

Investing with Endurance in the GenAI Era

Austin Cumblad, CPA
Relationship Manager,
Financial Intermediaries

In 2019, professors Bradford Cornell and Aswath Damodaran published a research paper that coined the phrase "The Big Market Delusion."¹ In it, they demonstrated that the promise of a Big Market leads to a predictable pattern, in which overconfident entrepreneurs and investors are drawn in, overestimate their individual chances of success, and ultimately attach a collective value to the companies pursuing the Big Market that is disconnected from their underlying fundamentals. The resulting bubble eventually pops, often leading to a painful correction, most famously after the dot-com boom of the late '90s.

Perhaps unexpectedly, the authors did not conclude their paper by suggesting changes or regulations that might prevent future boom and bust cycles, but instead argued that they are a natural feature of a market economy and a net positive due to the innovation they spur. They wrote: "the dot-com bubble did change the way we live, altering not only how we shop but also how we travel, plan, and communicate with each other. Furthermore, some of the best-performing companies of the last two decades emerged from the debris."

We believe today's Big Market—Generative AI (GenAI)—will almost certainly trace a similar arc to previous cycles, and at Riverbridge we agree that the inevitable bumps in the road are not something to be feared considering the opportunity ahead. However, we believe wise investors can position their emotions and portfolios for resilience and long-term success, while avoiding some of the pitfalls of chasing the current momentum of the market.

One of the biggest challenges during the rise of Big Markets is they tend to drive outsize returns that are difficult to resist; after all, the fear of missing out is one of humanity's most potent behavioral biases. As is so often the case, one of the best approaches to protecting against excess exuberance is both the simplest and hardest—develop an appropriate asset allocation and rebalance regularly.

In the late '90s, equity investors poured into the infrastructure providers for the emerging world wide web, as well as a host of speculative business models that were expected to benefit from this new connectivity—from e-commerce to search engines to broadcasting. When the fervor subsided, many companies were revealed to lack sustainable business models or long-term demand that justified their valuations, but the market was highly concentrated in these "new economy" stocks.

After the dot-com peak, the S&P 500 index declined nearly 50% from 2000–2002. Meanwhile, treasuries rose double digits annually during that three-year period. A balanced portfolio of stocks and bonds did not fully participate in the upside of the dot-com mania, but it provided critical resilience when the market corrected because it was less exposed to the temporarily dominant Big Market theme.

Since our founding, Riverbridge has sought to invest in sectors and business models with growth opportunities that are not dependent on a single Big Market driver. In the past 25 years, the internet's value has disproportionately accrued to businesses that leveraged its infrastructure to create new forms of value. Similarly, we believe forward-leaning companies across every sector of the economy will be positioned to leverage their domain expertise to deploy GenAI for the benefit of their businesses.

In our view, this is where the true power of a Big Market lies: visionary companies adopting new technologies to transform their operations, offerings, and business models to better serve their customers and build enduring earnings power. For example, the internet helped transform Ritchie Brothers (RBA) from a regional, in-person auctioneer of used heavy equipment into a global technology platform soliciting bids from anywhere in the world, leading to an enhanced experience for sellers and buyers alike. Similarly, GenAI is likely to transform their business and scores of others in exciting and unforeseen ways.

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As such, while Big Market cycles like GenAI may follow familiar patterns of exuberance and correction, Riverbridge remains optimistic about the opportunities ahead and focused on identifying companies that create enduring value regardless of the market backdrop. By seeking to invest in businesses with persistent earnings power and diversified catalysts, our objective is to position portfolios to benefit from long-term technological adoption rather than short-term speculation. This discipline reflects our belief that sustainable growth—not momentum—is the foundation of successful equity investing.

Source:
1. Bradford Cornell & Aswath Damodaran, The Big Market Delusion: Valuation and Investment Implications, Financial Analysts Journal, (2020) 76:2, 15–25, DOI:10.1080/0015198X.2020.1730655

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