



What We're Thinking

January 28, 2025

We wrote this in the evening last night and with the news so fluid, there are further things we could add this morning. In the spirit of getting our thoughts out to our clients, we're going with what we wrote last night and getting back to the task of analyzing the news flow today.

So, here we go, another fast and dramatic drawdown for the markets, centered in the area of Artificial Intelligence. While no one for sure knows the ultimate outcome of such concerns, we will attempt to share our thoughts, as always, to position our clients for the best outcomes, measuring both upside potentials while balancing the potential downside risks.

For those that might not be as aware of the situation as we are paid to be, here is a quick summary. Over the weekend, a Chinese entity, Deep Seek, claims to have developed a large language model that had similar results with a far less expensive capital spending profile. The claims sent many large providers of hardware technology infrastructure like Nvidia down as much as 20% in the market yesterday, on fears that the efficiencies gained might represent a threat to future revenue dollar opportunities. Others alluded to this as a "Sputnik" moment for Chinese tech companies.

While we hate to say that politics play a role here, it is hard to not look at such claims by Deep Seek with both a healthy dose of optimism, but also given where the technology stems from - a country known for not respecting intellectual property rights - with suspicion. I don't know how many times in my career that I've seen the Chinese violate Western society intellectual property rights willy nilly - from things as simple as power washer accessories - to Cisco routing code. The key difference then is that many Western companies overlooked such violations with the hope that they would make up for it in new export product markets. We all know where this story has ended, with the massive trade imbalances that have not resolved themselves in such manners.

Chinese accounting has always been suspect in my opinion, making many companies simply uninvestable. Why this might be isn't necessarily something evil or nefarious, but because we have an economic system that is based on different worldviews. That intellectual property and just basic individual property rights don't exist in many communist countries. If something is better for a society than an individual, the basic premise in more socialist countries is that those property rights are null and void when push comes to shove. As a result, innovation may suffer if no one has the incentives to take personal risks, knowing that in an extreme case, if you build a house for yourself, and the government thinks society would be better off taking it away from you, they will do so.

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We quite frankly don't know what the true costs were for China in developing this technology, but one analyst we know commented how the whole interface looked like ChatGPT, implying that perhaps they were running their model on top of the inputs and outputs already paid for by the technology that is "open sourced". So in that vein, "sunk costs" apply. Could this be a situation where "open source" comes into question if it truly is free and therefore not accounted for in the cost analysis they proposed? Again, we've read a few white papers here and are probably over our skis a bit, but it is something to ponder when such claims are made.

Regardless of the ultimate outcome, we are of the belief that lower costs are a good thing for the technology of AI in that in the tech space, lower costs have always resulted in multi-decade accelerations in new applications that drive further demand, not less. Despite the fall-out yesterday, it is true that things like lower energy prices are helpful to the economy at large. We also believe that we are quite early in the adoption curve of AI, and as classic economic theory claims, the lower the price, the higher the demand.

There's a show on Apple TV called *For All Mankind*. Definitely worth a watch if you haven't seen it, and a good ode given all the space race chatter. The show is an alternate history of 1969 in which the Russians make it to the moon first. Instead of crippling the United States, the alternate reality sets decades of space and aeronautical innovations into motion that we are still searching for today. The idea of getting to the moon doesn't seem novel enough today to pursue, but perhaps we aren't in a rush to Mars because it doesn't seem like we are in a big rush. Competition breeds innovation.

As of this morning, the "time spent complaining is time wasted" theme seems to be the most pronounced, as some mention that blaming the Chinese for stealing is unhelpful at best. President Trump said last night that this should be a wake-up call for American companies to innovate faster. At the same time, if it does come to light that DeepSeek stole the intellectual property of American companies, we hope that our government spends more energy defending our companies and ideas than they have in the past. While we might have let it slide due to the promise of selling into a new market, the current trade imbalance certainly suggests a more ferocious defense of the American version of capitalism may be required.

Heady stuff, to be sure. But we're on it and thinking about it and will make adjustments, both pressing bets and lightening up on them, as we see fit.

Thanks for your continued interest in Broadleaf Partners, and our growth equity portfolio. We're always looking to where the future is headed and hoping to capitalize on where new wealth may accrue.

Kindest Regards,

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