

Beyond the Buildout: Where Cheap Intelligence Creates Lasting Value

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Transformative technologies share a common, paradoxical trait: the cheaper they get, the more valuable they become. Cheap coal and then cheap oil spurred the industrial revolution, turning energy into physical work, expanding the economy's work capacity, and creating industries that were previously inconceivable. Cheap oil did not shrink the energy industry; instead, it enabled the automobile, highways, commercial aviation, petrochemicals, and modern agriculture.

Where the industrial revolution turned energy into physical work, artificial intelligence turns energy into cognitive work today. In the same way the industrial revolution dramatically reduced the cost of physical work, the cost of intelligence is falling quickly. Like the industrial revolution, cheaper intelligence will not shrink the cognitive work industry—it will transform what is economically possible.

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For the better part of the past four years, investors have wrestled with the question of who will capture the economics of cheap, abundant intelligence, and over what time frame. Thus far, the market has mostly rewarded proximity to the physical infrastructure buildout. The demand has been insatiable, the shortages have been easy to see, and the companies selling into the shortage have reported remarkable results. However, many are earning margins that we believe belong to the imbalance rather than the business. Previous technology revolutions are replete with examples of capital destroyed by investors who mistook imbalances for durable competitive advantages.

However, this presents a challenge: a margin that comes from scarcity and a margin that comes from differentiation are indistinguishable on a spreadsheet. Telling them apart requires knowing why a customer buys, what replacing a supplier involves, and who sets the price. It explains why we own what we own. It also explains why we have chosen not to own a great deal of what has worked recently.

Riverbridge's approach is simple but crucial: we have invested client capital in businesses whose advantages we believe survive intelligence becoming cheap and available to everyone. In addition, we have deliberately built a portfolio that does not depend on AI. Our portfolio companies were compounding earnings before this cycle started and we believe are positioned to continue compounding, regardless of whether AI arrives at the scale and on the schedule we expect.

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Though it is true that our portfolios and the characteristics of our portfolio companies have not changed dramatically in the AI market, that framing greatly underestimates the upside potential of our strategically positioned, adaptable holdings across every part of the economy.

Start with the AI buildout, the current epicenter of the equity market. We are not spectators to the AI buildout, but we are highly selective. Recently, indiscriminating themes like "infrastructure" and "picks and shovels" have flattened supply chains with dramatically different competitive structures into a single strategy. Rather than simply chasing a theme, we own capital-intensive businesses where we believe capital is the moat and avoid those where we believe it is the trap. A substantial portion of our largest portfolios is invested in the cloud computing providers, accelerated computing platforms, leading-edge manufacturers, and electrical and analog engineering firms that are building the necessary physical capacity, while possessing scale and expertise that is nearly impossible to replicate.

Machine intelligence arrived in software first, and most of the AI conversation has remained in that domain. We believe this is shortsighted. The industrial revolution did not culminate in better looms; it culminated in a physical economy reorganized around cheap energy. For machine intelligence to drive a transformation of that order, its largest effects must land where work is physical, regulated, credentialed, and expensive.

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Examples abound, but one rightly identified area of anticipated AI delivery is health care and life sciences. At Riverbridge, we agree with this identification, but we believe the current conversation is too narrow. Machine intelligence can compress timelines and increase efficacy for drug discovery. It cannot compress trials, manufacturing, distribution, or delivery. Faster discovery floods a physical pipeline with finite capacity and few qualified suppliers. We invest in many parts of that pipeline: bioprocessing and the instruments supporting it, drug containment and delivery, clinical research execution, diagnostics, and robotic surgery. We also own shares in the regulated systems of record on which the industry runs and care delivery. In care delivery, demand is set by demographics and supply is constrained by licensure. Should the next decade produce a step change in the number of medicines that reach patients, the opportunity across the health care value chain will be robust, and we believe our portfolios will participate across nearly every link in the chain.

We believe we are standing near the beginning of one of the most productive stretches in economic history. We believe its benefits will show up in rapid medicine discovery and manufacturing, in factories that run better, in power systems that finally get built, and in care that reaches more people at lower cost. And we believe the companies that convert cheap intelligence into real outcomes will capture the durable value of this transformational period.

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Investing in such companies requires patience that the market demands, but does not always reward in the moment. It requires being willing to look wrong for a period in exchange for being right across a decade. That is the tradeoff we have made since 1987, and we have rarely been more optimistic about what it can produce.

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