



Insights, Tacit Thought | Weekly Investment Insights

Disruption

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“Past performance is not a guarantee of future results” is pasted across multitudes of financial promotions that we see every day. While this statement is correct, the following question naturally arises: If the past is not a guarantee of what the future will look like, is the future fundamentally unknowable?

While past performance is not a guarantee of future results, past behaviour is often a guide to future behaviour: the key word here being ‘guide’. There are, unfortunately, no guarantees when investing as the 2008 collapse of Northern Rock and other banking institutions taught us even cash is not ‘guaranteed’.

Our belief is that time is the best filter when trying to understand consumer behaviour. Industries that have survived the ravages of time will, in one form or another, be around in the future. These industries are durable. The oldest industries like construction, gambling, restaurants, retail, theatre and entertainment have been around for 2000+ years. Breweries/distilleries for 1000+ years. Banks have been around for 700+ years. Insurance for about the same time. All these industries have an inbuilt durability that does not apply to the many fleeting fads that come and go. The longevity of an industry is a filter against fads.

Durability is the first and possibly most important test when trying to determine how much the future will be a reflection of the past. However this alone does not guarantee success as competition and innovation within an industry can lead to many companies failing. Companies in these durable industries without an edge, a moat as we refer to them, will ultimately struggle. Capitalism works by inviting competition: having a strong competitive advantage is vital. Many investors have forgotten this point as the cost of capital around the world has fallen to near zero over the past 50 years leading to poor allocation of capital in many sectors.

Another key point is that companies that produce durable goods/services and have a competitive advantage are more likely to succeed or even benefit from disruption. Take four companies in the 1990s: Sears, Beenz, Marks & Spencer and Amazon. These were all companies operating in retail – a durable industry that has been around for thousands of years.

Sears bet the Internet changed nothing, to its detriment. Beenz bet the Internet changed everything – creating a points-based currency valid only at online merchants – to its detriment. M&S bet that its customers would take out a M&S credit card to pay for their shopping because they loved M&S. Amazon bet the Internet changed distribution, allowing it to lease low-cost warehouses and passing the savings back to the customers. Amazon rooted its strategy in the fact that some things will never change – customers will always be happy with low costs and leveraging the internet was a great way of achieving this goal.

Why is all this important? At Tacit, when we select investment managers, we always gauge how well they understand these two concepts – the durability of a product/service and its competitive advantage. Both need to be in place to protect against the threat of technological disruption.

Currencies will rise and fall, presidents will come and go, and new technologies will make old technologies obsolete. In the midst of such turbulent changes, the companies that survive will all have a durable product/service and a strong competitive advantage.

Past consumer behaviour is often a guide to future behaviour. Consumers will always want lower prices, faster solutions to problems, more choice, entertainment, transparency, trust, and higher social status. This all comes from studying past examples of human behaviour. While things are not valuable simply because they are from the past, the past is valuable because it can be a guide to the future. It is not a coincidence that our strategies are heavily weighted towards companies in durable industries with strong management teams that understand the world does not stand still.

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