When it Comes to AI, Enduring Value Lies Beyond the Infrastructure

Austin Cumblad, CPA
Relationship Manager,
Financial Intermediaries

After a brief pause, equity investors returned to the well of AI in the second quarter. For the better part of three years now, market returns have been driven by AI hyperscalers and the companies supporting the infrastructure build-out, from chips to connectivity to networking equipment to data center construction to specialty materials.

The Riverbridge portfolios have not fully participated in this proverbial gold rush. Though we have owned shares in Nvidia and the hyperscalers (Microsoft, Amazon, and Alphabet) since long before the emergence of generative AI, we do so at lower weights than our primary benchmark, and our investment thesis for all four companies goes well beyond their positions as the scale players in high performance compute. Meanwhile, in the smaller cap portions of the equity market, the AI winners have been concentrated in capital intensive end markets such as technology hardware and construction and engineering, where we do not tend to find our investment criteria.

These dynamics have resulted in a period of challenging relative performance for the Riverbridge strategies, though not an unprecedented one. In the late '90s dotcom era, investors similarly flocked to the visible, here-and-now demand for the companies building the infrastructure for the internet. In that era, like today, we did not chase the short-term momentum in those business models. In that era, like today, it was not because we did not believe in the promise of the emerging technology–quite the opposite. It was because we believed that more enduring value would be created by companies building on top of the new capabilities, rather than those laying the groundwork. This ultimately proved true, and we anticipate the same trajectory for generative AI.

For examples of value creation built on the internet, one need not look past the largest companies on the planet. Amazon and Google (now Alphabet) were founded to offer customers new ways of shopping and obtaining information that were enabled by broadband. Microsoft's transition to subscription software and becoming the largest provider of cloud computing was likewise possible only because of global, high-speed connectivity. And it's safe to say the most transformational consumer product of the 21st century, the iPhone, would have been far less relevant.

Perhaps more importantly, we also observe that transformational technologies ultimately permeate every part of the economy. Though they may be forgotten for a period, we believe the businesses best positioned to create enduring value through AI advancements are those with strategic customer relationships, recognized domain expertise, and the financial flexibility to make forward-looking investments in emerging opportunities.

We seek to populate the Riverbridge strategies with such companies across a variety of end markets. As we move into the deployment phase of AI, we expect our portfolio companies to be key partners in delivering AI's value to their customers.

HERE ARE A FEW EXAMPLES:

Tyler Technologies builds modern, cloud-native software for state and local governments. The company is a critical partner to an end market that is not known for being on the cutting edge of technological advancement and is already beginning to add AI capabilities to its solutions to help bolster decision-making, improve the user experience for residents, and automate routine tasks for staff so they can focus on more complex challenges.

Kinsale Capital is an excess and surplus insurance provider that underwrites hard-to-place risks across a broad spectrum of coverage areas. As an emerging player in this growing space, Kinsale has built a proprietary technology platform that is more efficient and accurate than many legacy players, allowing the company to bid on more opportunities and underwrite the appropriate risks at the right price. Building additional AI capabilities into their existing technological advantage we believe will further bolster their market position.

Privia Health provides a technology and services platform for independent physicians to help them better run their practice and spend more time caring for patients. The company has already added AI capabilities to its solution to streamline documentation, prevent errors, and call out care gaps in real time. We expect management to continue seeking out opportunities to improve workflows and reduce administrative burdens.

Should AI become as ubiquitous as the internet, the physical scaling of the technology will be a footnote relative to its impact on consumers, businesses, and the global economy. Riverbridge will continue to invest based on the firm belief that a fundamentally diversified portfolio of strategically advantaged businesses is what best positions investors to participate in the enduring value creation that will be made possible by transformative technologies.

Information in this newsletter is not intended to be used as investment advice. Mention of companies/stocks herein is for illustrative purposes only and should not be interpreted as investment advice or recommended securities. The securities identified do not represent all of the securities purchased, sold or recommended and the reader should not assume that any listed security was or will be profitable. Past performance is not indicative of future results.