A.I.–Intelligent Portfolio Selections

AI’s Secret Gems: Portfolio Terminator or Money Duplicator?

"I'll be back."

Those three words launched an entire generation's fear that SkyNet would eventually overtake the world. The cost of artificial intelligence would be our way of living.

For me, the cost was a pillowcase full of Halloween candy—a bribe to get my brother to sneak me into The Terminator.

The movie was dark, gritty, and suspenseful, with groundbreaking special effects. Let's remember that Arnold Schwarzenegger was PERFECT as the Terminator.

When the movie ended, I asked my Father if he liked it, and his answer surprised me.

"It makes me scared for the world you'll live in."

Fast-forward.

For many people, Artificial Intelligence is "The Terminator" of today. Still, for investors, there are also opportunities out there as long as you can avoid the AI stocks that might terminate the returns in your portfolio.

First, it is crucial to understand the AI market's scope and potential.

The global AI market was valued at 150.2 billion dollars in 2023 and is expected to grow at 36.8% per year from 2023 to 2030.

With those numbers, we can expect the AI market to be worth an incredible 1.3 trillion dollars by 2030.

According to recent surveys, 59% of businesses are using AI, which is expected to reach 80% by 2025. In our view, it could be significantly higher than that.

Today's most common uses of AI in businesses are customer service, fraud detection, and predictive analysis.

4 Key Points

Four things stand out the most when looking at the key trends in the AI market.

1. The increasing adoption of deep learning and machine learning algorithms includes things like self-driving cars, recommended videos, and AI-assisted medical diagnosis.

2. The growth of the cloud computing market.

3. The development of open-source AI platforms. For example, Chat GPT is open source and has allowed developers to build off of it and expand.

4. The increasing collaboration between AI companies and traditional businesses. Examples include your accountant utilizing AI to optimize taxes or the local butcher using Chat GPT to optimize its Google SEO ranking.

You may not know this, but AI is being used daily by many businesses and industries.

In healthcare, AI is being used to develop new treatments and diagnoses. IBM's Watson Health platform helps doctors diagnose cancer and other diseases daily.

AI automates tasks, improves quality control, and optimizes production in manufacturing. Amazon has leaned heavily into AI to improve the efficiency of its warehouses.

In retail, AI is used to personalize customer experiences by recommending products. The popular cosmetic store Sephora uses AI to recommend makeup products to customers.

AI detects fraud, manages risk, and even provides investment advice in finance. Blackrock is even using AI to manage its $6.5 trillion portfolio.

These are just a few examples of how AI is being used today, and I'm about to give you four stocks that are changing the game in this fast-emerging market.

Our Core

The goal, for many, will be to gain portfolio exposure to the AI sector while not taking on too much boom or bust risk. The focus should begin with large companies, well-diversified but who can benefit from the continued AI trends.

Adobe (ADBE) fits that bill. The company already holds a strong market cap above $200 billion.

Adobe's total addressable market (TAM) could return to a strong growth phase thanks to the adoption of AI.

The exciting part is that Adobe is on track to seize AI-driven opportunities. The executives at Adobe have been saying they've introduced hundreds of AI innovations across their popular, mainstream products like Photoshop and Acrobat.

They are integrating AI into their software to make it more intelligent and valuable for their customers.

Additionally, Adobe has a software called "Firefly," their generative AI platform. It's gaining traction fast among users.

Firefly lets Adobe customers do amazing things, like creating images from text prompts, editing and painting images, designing flyers and resumes, and making catchy Reels on Instagram.

In just a few months since its launch, Firefly has been used over half a billion times for generating content.

As AI becomes more integral to content creation, we can expect Adobe's growth rates to improve.

They're forecasting revenue of $19.3 billion for the current fiscal year, nearly a 10% improvement from last year's $17.6 billion.

We even have more good news: analysts believe that AI's growing influence on Adobe's business will fuel more substantial growth in the long term. They estimate that Adobe's revenue will increase by double-digit percentages starting in the next fiscal year.

Now, let's talk about Adobe's earnings. They're expected to grow at 14% annually for the next five years.

If this prediction holds, their bottom line could reach just over $30 per share after five years, based on this year's forecast of $15.70 per share in adjusted earnings.

So, what does this mean for investors, especially those interested in AI-related stocks? If we multiply those projected earnings by Adobe's five-year forward earnings multiple of 35, we could see a market capitalization of just over **$1 trillion** after five years.

That's a 4x leap from Adobe's current market cap, just around $250 billion.

Adobe might be a wise choice. The potential for a solid upside in the long run is evident. With their AI-driven innovations, they seem well-prepared to capture the opportunities this rapidly evolving industry presents.

Potential Money Duplicators

When you invest in small AI companies, you're signing up for a rollercoaster ride. These don't give you the relative stability of a stock like Adobe would, but they offer significant upside for your risk.

It bears repeating that investors should anticipate significant volatility in these names.

These are three names that offer a high-risk, high-reward scenario.

Nerdy (NRDY)

Nerdy (NRDY), a relatively tiny player with a market cap of less than **$1 billion**, tends to be unpredictable.

Its growth numbers can be all over the place, up or down.

Between mid-June 2021 and mid-June 2022, Nerdy was on fire with some impressive year-over-year revenue growth.

But then, in late 2022 and into the first quarter of 2023, it faced some shaky times.

However, Charles Cohn, the CEO of Nerdy, bought 719,656 shares over the past year and did not sell any shares. Typically, if the CEO buys his own stock, he's confident about the company's direction.

Fast forward to early August this year, when Nerdy released its second-quarter results. The growth was back on track!

As you'd expect, Wall Street caught wind of this, and analysts from Needham and Goldman Sachs bumped their price targets higher for Nerdy's stock.

Now, let's be clear here. I do not doubt that Nerdy will endure more ups and downs in the coming years.

But that's precisely why you can still get in on the action while it's valued at less than **$1 billion**. Most of the big shots on Wall Street haven't noticed Nerdy yet.

But as they do, I expect the stock price to soar – assuming Nerdy keeps moving in the right direction.

Let's discuss some seriously impressive returns if everything goes according to plan. Think of it as a "moonshot" opportunity in the making! But you should know that moonshot potential comes with rocket crash risk; if Nerdy doesn't execute, it could mean failure.

Innodata (INOD)

This next stock is a company that has had a remarkable year, Innodata (INOD,) whose stock has surged an astonishing 327% year-to-date.

If you took the bold step to invest in Innodata at the beginning of this year, I commend you for your exceptional foresight.

Now, what makes Innodata tick?

This company specializes in helping other businesses transition into the digital age, strongly focusing on AI data annotation and collection.

They've recently inked a deal with one of the world's five largest technology giants. This partnership involves Innodata training the customers of this tech giant in the intricacies of AI large language models (LLMs).

The revenue from this contract is projected to reach a substantial $8 million by the end of 2023, with the potential for future annual revenues to soar as high as $15 million.

These developments prompted Innodata's CEO, Jack Abuhoff, to express his belief in the potential of this relationship. He stated, "We believe that this new relationship — with the wins we announced on June 14 and June 27 — is potentially transformative for Innodata."

You may say, "What are the June 14 and 27th wins?

Well, they're expected to generate at least **$8 million** in revenue for 2023.

While the June 27 announcement didn't specify the dollar value, it involved one of the world's largest cloud infrastructure and platform services companies. So, I can assume it's in the millions.

We know CEOs are trained to say things that will increase the stock, but this relationship could be transformative for Innodata.

The CEO noted their history of 'land-and-expand' success with major tech companies. This, coupled with the growth prospects afforded by generative AI, positions Innodata exceptionally well for significant growth.

They can see significant revenue growth opportunities with these tech giants in the near, medium, and long term.

To sum it up conservatively, these three announcements alone could contribute **$20 million** in revenue in 2023.

Now, let's put that into perspective. This represents 25% of Innodata's 2022 revenue, which was $79.0 million. This isn't a trivial sum.

But what's even more significant than the money involved here is Innodata's opportunity to establish itself as a credible player in AI. In our view, this holds immeasurable value, far beyond the $20 million figure.

This is a testament to their success in the fast-evolving landscape of artificial intelligence, and it's something we should take note of.

Sound Hound (SOUN)

The last stock we will discuss is Sound Hound (SOUN), a company making waves in voice artificial intelligence.

I know the stock might not have had the smoothest start, but let me explain why I believe it could be a compelling long-term investment opportunity.

SoundHound AI (SOUN) specializes in cutting-edge technology that understands and responds to human speech.

It debuted on the Nasdaq Stock Market in April 2022 through a merger with a special purpose acquisition company (SPAC) called Archimedes Tech SPAC Partners.

From the get-go, the company faced challenges, such as going public in a challenging economic environment, concerns over customer concentration, and a complex business model that didn't receive the warmest reception from investors and analysts.

The stock started trading at $8.72 a share and hit a low of $0.93 by December 2022, a substantial drop of 89%. However, despite this rocky start, I see tremendous potential in SoundHound AI, and here's why.

SoundHound is poised to tap into the burgeoning voice artificial intelligence market, projected to reach a staggering $160 billion by 2026.

They aim to capture a significant market share by offering an independent voice AI platform that meets the growing demand for voice-based transactions, including payments, bookings, and reservations.

What sets SoundHound apart from giants like Amazon, Alphabet, Apple, and Microsoft is their dedication to providing independent voice AI solutions.

These tech giants often integrate voice AI as an add-on to their primary services, potentially compromising their businesses' control, branding, and user experience.

This can stifle innovation and personalization for these companies and sometimes even create competition between them and their voice AI providers.

SoundHound safeguards its unique solutions through significant investments in intellectual property, boasting over 120 granted patents and 140 pending ones in various areas, including speech recognition, natural language comprehension, and machine learning.

What's truly promising is that SoundHound already counts top-tier clients like Mercedes-Benz, Hyundai, Pandora, and Snap among its satisfied customers.

These partnerships indicate that SoundHound's platform is gaining traction in the industry.

Now, let's address some concerns. SoundHound AI has incurred operating and net losses since going public, and its free cash flow is negative.

This financial situation is risky, as it suggests the company is spending more than it's generating, potentially leading to cash shortages or additional funding.

Another concern is that a significant portion of SoundHound's revenue comes from a small number of large customers. If any of these customers were to cancel their subscriptions, it could pose a significant challenge.

SoundHound is still in its early stages, and until it diversifies its revenue sources and becomes profitable, investors should be aware of the risk associated with unexpected declines in its stock value.

Now, let's talk about how SoundHound makes money. Their primary source of revenue comes from product royalty revenue generated by Houndify, their voice AI platform.

Developers who use Houndify to create products pay SoundHound a royalty for each unit sold.

For instance, the growing demand for voice-activated car features has increased auto units sold and a slight rise in auto unit royalty prices. This drove a substantial 42% revenue growth in the second quarter of 2023.

SoundHound also charges subscription fees for hosted services on the Houndify platform, which allows customers to use it without owning the software.

One of their popular services is Smart Ordering, a voice assistant for restaurants that streamline phone orders and drive-thrus.

SoundHound envisions a massive opportunity in this sector, with potentially over 1 million food establishments in the U.S. alone.

They're also expanding their offerings with products like Smart Answering to cater to a broader range of businesses beyond restaurants.

As the potential of voice AI-powered solutions gains recognition, the company can emerge as a leader in this field.

While it may face challenges due to its early-stage financials and customer concentration, this stock is worth considering for investors seeking to get in on a game-changing technology at its early stages.

Artificial intelligence is a sector that is not going anywhere; it isn't here to be the terminator. It's here to be a tool to help businesses and individuals.

Remember, folks, successful investments often require patience and a focus on the long term.