

A Generational Opportunity Lies Ahead

Bayshore's Chief Investment Officer shares his thoughts on current events and topics.

In this issue of *Views From the Top*, we discuss a brief history of innovation and the opportunity that presents itself today.

2023: Chat-what? I hope you had a peaceful Memorial Day weekend and are prepared for what will hopefully be a great summer. Despite bumps in the road, 2023 so far has provided investors with relief after the difficult last year, with broad U.S. equities¹ up approximately 10% through Memorial Day. These gains were largely driven by a technology sector gripped by Artificial Intelligence (AI) fever following the public release of ChatGPT, an AI chat application that can respond to prompts with natural, human-like text. The launch of ChatGPT was a timely reminder that innovation does not care about economic or market cycles; it is the inevitable result of humans' age-old urge to tinker, explore, and improve. The launch of ChatGPT provided a shot in the arm for technology equities,² which are up nearly 25% year-to-date.

While near-term market risks remain elevated as higher interest rates slow the economy, we are preparing for a green light to participate in what we believe to be the most diverse and attractive multi-asset-class opportunity in decades: i) after 15 years of nothingness, bonds and fixed-income alternatives now offer high yields and can retake their defensive role in portfolios; ii) we expect that U.S. equities will come out of the current economic weakness at attractive valuations, and the next bull market will be led by technology and a boom in infrastructure investments; and iii) we anticipate that resources/commodities (minerals and energy) will rise in price, as past underinvestment results in suppressed supply while demand accelerates in the recovery. This letter will focus on what Bayshore believes will be the engine of the next bull market and represents a generational investment opportunity: innovation and technology.

The generational opportunity in technology and innovation. Investing in private equity and venture capital, which constitutes the bulk of Bayshore's "private market wealth creation" exposure, is based on a view of how the world will evolve over the next 5-10 years and the transfers of wealth that it will cause. In an economy that's growing 2-3%, doubling your money in 5-7 years³ requires finding businesses that can gain market share from somewhere else; there is just not enough growth to go around to make everyone a winner.

For centuries, money has been looking to fund the next disrupters, and the resulting innovations have pushed humankind forward through fierce competition and survival of the fittest. Johannes Gutenberg's innovation of the printing press (c. 1440) probably launched the innovation mega-cycle from which we're still benefiting today. All the groundbreaking scientific and industrial innovations that followed are hard to imagine without the ability to disperse ideas and information into the wider population and create an accessible knowledge base that can be improved upon by anyone willing to jump into the fray. Collateral damage is also part of the process; where there are winners, there are losers. Gutenberg's innovation was dropped into a civilization whose daily lives were dominated by religious

¹ Based on the S&P 500 index.

² Based on the NASDAQ index.

³ Roughly the stated goal for investments in private equity and venture capital (before fees).

faith and the word and morals of the Bible, the interpretation of which was left to the Catholic Church. Handwritten books were too expensive for ordinary people, and most could barely read anyway, particularly Latin which was the language of the Bible. Once Gutenberg made the Bible accessible to a wider audience,⁴ public arguments about the correct interpretation of its content began, and the implication on meaning, purpose, and one's place in the world. This may sound like no big deal through today's lens, but it was earth-shattering back then, and the arguments resulted in centuries of religious conflict, war, and the death of millions of Europeans. Eventually, it upended the existing power structures that were traditionally dominated by the Pope and the monarchs and paved the path towards liberalism and democracy. All of this was triggered in part by inventing a simple technology that dramatically lowered the cost of distributing ideas, information, and knowledge. Call it the mother of all creative destruction.

Fast forward and casually ignoring the industrial revolution of the 19th century with all its life-changing innovations, the digital information age started in the post-World War II period with the advances in transistor technology and computing, resulting in the innovation of the internet, the ultimate printing press. Thanks to nearly ubiquitous broadband connections, we are now able to read and write information instantly, anywhere, and at nearly zero cost. We are continuously building a digital knowledge base that captures a wealth of data, the dimension of which is difficult to grasp. Every day, new data feeds the knowledge base, captured by technologies that transform our daily lives into data. Data is the new oil, it is often said, and there's simply too much of it for humans to handle.

Enter AI. It is obvious that in a world where data is the new oil, a technology that allows near-instant processing of all digitally available data is immensely powerful. I never thought that my smartphone was that smart (Siri has taken plenty of abuse from me) but testing some of the available AI platforms in recent months has felt like dealing with something incredibly powerful. AI has already started to disrupt traditional learning and education, and it will drive us further down the path that was started with the printing press, towards free access to knowledge for every human. AI has been around for almost as long as transistor technology, but its potential was limited by the cost and availability of computing power. If data is the new oil, then "compute" is the combustion engine that turns data into "horsepower"; without it, data is largely useless. Seeing how a technology with its origins in the mid-20th century has suddenly become so powerful simply because the computing bottleneck was removed makes one wonder what else is in store if we continue to remove other bottlenecks, which we inevitably will.

The digital age truly began approximately 75 years ago. Since its inception, we have continually developed successive layers of technology. Each new layer has provided a foundation for the next generation of entrepreneurs to build innovative businesses and generate value for society. As these layers continue to evolve, they unlock new opportunities for future generations to explore and capitalize on. This process brought us the personal computer (PC), the internet, and the smartphone and allowed us to do previously unthinkable things, such as decoding and manipulating the human genome. However, big, measurable productivity breakthroughs have not happened thus far. Quite the opposite, indeed, as lack of economic growth has been a constant worry of policymakers since the financial crisis of 2008. One theory⁵ is that companies delay adopting new technologies until the threat to their bottom

⁴ Some estimates put the collapse of book prices in the wake of the printing press innovation at 70-90% over a century.

⁵ This paragraph has been influenced by the views of Carlota Perez (<https://carlotaperez.org/>).

lines becomes real. Only then will they free up the funds and energy to invest and innovate in new directions. The period since 1990 was largely characterized by cheap labor (thanks to the offshoring of jobs to low-wage countries), cheap energy (thanks to the deluge of energy exports from the former Soviet Union after its collapse, followed by the shale revolution), and cheap capital (thanks to central banks). This was an environment where companies could afford to delay investing in innovation because input costs were low, and profits were strong. As I have written before, we believe that the time of low wages and cheap energy and capital⁶ is likely over for a while, and the pressure on companies to invest in technology and innovation is building fast. AI may be the catalyst to tip the scale—slowly at first and then all at once.

An exponential age upon us. If our thesis is correct, we are entering an innovation investment cycle, as companies are forced to adapt to evolving technology or risk irrelevance. We are approaching a technological tipping point; everyone must now choose between remaining in the familiar past or embracing an uncertain future. In this new era, previously isolated technologies begin to interact and synergize, leading to exponential breakthroughs and outcomes. Humans are linear thinkers by nature. We struggle to envision the path for one exponential technology, and we are lost when several are combined. Without a doubt, the result will be massive transfer of wealth, as we migrate into a new economy based on transformative technologies, such as the internet, mobile, satellites, 5G, biotechnology, AI, nanotechnology, and quantum computing, supplemented by tangential technologies, such as 3D-printing, sensors, and blockchains. While it's difficult to wrap our heads around it today, this is the direction we're going, and the changes will be coming fast.

Bayshore's goal is to ride future wealth transfers. Some of these will be related to innovation, others will be related to geopolitics and the reordering of powers. Call it micro and macro, and we would like to have a bit of both in our portfolios. Our strength is that we have developed a process and network that allow us to keep the idea funnel wide and test opportunities against our fundamental investment beliefs and our long-term view of where the world is heading. While the current uncertainty can be daunting, these are exciting times full of opportunity. The next 12-18 months will most likely offer the low valuations needed to generate outsized returns in the next leg of this journey.

The entire Bayshore team is very optimistic about what's ahead, and expectations for our "private market wealth creation" strategy could not be more promising. As always, please don't hesitate to reach out to our team if you have any questions. We hope that you have a wonderful summer, and we are grateful to serve as a trusted advisor for your capital.

All the best,

Patrick

⁶ Meaning we are unlikely to return to zero-interest-rate policies anytime soon.

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