

Bright Prospects Podcast: Episode 2 - Transcript

SARAH: Hi everyone, welcome back to the Bright Prospects podcast. I know we've had a bit of a hiatus into the end of the year, but we're back and picking things up for 2026, so expect to hear more from us as we move through the year. I'm joined once again by Alex Gabriel, Portfolio Manager for Global Stars. Hi, Alex.

ALEX GABRIEL: Hey, hey Sarah, good to be back.

SARAH: I think we've got plenty to be talking about, obviously being quite a start to the year with the geopolitical shocks, such as US actions in Venezuela and obviously the discussions around ownership of Greenland, and then the resulting new tariff threats that came about from that. So, plenty to be discussing.

ALEX GABRIEL: Yeah, I mean it feels as though the world's just descended into chaos. Most mathematical definitions of chaos, and there are several different ones, but most of those definitions have two features. One of those is velocity increases and the other is uncertainty accelerates. And I think we are literally in that at the moment, whether it's the pace at which AI is evolving or some of these world order structures just going through some change at the margins. We're getting these sort of accelerations in the speed of these changes and the variety of outcomes that people are prepared to believe as a result. It sort of was unimaginable to think of America as directly threatening a NATO country not too long ago, but the unimaginable has happened and here we are.

SARAH: It gives us plenty of content. I'm going to pick up, I think, and dive straight in on one of the things you just mentioned because it's clearly the topic du jour and one that we ourselves are spending plenty of time considering within the team. But clearly, since the beginning of February, we've had a number of new AI LLM models sort of launched, and I really want to hear from you, I guess, what do you think has changed, if anything has changed, as a result of this?

ALEX GABRIEL: Yeah, I think a few things have changed. I mean, so firstly, I just think that it's sort of crazy to see how quickly these LLMs are improving in capability and the speed at which these things are changing and getting better. I think, I don't know if it's caught people by surprise, but I think it's happening faster than institutional wisdom is adapting to it. Just the development process of these LLM providers is just quicker than institutional research is adapting. You've got all these fun facts along, depending on who you ask and what part of coding you're talking about. But for some areas now, OpenAI or Anthropic have openly said 100% of the code is written by the previous version of the LLM. You know, Amazon's talking about 75% of their production code is written by the previous, sorry, by AI already. But the reality is that because AI is writing lots of the code, you can just iterate faster. And the better the models get, the better and the faster they iterate. So that then throws open lots and lots of questions. You know, what really is the moat around certain software businesses? What happens if you actually start to hand over some of those tasks to agents so we just work in a different way? You know, can you actually do loads of cool stuff now, which is much more customized than before? So in the old model, everybody had to conform to whatever the SaaS software provider decided the template was. You sort of didn't really have much choice. And

for some things, that makes plenty of sense. But actually, it's sort of annoying. It's sort of annoying to have to change the way you work, to work exactly how some random software provider has decided you should work. You're running a gym, you've got your gym management software. Maybe you don't want to run the gym that way. Maybe your staff and your way of doing things in your market are a bit different. So this ability for LLMs to write code so well, so quickly, and at an ever-improving rate, it's going to enable lots more customization. It's going to meaningfully allow for cost savings and productivity improvements.

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And so I think that's been thrown out in the open. So there's been a massive wobble in software. And nobody really knows exactly which software will survive and which software won't. But we're pretty sure that there are going to be some casualties. So I'm not personally – I'm not apocalyptic, by the way. There's all these people who think the end of the world is coming. In reality, someone like my dad is not going to stop using his accountant or his lawyer who, because he's done that for the last 70 years. I'm not sure why he'd change. He just wouldn't be comfortable. But, you know, my best mate runs a gym. I know quite a lot about gym software and I don't see why he would bother with an accountant or a lawyer. He is just going to upload all his bank statements and all his terms and conditions and all his issues onto Antropic and chat GPT. He already does. And for 95% of the issues he has to deal with, Antropic will give him the answer. Sure, there's a few bits and pieces at the edge. He'll need some advice, but that's a lot less work for these professional service providers, for these data providers, for all that, for that entire ecosystem than there was before. So, yeah, so I think there's lots going on. And I think, as I said before, the pace of advancement of these LLMs is accelerating, probably because they're able to improve themselves. The previous generation of LLM is helping code the next generation.

SARAH: Fascinating. I'm glad you're not totally apocalyptic yet. But yeah, it's definitely a period of fast change. And I guess sort of linked to that and linked to what you said around moats. It gives you sort of pause to think about what are the barriers to entry now? What might quality, I guess, evolve to if what we previously thought were the moats, the IP, you've obviously referenced here, things like proprietary data or some of the software stack here. And I'm wondering if that's influencing your thinking. I know we talked in our first podcast about what you define quality as. Is that changes at as fast a pace as some of these developments?

ALEX GABRIEL: So it's easy to, again, you've got to try and moderate being a flat earther and being a four-dimensional round earther. The truth is somewhere in the middle. You know, sorry – just for clarity, the earth is round, but you...

SARAH: Thanks for that.

ALEX GABRIEL: ... you – you have to, you know, what is going on with quality? For most of the last 20 years, a shorthand

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for quality has been, if you have high returns on operating capital and significant intangible assets on your balance sheet and accounting terms, that's been a late – a sort of a shortcut for identifying great businesses. Now, what we've seen, what we are seeing is a step change in that. That's not to say, by the way, that over the last 20 years, there haven't been quality businesses that have been disrupted. So a good example is, you know, prior to the internet, newspapers were a great business. Okay. And then they became a terrible business. So I don't think the definition of quality necessarily is changing, but I think some of the intangible assets that previously defined quality in the same way that newspapers would have looked good before the internet, some of those things are inevitably likely to get disrupted by AI. So I have a suspicion that if you are – if you imagine us in five years time looking back, there's going to be – there's the possibility that... I don't know... here's an example. Halo. I've seen the term halo flying around – Hard Assets, Low Obsolescence. It's possible that in five years time, when you're looking back, people shift their understanding of shortcuts for identifying quality. And it turns out that airports and railways and gas distributors suddenly look more like the quality assets or the quality economics that we've got from some data and software businesses today, these infrastructure assets, whether they're physical or digital. So you might not look with quite such confidence at return on intangibles if large swathes of intangibles go the way of the newspaper. So I think you know... what's sort of fascinating is the distribution and processing of information feels like it's taken another exponential step up. So again, I'm not a particularly good historian,

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but you go back, whatever, to the mid 1500s, they invent the printing press. Okay. So prior to the printing press, it's someone scribbled something on the church door and pins it up. Then you get the printing press. Okay. And then information spreads more widely. And then you get the radio, the television, the newspaper, the internet. With each of these iterations, information has spread sort of exponentially faster. The AI is like another step up again. If you have machines exchanging information amongst themselves and then spewing out summaries and like the sheer volume of information LLMs can consider and then summarize and re-output is on a whole order of magnitude up again. You see some random article on Twitter by a guy called Matt Schumer, which was super interesting, had many flaws, but there's still a super interesting thing. It got 40 million views in like a day. Okay. And it got spread around the system so quickly. So I just find it interesting how the one has to be much more discerning about things you could take for granted in quality. I think that's what's changing. And we're in a period of sort of a mini step change. Nobody knows exactly how this is going to end up. And it's probably going to take a couple of years to work it out. But coming back to my thing about chaos, the uncertainty and the velocity are both going currently accelerating for a bit. So it is a bit chaotic.

SARAH: I'm looking forward to our podcast getting as many hits in its first 24 hours. So, joking aside, obviously, we are only human. We cannot digest that much information as fast as you say these models, these sort of algorithms, re-sentiment, etcetera. So how do you, as a fundamental investor, actually go about trying to navigate these types of environments, trying to assimilate all of this information and ultimately, I guess, trying to compete with those kind of participants? Because they are obviously also participating in the market.

ALEX GABRIEL: Well, I think the way this all started was everybody sort of tried to do a mathematical exercise on earnings. And as we go back to sort of, I don't know, the autumn, I think most institutional grade processes start with earnings, right? You start with the sort of more certain parts of the equation,

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but it's rapidly evolved into an imagination assessment exercise. Actually, the earnings haven't really moved that much yet. What we are seeing is mass moves in multiples, multiples which frankly, if someone gets the fear, just the multiples in that stock just collapse very quickly. So how do you go about these situations? You literally can do a 80-20 back-of-the-envelope imagination exercise on the bull case and the bear case for AI in your industry. You go through, you do all of that. You try and work out what do we know, what do we not know, and what do we think? And you try to be very hygiene – you have extreme hygiene on thought versus opinion and known fact versus unknown fact, because often the conflation of those causes trouble. So you go through and you do all of these assessments. You think about the role of earnings, you think about the role of valuation, and then you just have to think about option skew – you know, not in the literal sense, but what people would have to believe for something to re-rate up. How is that provable or not? I sort of feel like we've moved from an environment of innocent until proven guilty to an environment of guilty until proven innocent. And when you flip that coin, it's quite difficult to prove innocence in a lot of cases. That's quite hard. So then you come back to, well, if we're in the guilty until proven innocent box, is that really a quality thing? Should you have that degree of doubt in a quality asset? That's a perfectly legitimate thing to be doing for a turnaround specialist or for someone that wants to make a contrarian bet on value. But valuation on its own doesn't massively help you if you're in trouble. W

Well, you look at stocks that used to be call centers, managers of call centers, and they've gone all the way down to three and a half times earnings. You look at stocks that used to be highly rated quality advertising agencies. There are several of those below five times PE – at or around below five times PE. So the earnings become irrelevant

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once the fear properly sets in. So then you do all these assessments, you do all these thought exercises, you do all this imagining. You have to come to a view on a strategy. This is strategically what I think, where we're going to go, where I think the upside downside skew is, where I think the risk is okay and where I don't. So there's a strategy aspect of where you want to end up. And then there's a tactics thing, because sometimes, even if the end point is you want to sell something, it might not be the right time to sell today because the stock market does move up and down. These narratives are quite volatile. And the extremity of the reaction, sometimes it goes too far. Even if there is probably a problem, you've got to be – you've got to try and manage things tactically on the way out. So how do you navigate these situations? The answer is with humility and imagination. You have to try and entertain the view that the market's onto something. Your old way of doing – your old framework needs to be revisited. There's a new, greater range of uncertain outcomes that requires a new framework strategically, and then you've got to navigate the tactics along the way to try and manage your way through it.

SARAH: Yeah, I think it's definitely true to say that it definitely feels like you've got to be more adaptable and that really without sort of perfect score sheets, these stocks, well, people are looking for the confirmation, right, of their theory rather than any sort of signs of strength or of hope. And I wonder, I guess, if – I know you and I have talked in the past about some of the different market participants influencing some of these moves, you know, obviously whether it's basket trading, hedge funds, or the sort of rise of some of the passive investing, but just changing the way some of these stocks behave rather than the fundamental investor being the kind of driver of markets. I'm not sure if you agree and sort of see that playing out a bit more meaningfully this year.

ALEX GABRIEL: Well, I mean, I do agree. Actually, funnily enough, there's an interesting segment in the Pershing Square AGM that happened a couple of weeks ago – I think it was last week – which sort of touched on this subject. What they said was

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with the rise of index ETFs, mathematically, you sort of end up with higher volatility because those ETF holdings in stocks, which are now getting bigger and bigger, are basically taking share count out of the free float. So that means that even with big companies, the free float available to trade every day gets more and more influenced by retail or by high frequency traders, because ever more of it is effectively just stuck there and doesn't trade in these big ETFs. It's just being taken off, effectively off the trading pool, out of the trading pool. So the market is definitely changing. If that's true, if that assessment is correct, which I personally agree with, this higher volatility in larger stocks is here to stay. And there's just general higher volatility across the system is here to stay. And that is sort of a new thing from the last five years. And it has quite a lot of implications for how you manage money differently today and what could drive alpha in a different manner to before. So simplistically, in the old days, as a concentrated long only manager, you could effectively have your pet list of your favorite 30 stocks and you keep rotating out of the ones that do slightly better and into the ones that do slightly worse. And that was a very that was a pretty successful alpha generating, not particularly high volatility method over time. I think today, in light of the new environment, that old model of risk management has been caught short because what's happening is if any fear sets in any vaguely in an area, every single one of those names gets whacked. The whole sub industry gets taken down. So there is probably more positive alpha to be gained from a much tighter risk management process around exposures and where your exposures are in real time. And keeping an eye on that and constantly effectively in the old days where you were rotating between the names you like, I think in the new world, we're going to have to move to rotating between exposures that you are

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more or less okay with or that have more or less uncertainty. So there's going to be a bit more alpha, for me, that comes out of the risk management process. Perhaps it always did come out of the risk management process, but I think before, there was a way of not having to deal with it quite in that way. And I think on a go forward basis, we're going to have to do more of that, personally.

SARAH: Okay, well, I mean, I guess these times of fast change are also times of opportunity. So an exciting time to be an investor, but also, I think, I guess, quite a tough time because obviously we're sort of working with the information we have, assimilating new information. And as you say, perhaps changing either how we structure portfolios, where we're looking in the market.

ALEX GABRIEL: In the current environment, positioning is sort of key because no matter how good you are as a stock picker, if you're positioned in the wrong neighborhood, it's sort of irrelevant how great you are as a stock picker at the moment. So really to succeed in this environment, you have to get the positioning right. Hedged positioning or bad positioning will just will just kill you. And that's quite a difficult thing to do. There isn't some secret formula. That's pretty much all you can do. And then eventually things start to get better. Eventually, this all will calm down. It'll be a bit clearer what's going on and it will get easier. We're just slightly in – we're in a slightly unpleasant, turbulent period. I always remember... I mean I fly frequently to the US and I'm not a nervous flyer, but I don't particularly enjoy flying. But it's always the same place where that flight experiences extreme turbulence. It's always when you're flying over the southern tip of Greenland. Always, every time when the plane starts shaking, you're like, I know where we are, look at the map and we're over Greenland again. So it does somewhat feel like, particularly for quality investing, we're somewhere over the tip of Greenland. But at some point, the plane, whether you land at home or land in New York, you know, eventually is going to keep getting through to the other side.

SARAH: Good. I'm glad you're still flying. And, yeah, we'll make sure that we get some of that space and balance. And maybe you should make sure you have a gin and tonic next time you're over Greenland. Thank you, Alex. Thanks for taking time to chat to us today. I look forward to the next one.

ALEX GABRIEL: Brilliant. Thanks very much. No problem.

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