

Eureka Report - AI, ChatGPT Turbo-Charge Loftus Peak's Portfolio

(Alan in bold, Alex in plaintext)

Alan Kohler here and I'm talking to Alex Pollak who is the founder and chief investment officer of Loftus Peak Capital and they were somebody we've spoken to many times over the years and Alex invests in technology and in particular, disruption. It was a tough year last year but things have gone much better this year because of Artificial Intelligence and ChatGPT, so I thought it would be a good idea to get him on the blower and talk about that and how he's playing artificial intelligence.

Here he is, Alex Pollak of Loftus Peak.

Alex, last year it was a tough year for technology investors and disrupters like yourself, but how's it looking this year with Artificial Intelligence and, in particular, ChatGPT and the rest of them?

Well, it's turbo-charged our portfolio, we're up 20-plus per cent in the first two-and-a-half months of the year, so that's working and ChatGPT and AI – which has been bubbling along in the background now for, really, 15 years, but it's really hit its straps I think in the last 12 to 18 months. So, frankly, we've got a portfolio full of stuff that takes advantage of all that, so it's been good.

Such as what? Let's go through what stocks are taking advantage of AI.

Well, the obvious one is Nvidia, right, but there is no AI without the – it's the story of what happens in technology, in a general sense, is the story of successive breakthroughs for people, for humankind, so to speak, have only been capable with the underlying tools that enabled them. So, you could never get a rocket ship to the moon unless you could work out how rocket propellant worked and you couldn't do that unless you had processing power, etc.... So, with more technology comes more ability to feed more people, do more things, etc. fly people around the world, all that jazz.

The core of what's going on inside of AI right now, is what Nvidia is doing with parallel processing and the parallel processing part is profound and massively important. A CPU needs all instructions to go through it sequentially. A parallel processor, which is what Nvidia produces, allows millions and billions of decisions to be made in a decentralised way, in parallel. In other words, each single part, so to speak, of the chip, can handle only a small piece of information. Maybe it's turning the pixel red or turning the pixel blue, but in combination it makes a picture and that can only happen with GPUs and the big GPU makers, of course, are Nvidia and there are others as well.

You can't even start it without big GPUs and Nvidia's a company that we've held, really, since 2016 at one weight or another and we continue to hold it, it's very important. You want to ask me about others as well?

Well, let's keep focusing on Nvidia for a moment, it's up about 90 per cent this year so far to \$US264 ...

Correct.

What do its valuation metrics look like now and is it getting to the point where it's expensive?

Well, we've held it through this appreciation. The answer to the question is, it does look expensive, it absolutely does look expensive right now. In order to get to the valuation that it's sitting at right now, you really need to imply 40 per cent compound revenue growth for the next five-plus years. Now, that's possible...

But you're not selling, I presume, Alex?

Well, let's just say that it's not the biggest position in the portfolio because of the valuation right now. There are cheaper ways to take advantage of machine learning than Nvidia, but you've got to have some, right?

Right, because you never know, maybe it will do 40 per cent compound revenue growth, is that right?

Correct. We adjust the risk of the portfolio through the choke of the position size, so if we have a very high degree of confidence that they will achieve a sensible rate of revenue growth, for example, over the next five years, we could hold a stock at a higher weight. Where a stock's got to make absolutely heroic revenue growth, we would hold it at a lesser weight and that's how we adjust risk and sort of are pretty steady around our performance numbers for the last, you know, nine years, eight years.

So, is it possible to invest directly into AI? Because I know that Open AI, the developer of ChatGPT, I think is listed – well, it was a not-for-profit.

It was a not-for-profit, so...

I think it's becoming a for-profit somehow.

Who knows how that will work. But the point about AI really is, it becomes important on the applications on which it is offered, right? So, the point is that if you write things, if you create spreadsheets, if you are in the business of drug development through the folding of proteins, you use AI tools to do those things when you haven't been able – where you would have done them manually, so to speak, before. So a big way in which to play AI is not just through Nvidia, but it's through the companies that are providing the applications on which the machine learning will run and the obvious ones obviously are Microsoft, tons and tons of applications on which machine learning will run; Google, tons and tons of applications. There's other plumbing stocks like Arista that make the data centre machine learning run around quickly, etc.... There's a whole bunch of different ways to play it and indeed, we're playing it a whole bunch of different ways.

Are you buying Microsoft and Google as AI plays?

We own Microsoft and Google as AI plays, 100 per cent, that is correct. That's 100 per cent correct and others besides.

But obviously those stocks in particular are much more than AI.

Well, they are much more than AI. We owned them always because they're platform companies on one which you can bolt additional businesses. AI was always one of those businesses that was being bolted onto it. It got very interesting this year, but the implications of AI on the Google and Microsoft business for example, are really, really significant. You know, Sachin Adella has said, "If I pick up 1 per centage point of share from Google in search, it's \$2 billion of revenue to me."

Right, is that so? I haven't heard that.

That's what he said, so, yeah.

And that's the reason that they are going with this Bing chat bot?

Correct, a chat bot co-pilot? It runs alongside you. So, I mean, simply put, to go back to the applications, let's say you were a real estate agent and you want to write a blurb, and I did this myself the other day for a house, right? And you want to write a blurb about a property in Brighton, in Melbourne, for argument's sake. You know the property, you tell the AI the address of the property and say, "Write me a script that I might use as a real estate agent to sell the property." And in 40 seconds I had that script "Beautiful views, four bedrooms, architect design, blah, blah, blah..." It led me to believe that it actually knew the property, meaning that it had crawled the web, because the latest AI does crawl the web, and it actually had found other people's comments on this particular property and so, knew the property specifically and then described it.

[Laughs]

Yes, I'm not kidding, in 40 seconds. I talked about Brighton, I used my own house just to see what it would do, it described my own house. I just gave it the address, it described my house, number of bedrooms, blah, blah, blah...

So, as I'm sure you have, I've been reading a lot of stuff about AI and ChatGPT and so on and a lot of commentators are describing it as humanity's new Prometheus moment and so on. But really, it seems to me that it's basically a business proposition. I mean, it's a big deal in a normalised philosophical sense, but the way it's being developed, is as a business, right?

Yeah, it's a business tool. I mean, the invention of the steam engine, right, notionally was a mechanism to pump water out of mines. But actually, if you were to write the history of the steam engine invention right now, you'd say it was a machine for decoupling economic growth from population growth. So, AI is another one of those things, right? It decouples productivity from the number of people that were involved in it to date and adds whole new layers of productivity that were not possible before. So, yes, it is a fire moment in its own right, but I'm not going to say it is fire,

because we don't know all the ways in which it will work and will not work, but it is a business and it's investible as a business and it looks like it's a very important business at that, because it has so many applications. Folding proteins, drug research, writing personalised children's books, real estate blurbs, etc....

I mean, obviously there have been a lot of inventions over the years since the steam engine that have decoupled economic growth from population growth, including electricity and the telegraph and personal information engine and computers themselves. So, but there's always losers as well. Do you think there's losers with AI?

I'm sure of it. I'm sure there'll be people that lose as a result of AI, just as the weavers lost their jobs as a result of the mechanised knitting mill, etc.... But the point of the exercise is, that is the way that progress on this planet works, and so there are winners and there are losers. Those that learn how to manipulate the tools will probably win, those that don't want to change, will probably lose.

I suppose, I'm specifically wondering whether you are aware of investment losers?

Companies that will not benefit from AI?

Yes.

Well, yes.

Who gets disrupted by it?

Well, if you needed 10 people to do a series of different jobs around the creation of your website and marketing, etc., you might only need one, right? Because you can tell the AI to design a website that features this, looks like this, has these kinds of words on it, etc.... Like, there's a Wharton professor out there, literally yesterday, who's set himself 30 minutes and instructed his AI to build an AI around a game, do the website, the marketing, etc., etc.... He described the output as superhuman, in just 30 minutes. So, all those people that were involved in the creation of the game previously, will either have to make more games themselves or learn how to use the tools, that's the way it works, I think.

Let's talk about other specific companies that are winning. We mentioned Nvidia, Google and Microsoft, are there any others that are invested in that are perhaps smaller than Google and Microsoft that are going to take advantage of this platform?

There's another chip maker called AMD, in which we also hold. We also hold TSMC, which is, as it were, the world's foundry, so to speak. Because the speed at which this all has to happen, it's manipulating 175 billion parameters. You know, the data centre itself has to be super-fast speeds, so that requires Arista in the background as a networking play and there's a bunch of companies besides that as well.

What about data centres, do they become winners given the amount of data that needs to be stored?

Absolutely, and again, that's the Microsoft, Google, Amazon question around data centres and they are massive users of machine learning and AI tools. They will have to provision accordingly and companies all over the world will use their – you go onto the Qantas website, a chat bot comes up and talks to you about the flight that you want, right? That's going to get a lot more sophisticated in the next 12 months and to get more sophisticated, it's going to require a truckload more grunt up in the cloud for you to get the results that you want. Because, currently, the chat bot experience is just not that great, for mine. So, this will allow it to be much, much better. So, yes, obviously the cloud.

So, Amazon's AWS and Microsoft's Azure will take over the world.

Well, taking over the world is a big call because there's anti-trust and all that sort of stuff.

But the point you're making, I think, is that these things, these engines, are going to be doing far more work.

Well, they are. Alibaba just was forced by the Chinese Government, I believe, to split itself into six different companies. I mean, the answer to the question is, there is accretion of power and wealth to these big companies, but then Washington has its own way of dealing with over-large corporations and the breakups are possible. But yes, prima facie, these companies that have these big tools and capital is a massive moat on this, right? If you're going to roll out AI with 175 billion parameters, it's going to cost you tens of billions of dollars. This is not for the faint hearted. That is not to say, by the way, that there won't be a bunch of very clever little baby companies that specialised in certain particular niches, areas, like Jasper is one of them, right, it's good for – I can't remember what Jasper does exactly, but it's on a little AI niche. You know, there will be start-ups that use those tools and as it were, retail the wholesale cloud to people that have specialist needs. Here's the example, right? You go to the doctor, if you approve it, the conversation between you and the doctor is rendered into text, summarised, the doctor checks it, copies sent off to the specialist, copies sent off to the imaging people, copies sent off to Medibank, all done, right, at one go. That's kind of impossible, a bit, in the last five or ten years, it's going to get turbo-charged.

Alex, you tend to not trouble yourself too much with Australian companies, are you aware of, though, any Australian businesses that are engaged in this at all?

Currently, it's a large cap game, right? There just aren't the size – because Microsoft's investment in open AI is \$20 billion, right? That only works if you've got a sufficient number of subsidiary businesses that you can lay off that capital cost and use other businesses to fund it, so no, I'm not aware of too many. I'm sure there are some, but we involve ourselves mostly in the main game, where the big trends go and that's worked for us in terms of a return over a protracted period of time, so we're disinclined to change.

Excellent to talk to you, Alex, thank you.

My pleasure, AI.