

Hidden Growth

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In 1892, the Holborn Viaduct power station in London became the first of its kind in the world. The location of the now defunct plant is coincidentally just a short walk from our offices. The plant supplied electricity to nearby streetlights and private residences. It used coal to drive a steam turbine which drove a generator that produced electricity. While its significance at the time was not appreciated, this little power plant was the first of many that changed our relationship with energy.

Before energy utilities rose to power (excuse the pun), people and businesses had to rely on themselves to generate energy. One had to own the means of producing energy through one's physical labour or owning a labour-saving machine, usually steam engines or a dynamo at the time in Britain. The key word here is *owning*. The need to own excluded the benefits of these technologies to large swathes of the population. What the early energy utilities did was to, in effect, allow people to "rent" energy without worrying about owning or operating the underlying infrastructure.

In financial parlance, this apparently insignificant change from owning to renting your energy, transformed a capital expense to an operating expense. This reduced the cost of electricity and made it available to individuals and companies who would not have otherwise been able to afford it. It also increased the pace of innovation because now companies did not need to worry about operating their own small power plant, worry about breakdowns or scaling for future growth. Electricity production was abstracted away freeing up time and resources to focus on their customers by building better products and services.

Something similar is happening today with computers. The major cloud providers – Amazon, Google, and Microsoft, are in effect doing something very similar to the energy utilities in the early 1900s. The cloud is simply a datacenter – a large building with lots of computers inside. The large cloud providers essentially allow companies to rent compute and storage capability instead of building and maintaining it by themselves. The growth of the cloud, just like the growth of energy utilities in the early 1900s, has spurred innovation and is the catalyst for the rapid growth behind many technologies we rely on daily, from watching something on Netflix, to ordering an Uber or jumping on a Zoom call. None of these would exist the way they are without the cloud.

Some professional investors may be sceptical of these innovations. Scepticism is after all an important ingredient when managing other people's money. However, just as too much salt can ruin a dish, so can excessive scepticism ruin an investment strategy. Other ingredients like the ability to think using analogies in order to understand a new technology in the context of history are equally important.

This is of course not a call to arms to abandon all investment strategies and focus on innovation alone. Valuations always matter regardless of how magical the innovation. However, understanding that the world has changed and how this will disrupt incumbents resistant to change remains vitally important as we make investment decisions with your capital at Tacit. As Mark twain once wrote, 'history does not repeat itself, but it rhymes'.

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