Liberty Street's Munafo On Hunting For Unicorns in AI

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Chuck Jaffe, in this episode of The NAVigator podcast interviews Christian Munafo, chief investment officer at Liberty Street Advisors, the manager of the Private Shares Fund. Christian discusses how there are plenty of opportunities among late-stage venture companies working to make a splash in the artificial intelligence field, but how hard it is to find the transformational companies positioned to succeed. He discusses what he is looking for, and where he thinks the best prospects are, and also gives an update on initial-public offering and mergers-and-acquisition action, as well as how market conditions have stiffened for private companies looking to raise capital now.

The podcast can be found on AICA's website by clicking here: https://aicalliance.org/alliance-content/pod-cast/

CHUCK JAFFE: Christian Munafo, chief investment officer at Liberty Street Advisors which runs the Private Shares Fund is here, and we're talking about the never-ending hunt for unicorns, welcome to The NAVigator. This is The NAVigator, where we talk about all-weather active investing and plotting a course to financial success with the help of closed-end funds. The NAVigator is brought to you by the Active Investment Company Alliance, which is a unique industry organization representing the full spectrum of the closed-end fund business, from users and investors to fund sponsors and creators. If you're looking for excellence beyond indexing, The NAVigator's going to point you in the right direction. And today, we are definitely looking for excellence beyond indexing because we are, well, not literally hunting unicorns, but the proverbial search for unicorns is what drives investors to private companies. My guest is Christian Munafo, he is the chief investment officer at Liberty Street Advisors, manager of the Private Shares Fund, which is an actively managed continuously offered closed-end interval fund. Yeah, that is a mouthful, what you need to know is they invest in the late-state venture-backed space which normally is reserved for high-net-worth and venture capital companies, but which you can look at in the Private Shares Fund. For more information, PrivateSharesFund.com, for more information on Liberty Street Advisors it's LibertyStreetFunds.com. If you want to learn more about closed-end funds, interval funds, and business-development companies generally, visit AICAlliance.org, that's the website for the Active Investment Company Alliance. Christian Munafo, welcome back to The NAVigator.

CHRISTIAN MUNAFO: Chuck, it's great to be with you. You never cease to impress me with having to get through all that word salad. That's a lot. That's a lot.

CHUCK JAFFE: Well, it's easy when we're talking about things like hunting for unicorns, so I want to kind of throw a couple different things out to you because you are looking for what's next, that's the whole point of doing this. So let's talk about what's next, because the hot story for everyone is AI, how many times am I going to hear some company described as the next NVIDIA? Trust me, there are a million next NVIDIAs, none of which are going to be like NVIDIA, but somebody out there might be like that unicorn that is kind of like it. So for you as you're looking at AI right now and the development of AI, is the big story what's coming next, and is it the stuff that we don't see yet? Or is it the stuff that we're seeing yet and figuring out who's going to be able to share the spotlight with the NVIDIAs of the world?

CHRISTIAN MUNAFO: I think it's probably a combination of the two, Chuck. As you pointed out, in the last couple of years, something that those of us in the venture capital growth innovation ecosystem, something we've been following in terms of artificial and intelligence and machine learning for quite a while has obviously become much more mainstream with the launch of some of these very popular, what are called large language models, like the OpenAIs, the Anthropics, the xAIs, et cetera, which is essentially leveraging improvements in computing power to enable this AI to become more mainstream. If you kind of think back to the nineties when we had this transformational development with the internet, a lot of us think that artificial intelligence, generative artificial intelligence is likely the most transformational development that we've seen since the internet. I would say it's still early days, but it is developing quickly, so you know, NVIDIA clearly has a very strong handle right now on its role given the power that its GPUs offer the market. There are competitors, both incumbents and companies that are private. We own a company called Cerebras, for example, which has a chip that has much greater efficiency and speed than some of NVIDIAs chips on the market, and it's something that a lot of people don't yet know about because it still is private, we'll see when it becomes public, so there are things going on privately. Companies like OpenAI, Anthropic, xAI, like I mentioned, those are still private companies, so they are kind of challenging your mega-cap tech public companies who are actually investing significant dollars, in many situations, in these next generation disruptors. But there is a whole lot happening, we think it's early days, and I think a lot of the money that we're seeing and that we're focusing on is really going into the infrastructure side. That's going to enable this next wave of AI development and proliferation, Deepseek, the Chinese-based model has certainly gained a lot of attention, so we can talk about our views on that if that's of interest.

CHUCK JAFFE: It is of interest, but also of interest is the idea that in the early stages of the development of the internet, anybody who said they were doing any business on the internet wound up watching their stock get a boost like, "I got a website!" "Okay, you're an internet company." We definitely don't know who the AI champions are going to be, there does seem to be a lot of rush in the industry if we're going, "Well, okay, let's capitalize while we can," so what percentage of the late-stage opportunities you're seeing in the venture-backed space are things that you look at and go, "Yeah, that's not the investible AI that we're looking for"? Is there more to it than we know in terms of people make it sound like they're going to throw everything up and they're all going to stick to the wall, but the wall is not a sticky place.

CHRISTIAN MUNAFO: No, it's not, and you actually just hit on it, because the majority of these companies are not what we define as late stage, they're still at the early stages and the startup phases of their development, trying to essentially validate that their technology and their solutions work. That's a perfectly fine place to invest. Our strategy, as you said, focuses on later stage companies that are beyond that technology validation, they've achieved a level of scale with validation, with operating metrics, diverse set of customers, product roadmap, et cetera. You don't have a lot there yet, so you still have I think the early stages of the buildout of what this AI really means, and so having invested in this industry for more than a couple of decades, what typically ends up being prudent is to focus on infrastructure investments that are going to essentially enable the entire ecosystem. Rather than betting on specific stocks, if you will, you're actually betting on the infrastructure that these stocks are going to require, so think of it as the picks and shovels, the rails, and so that's where we and I think a lot of other smart investors have been investing, is in that infrastructure. However, as this technology continues to validate itself, continues to become more efficient, and that's what we're seeing with the example of DeepSeek, you're now going to essentially have this shift from investors looking at the enablers to companies that are going to actually now be able to adopt it. One of the things that we heard with DeepSeek, and again we're still doing work, as are others, to validate it, is that DeepSeek is essentially using a much more narrow version of what an OpenAI and others can do. Think of it as a much more distilled version of their much larger, more complex large language models, but trained on those to essentially go after, think of it as a cliff notes version. So if you are going after a topic that may not require having all of that significant comprehensive data backup, you can run a model more efficiently to answer questions, generate text, look at images essentially in a more defined way. What we see with DeepSeek is essentially it's using a much more distilled version of those models, but trained on those models in a way that it's now going to allow the next wave of companies to be able to adopt this transformational technology at a much lower cost basis. So a lot of the infrastructure that has been required to run these large language models is actually going to essentially now be made more efficient by DeepSeek and other versions of DeepSeek that are using more distilled versions with very specific use cases. So that's a change, and what that's going to we think enable over the coming quarters is for a lot more companies and innovators to come out with applications that can run more efficiently and profitably than they could prior to that.

CHUCK JAFFE: Here we are talking about the AI space, that of course has been heating up and picking up, but what's your take on IPO activity and merger and acquisition activity generally? Because of course that's a big part of your game plan, is watching them go from late-stage venture to where they're going into the IPO market.

CHRISTIAN MUNAFO: Exactly. At the end of the day, what we do need to see is that there's a robust market for these companies to not only exit but also to raise capital before they exit. And over the past few years, due to macro conditions, rising interest rates, geopolitical concerns, there's been a massive constriction on the amount of companies that have been going public, on the amount of acquisitions that have been happening due to regulatory constraints, and investors really reined in their capital deployment due to all these factors. Following now what we have in terms of visibility around the new administration here in the States, more visibility around what may be a loosening up of the regulatory environment, what you're seeing now is capital become unlocked, you're seeing an increase, we think, in engagement of these companies with capital markets, investment bankers, we're seeing more companies going out to raise new rounds, and you're seeing an increase in companies that are planning to list and are planning to pursue potential combinations. And so we don't think any of this is going to happen overnight, we don't expect the floodgates to open with a switch, but we do expect to see an increase in exit activity and capital formation this year, and frankly it's already started in Q1.

CHUCK JAFFE: Given what we've seen happening with the economy and interest rates and the rest, what's your general take on raising capital for private companies? I mean, are you seeing more opportunity or are they turning to other different sources? Where are they looking for their cash?

CHRISTIAN MUNAFO: There continues to be a massive supply-demand imbalance, where you have a lot more companies seeking capital than there are investors willing to allocate that capital, and frankly a lot of that is just due to the wave of capital deployment in 2020, 2021, and part of 2022 before we had that rationalization event. So you have now essentially, Chuck, a bifurcation of the market, where you have a lot of companies frankly that we think are going to go away, they're not really unique, they're not differentiated, they're not outperforming, and on the other side you have companies that are differentiated, that are performing strong, that are unique. We're seeing capital essentially lean in more so to those stronger performing businesses, as you would expect, and so from our perspective we absolutely are seeing a tremendous amount of opportunities on both sides, but the most sophisticated investors are being extremely disciplined on where they're deploying that capital and they're looking validation, not just essentially taking at bats. And so we expect that to continue, we expect to see that bifurcation continue, and overall frankly it's healthy for the ecosystem.

CHUCK JAFFE: Christian, appreciate the take, look forward to revisiting some of this stuff with you as we watch it play out down the line. Thanks for joining me on The NAVigator.

CHRISTIAN MUNAFO: Thanks Chuck, we'll talk soon.

CHUCK JAFFE: The NAVigator is a joint production of the Active Investment Company Alliance and Money Life with Chuck Jaffe, and I am Chuck Jaffe, and you can check out my hour-long weekday podcast by going to your favorite podcast app or by looking for it at MoneyLifeShow.com. Now if you're looking for more information about closed-end funds, interval funds, and business-development companies, go to AICAlliance.org, the website for the Active Investment Company Alliance. Thanks to my guest Christian Munafo, he's chief investment officer at Liberty Street Advisor, manager of the Private Shares Fund, an actively managed continuously offered closed-end interval fund that trades as PRIVX. Learn more about the firm at LibertyStreetFunds.com and about the fund at PrivateSharesFund.com. The NAVigator podcast is new every Friday, make sure you don't miss an episode by following along on your favorite podcast app. We'll be back with more closed-end fund fun next week, until then, happy investing, everybody.

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