing concept. We should be mindful, however, that an appetite for excitement and treasure-seeking alone should not be a sufficient inducement to climb aboard blindly. Many a pirate and gold miner were recruited seeking the same.

Shiny stuff is nice. But, all that glitters is not gold.

<u>The last word:</u> While being thoughtfully diligent and prudent around the concept of AI, we will almost certainly see some companies emerge who can, ultimately, leverage the technology profitably and efficiently to create or grow businesses. With the expectation that adoption will continue to increase, especially in the use of customized AI engines rather than solely general, large language models, one can readily and easily imagine the applications of AI in disparate industries like robotics, manufacturing, production, logistics, pharmaceuticals, agriculture, video and sound production, entertainment and other areas. There will also be a myriad of helper applications that will enable greater productivity, reduce cycle times, ensure better quality control. To be sure, we are actively and constantly scouting industries to see where some of these applications satisfy critical investment metrics. All of which to say, it is not our contention

that the concept of AI is without merit. Rather, we simply steer toward thinking about the mathematics and financial metrics that are necessary to rationalize and monetize the hope that is so deeply embedded in the current investment narrative about which we are justifiably pragmatic.

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