FRIDAY, DECEMBER 1, 2023

Well, hello and welcome to the Dividend Cafe. I am recording here on Friday morning from my hotel in San Francisco. I will be speaking at an event tomorrow that I speak at every year. This is my 23rd year at this conference. And in the meantime, I got to wrap up this Dividend Cafe that I had been working on for several months this morning. And so that is our subject today is the Dividend Cafe I've been working on regarding artificial intelligence, one of everybody's favorite topics. And yet from an investment standpoint, my goal is not to do a treatment of the issue on what so many have felt a need to do, which is evaluate potential societal risks, privacy concerns, governmental controls, some of the kind of moral ramifications of this complicated topic. There's a lot there. I don't think that there's a lot of good material there or good perspective there. I think most of what I hear is either rather shallow or driven towards something dystopian, but not necessarily super intelligible. But be that as it may, it just isn't in the category of what I'm after today. I want to do an investment commentary on the state of artificial intelligence and what this means for investors. And as I am prone to do evaluate in the context of what historical lessons may exist.

So the hype around artificial intelligence right now, particularly as people think about it from an educational or political point of view is pretty high, but there is an investment hype that is kind of my bigger interest or concern today. And if I get to a point where I think people read Dividend Cafe for my assessment of a technological innovation, then perhaps we'll add more to this. But I'm gonna stay in my lane and hope that you find some

benefit. I think that we're gonna start off by the way, when I say I'm doing Dividend Cafe on the investment ramifications of artificial intelligence. I wanna first point out that you cannot invest in artificial intelligence. You can invest in a company that is marketing artificial intelligence. You can invest in a company that is contributing to the platform of artificial intelligence that makes chips that help feed artificial intelligence that are related to big data, that are related to the infrastructure.

There's any number of particular ways that one can invest in a company, in a public or private company, in debt or equity, in a fund, all of those things are on the table. But this is not a point I'm making about artificial intelligence. It's a point I'm making about narratives in general. Throughout my whole investing career, we have talked about people have a thematic approach. Themes exist. Themes cannot be invested in. We are investors in the world of midstream energy, but we don't really start investing by talking about midstream energy, by talking about some of the story, by talking about what the sector opportunity may be going forward. You don't have an investment until you have bought with money a company.

And it could be debt, equity, public, private. There's other variables that help make it a more particular investment. But fundamentally, we invest in companies and narratives are not investable. I think that there is a long history of people utilizing narratives, companies utilizing narratives for a marketing advantage, and maybe not even a discernible one. Maybe it's just a Hail Mary. I recall off of the 405 freeway in Orange

County, California, throughout the late 90s going in the early 2000s, seeing signage on the various companies that were there around Jamboree, MacArthur, in the Newport, Irvine, Costa Mesa area, companies I had seen off of the freeway for years, all of a sudden the same company, same logo, same sign, with the words, with the dot com added to it. And for some, it may have made sense. Maybe it was a print magazine that was becoming a digital magazine. But I mean, there were things that were just absurd, that were going to try to exploit a narrative about dot com.

And this was true in recent years with crypto, with companies trying to take on an angle of something that wasn't coherent, wasn't intelligible, but nevertheless tried to create an attachment to a narrative, but it's not investable. And this is the thing that we're gonna start our conversation with is the reinforcement that it is not sufficient for a investor to say, "Hey, I'd like to invest in artificial intelligence." You then have to go execute and therein lies the rub. And execution around a narrative requires companies. And so we're starting off our analysis with a tale of two very specific companies that I think lay out what is fundamentally the major risk, not the risk of AI failing, not the risk of they're not being a real use for artificial intelligence. That stuff's out there too. I'm gonna talk about some of that. But I'm right now starting off analysis with a tale of two companies, just to make the point of how things can go badly if they go perfectly, if they go really well. You go, "What in the world is this guy talking about?" So at dividendcafe.com today, there is a chart of Nvidia, which is a company I'm using

as an example that has been an extraordinary performer, that I'm not saying anything positive or negative about buying it, and it's not a name that we own. I'm making, it's for illustrative purposes. There's a link attached to some of this stuff at Dividend Cafe. The company has grown its revenue 40% per year, more specifically 37.6% per year, but who's counting? We'll round up 40% per year, almost, for five years in a row. Massive revenue growth. And of course, the stock price has gone up an awful lot as well. I then produce a second chart. It's another company that for five years grew revenue 40.3% per year. Actually even a little bit more per year than Nvidia has done. Nvidia being at the very apex of the artificial intelligence moment, producing chips and software that are so pivotal to feeding and serving AI models.

The company that I'm referring to, that has a five year compound annual growth rate of 40%, their top line revenue, is the company Cisco. And yet the period of time I'm referring to is from 1996 to 2000.

At that point, they grew 5% or 40% per year as well. So an almost identical revenue growth number, an almost identical period of time, albeit 25 years apart, between Cisco and Nvidia.

And then I have another chart. And again, at dividendcafe.com, you can see all these, and it is Cisco stock price since 1992. And you see that Cisco had banned between zero and $10 from 1992 up until about 1997. And then it went up very, very

quickly over a couple year period from roughly 10 to nearly 80, and then dropped back down to nearly 10.

And now 22 years later is sitting there around 50. So it's up 400% from its bottom 22 years ago, but it's still down, call it 50% from its high, 1999. And you could think for a moment, well, wait a second. Maybe they just failed. It didn't work out. They didn't do what they said. But in fact, what you see is a company that actually has gone from 22 billion in revenue when it was that high to 57 billion now, earnings that have quadrupled from when it was at that high to where it is now. So mathematically, logically, economically, there's only one thing that happened, a preposterous price level to enter at that point of time. You take out that moment in which it bubbled up that high, you really just have a trend line of a company that's revenues have grown, profits have grown, and the stock price has grown from 10 to 50 if it hadn't gone from 10 to 80 to 10 to 50.

You follow me? And this to me is the risk. It's not to make a comparison, and video will do the same. It's not to say anything good or bad about Cisco. It's not to say anything good or bad about Nvidia. It's to make a point. And Cisco happens to be one of the most known companies. And at that point in the late 90s, everything people were wondering was true. They literally were the leader necessary for network computing, for basically building the routers that were served as an ecosystem of technology products in enterprise and personal computing as wireless use was exploding to change the world. And revenues

have grown, profits have grown, big company, all those things. And yet for 23 years, the stock is still much lower than it was at that peak at that time. There's other companies you could use as an example too, but this is a big deal. It is a byproduct of the era in which I grew up as a professional investor. It also is a evergreen principle that when you overpay for something in a point of hype, disconnected from rational valuation, that there can be all sorts of problems. If a company doesn't perform, if the hype proves to be preposterous, if the competition comes in and beats a company up, all of those things are pretty big problems too, last time I checked. I am not right now referring to certain companies in the AI space for whatever their operational failures may be or competitive risks may be, or execution challenges may be, all of which are really, really important. I'm saying even if none of that surfaces, even if there ends up not being any issue there, the reality is that we have a tremendous parallel between a moment in time in which very successful company after a really big period of growth, got evaluation that made it impossible for an investor to make any money for decades.

Think about that. And that's what the good companies, the cream of the crop of the moment. So you have a parallel between companies that grew revenue through the sky, had buzz, hype, leadership, they continued to execute, they saw the stock price then go nowhere for many, many years. This is not merely about these two companies we used as an example, but it's about the internet at large in 1999, no doubt a world changing phenomena, and then the potential of where we are

now with AI in 2023. I think part of it too is the rapidity with which in the case of Cisco, the stock went up so much that quickly, but really the whole tech boom and dot com bubble of the late nineties. That doesn't happen at scale across a whole sector of companies, at least these two companies I've used as an example in the here, the then and now had tremendous revenue growth. It was happening as well with companies that had no revenue growth.

It didn't even have revenue. And I think that using the late dot com era for memes and cultural sort of nostalgia about those old Super Bowl commercials and the kind of joke of pets.com and things, I think it's very useful, but I do want to point out that there is a really important investment lesson in it too, that hype is into a narrative, but investing is into a company, and those two things are simply not the same. Now, where does that leave us? What would I say about the moment in which we find ourselves? I think people need to think about AI much like the internet, that there will be some companies involved in making AI, doing AI, touching AI, just as there are companies that do the internet, that are the internet, but that for the most part, AI will prove to be a means, not an end. There will be something companies you're investing in do, not something that you invest in directly. I use analogy in our portfolio now. I think we have two, maybe three companies that are involved in some aspect of direct AI application, but that we have 32 companies that are likely going to be utilizing AI and the way supply chains are managed, or logistics, or some form of data analytics. That AI will be a tool, but it will not be the investment

itself. It'll be a tool used to add value to an investment, and I use analogy of the internet itself.

There's a couple companies in our portfolio that are involved in the tech world, but all of our companies utilize tech, and you could go back to the light bulb, and electricity, and industrial revolution, and what have you. We don't need companies that make the wheel to invest in companies that use the wheel, and that's basically where I think AI investing will need to go, but that doesn't allow for the narrative. That doesn't allow for the craze, and it doesn't allow for a stock jumping up 150% in six months.

I think that if a douchey investor who cares about their duty to clients, and matching solutions to real goals of real people, they could ask themselves, this AI company with a PE ratio of 80 right now, I wonder if it can go to 200.

They can try to do that, or they can say, can Mr. and Mrs. Smith afford to see this money blow up? Can they afford to buy a stock that goes down for 23 years, even if it proves to be a pretty good company? That's a practical question that is of far more significance than speculating on which AI companies are gonna survive at all, which ones have elevated prices that are gonna end up dropping, which ones are then gonna see their prices recover when past the survival phase, they go into a thrive phase. All of these things are pretty much unknowable. And to speculate on them, I think would almost certainly violate a fiduciary duty, whereas I think there's an alternative available

that doesn't require one to do that. And that is to see it as a means to an end, and where it will facilitate business processes, but not be the business itself, or maybe it's tangential to the business itself. So where AI is gonna go from here to me is it's ironic that even apart from the concerns I bring up from a investment standpoint about valuation, about timing, we really live in a completely uncertain moment around the regulatory apparatus, governance, valuations.

You see this reports that lawyers are using AI to write briefs, and then you see reports that a judge sanctioned lawyer for getting stuff wrong with AI, and that certain language model companies are worth 90 billion, and then there were zero, but then there were 90 billion again. It is not a period for people to be arrogant about what's going to happen.

FOMO, fear of missing out, is real, but FOMO should not be mistaken for confidence or for knowledge, let alone certain knowledge. No one knows, no one knows.

There's only one thing I know. Well, actually there's two things. The first is that even if it proves to be good and valuable and have high utility, bubbles happen. Gold has a use, Japan has a use. Technology, the internet in the 90s has a use. Mortgages, housing have tremendous use. You go through the cool tech era in more recent years. All of these examples are real, valuable, wealth-creating, substantive to one degree or another, and all went through periods of substantial bubble and burst. And I would be very careful about assuming that AI

will be immune from that. Then I think you have to say, well, where are we going from here in that context of avoiding bubbles, being aware of these economics valuation concerns? Is AI going to replace things that people are saying it can replace? And this is the thing I was saying, I know. It can't and it won't.

Because reason and processing of text are different things. Beauty and emotion and human interaction is different than searching through data, no matter how quick and efficient one is at searching through data. Humanity is what we want to invest in. Humanity was what was created by God and from which we derive free enterprise. That's not getting replaced by artificial intelligence. I promise.

That is the end of this week's Dividend Cafe. Please do read the written dividendcafe.com if you want to see the charts a little more color around these things. Thank you for bearing with me on this and have yourself a wonderful weekend. Thanks for listening, reading, and watching the Divening Cafe. We'll see you next week.

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