AI Takes Share in Mid Caps

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ALEX BERNSTEIN: Hello, I'm Alex Bernstein and you're listening to The Alger Podcast: Investing in Growth and Change. Savvy investors are keenly aware of the role AI has been playing in the markets over the past few years. But a majority of that attention has been focused on the large cap space. Since early this year, though we've started to see what could be a significant shift on that theme, into the mid cap space. Here to talk about how he currently views AI in his portfolio is Alger Mid Cap Growth Portfolio Manager, Brandon Geisler. Brandon, thanks so much for joining me this afternoon.

BRANDON GEISLER: Thanks, Alex.

ALEX: Brandon, before we jump into specific companies, I just wanted to ask – consideration of AI is now such a part of everyone's process – when you're looking at a new company, do you have, I don't know, AI screens? Must there be an AI component for you to even consider the company?

BRANDON: I don't know if it's necessarily like a screen but I think it's necessary when you're talking to the management team to understand how they're thinking about it. If they're developing it or they're using it or they're going to be competitively impacted by it. And I think, the enablers, most of the market has been focused on them over the last 36 months. But now, the adopters are this new wave. And then, I think there's also this series of businesses that are somewhat AI resistant but they're in these either highly regulated industries like aerospace or maybe in healthcare or they're in industries like travel. So, you can imagine a company like Hilton who has beautiful hotels around the world. They use AI to improve the operations or the marketing and to make sure those hotels are full. So, I think there's going to be industries that have businesses that can really take advantage of AI and not have to give it back in price, and we're also super focused on those as well.

ALEX: And with all of the attention on large caps, what would attract an investor interested in AI to mid caps?

BRANDON: Well, I think these companies are very fast moving in the mid cap space. Think about companies like Rocket Mortgage, Robinhood. We think these businesses are using AI basically as a disruptive force to take share from the incumbents. And I think what's interesting is that certain businesses, if you have a unified data platform and you're in the cloud and you have something that's proprietary, you have a leg up on much of the competition, and a lot of those businesses started in the last 15, 20 years. Businesses that we think really want to position themselves to take share. Robinhood wants to take share from Charles Schwab. How's it going to do that? Well, I think it needs to be investing in AI and be on the front foot and move faster and be disruptive and, I think, if you think about things like vibe coding in the AI world, it's allowing things to be developed by a much faster pace, and when the backend can facilitate what you want to do in the frontend, we think you can get to market quicker and really be disruptive.

ALEX: So, let's get to the meat of the conversation. Companies. You like how Rocket Mortgage has been leveraging AI. Tell me about that.

BRANDON: Rocket digests 62 million documents a year from people like you or I, and for the longest time, it was a manual workflow process, and it was people intensive. And so, today, roughly 80% of that workflow can be automatically entered through the system and don't need a manual check by a person. Think about the hours that are saved there. Years ago, core Rocket was really focused on primary origination in new home sales, but most recently, they got a new CEO and I think he's really changed the culture of the business and bought a business called Mr. Cooper, which is on the mortgage servicing side, and they also purchased Redfin. So now you have a fully integrated mortgage origination platform from the front to the backend.

I think one thing that's been really powerful on that platform is they've been launching out a series of agents. So, they have created an agent for the broker. So, if you were buying a new house, now they can enter your documentation and your background and preapprove you in 15 minutes. Similarly, if you decide to purchase that house, now they have that process agent who's actually managing the entire workflow and making sure all your documents are in and manually going back and making sure everything is cross checked.

So, when you roll this all up, you have a business now that is an AI-first business going forward. We think they could do almost double the amount of originations with no extra or incremental staffing. So, I think it's really impressive to see this business evolve and get away from being incredibly cyclical to one being led by AI.

ALEX: Great. You're also interested in Robinhood. Tell me how Robinhood uses AI.

BRANDON: I think Robinhood, over the last several years, has really just transformed itself to be a, we think, really impressive business. Many of us grew up on Charles Schwab or TD Ameritrade or one of those platforms. Robinhood is one of these next generation platforms that is really going after wealth transfer. They started out early on with stock and options and cryptocurrency. The CEO has been very clear that they're using internally AI to write 50-60 % of their code and we think this has really allowed them to have a first mover advantage.

But I also look at it from a user's perspective, and so how am I interacting with it on the platform? So, a couple examples. They have one program called, for example, Cortex. And we think companies like Bloomberg or FactSet are very expensive ways to kind of sift through information and data. Robinhood created Cortex to use natural language to sift through key important data series and news events and trend alerts that are important to you. So, here now, AI is acting almost like an agent on my behalf, inside the platform, to help improve my experience inside the platform to make sure I'm utilizing the services and in the way I want to. Similarly, on their Legends platform, which is their high performance trading platform, you can now use natural language, so effectively almost vibe coding inside their platform. You can use natural language to ask it to create charts. And they're going to further enhance this by launching Robinhood Social, which is going to be a network.

So, you can see it from multiple perspectives. And this goes back to what I mentioned earlier. We think these disruptive businesses with disruptive leaders that come in with a low-cost structure are using these new technologies to take share and grow healthy businesses. And a lot of these are in the mid-cap space, so we're pretty excited about it.

ALEX: Brandon, investors have seen a lot of headlines recently about AI: Boom or Bubble. What are your thoughts on that?

BRANDON: Yeah. I certainly don't think we are in a bubble from the perspective is AI going to continue to march forward. And so are there pockets of the market where maybe people are paying too much for the opportunity? Sure, there could be, but I think if you look big picture, we're certainly, in my opinion, not in an AI bubble from the fact that this technology is now starting to work forward. It's continuing to grow. You look at how the Mag Seven are investing behind it. I don't think there's any change in that. You see how businesses are investing behind it, how it's driving topline, how it's driving margins. I think that's not going to slow down. Are we going to have fits and starts in the market? I'm sure. But I think when there's this much opportunity in front of you to really improve productivity and really change the complexion of businesses and invest with true disrupters, I think, at Alger I know we're going to participate in something that thematic and we'll just have to be careful.

ALEX: Brandon, when we were discussing companies to talk about for this conversation, you picked up on Rocket Mortgage and Robinhood pretty quickly as "quintessential" Alger stories. What sets them apart?

BRANDON: Well, because I think, Alger tries to invest in disruptive growth. At the core of everything we do is, what is the change agent? Is it a new manager? Is it a new product? Is it a new process? And if you think about what we've been talking about today, these businesses now are having big change. Those are quintessential Alger ideas because we can invest against them for a period of time and that's really important to us because we're trying to understand what's coming around the corner to try and preposition our portfolios to take advantage of that over the next few years.

ALEX: Brandon, thanks so much for your time this afternoon.

BRANDON: Thanks, Alex. It's been great talking today.

ALEX: And thank you for listening. For more information on AI and Mid Cap investing, and for more of our latest insights, please visit www.alger.com.

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