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Evenlode Investment Management
The Curate Global Quality Equity Fund

Why we believe Alphabet is still a good investment

In the first three months of this year, Alphabet – the company that owns Google – meaningfully underperformed the market. This was due to concerns that it was being ‘left behind’ by new generative AI technology.

The concern was that its generative AI suite, called Gemini, was not competitive with new entrants like ChatGPT and Perplexity. Consumer search traffic would therefore be likely to switch rapidly to these new entrants, away from Google Search. As Alphabet is highly dependent on Search’s extraordinary profitability, this would be disastrous for the company’s earnings.

We have held Alphabet since launching our Global Quality Equity strategy in 2020. We were attracted by the powerful network effect created by how much internet search activity goes through Google. We believed that the ‘click-and-query’ data that Alphabet has access to from how consumers use its search engine is exceptionally hard to beat.

At its most basic level, Google learns which search responses are most highly valued from tracking user activity. It then promotes these results for the appropriate queries. This allows it to firstly monetise consumer traffic to advertisers, and secondly to reinvest surplus cash into powerful propositions like Maps, YouTube, Workspace, Gmail, and Cloud Platform, which it can monetise further over time.

In early March, Alphabet was down 5% for the year and lagged the MSCI World Index by 12 percentage points. High-profile embarrassments such as misfiring image generation by Gemini and a drumbeat of adversarial publicity from OpenAI and Microsoft had created a narrative that Google was the next Word Perfect or Blackberry – a technology that’s had its day.

We decided to re-examine the investment thesis we had for Alphabet to try to establish if its core competitive advantage was compromised or destroyed by this new innovation. To do this, we looked at data from a variety of providers to see high-frequency indicators that would show whether user behaviour was changing radically.

What we noted was that:

- User visits to prominent gen-AI search alternatives like ChatGPT appeared to be flatlining (and to be closely correlated to the school year);
- Click-through rates on search ads remained superior to those on display ads;
- Query types favoured Google’s larger click-and-query data set; and
- Google Search ad revenue was growing faster than Microsoft Search, despite Bing having more generative AI firepower available to consumers.

To us, these were all meaningful indicators that consumer usage of Google Search had not meaningfully changed. In other words, consumers continued to place a high value on its enormous superiority in serving them the right responses to their queries – a superiority ultimately underwritten not by any technological edge, but by the critical mass of user behaviour.

We cross-checked these quantitative data with calls to domain experts and reviewed transcripts of other expert calls available from our networks. These confirm important information about the size of the risk.

Our conclusion from the expert conversations was that generative AI was unlikely to be as transformational for search activity as Alphabet's share price was now discounting. We therefore decided to add to our position in late February and early March.

So far, this has worked out well, and results since the early March dip suggest that Alphabet's competitive position is unimpaired. We will, however, continue to monitor the company and update our risk scoring as new information becomes available.



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