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Lessons from the Future

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In investing, there is always a metaphorical tug of war between the past and the future. Is history always doomed to repeat itself, or will the future be vastly different? Is looking into the past the best way to predict what's ahead, or is such an approach as flawed as driving while staring in the rear-view mirror? Like most questions involving extremes, the rational answer is usually somewhere in the middle.

In many ways, history repeating itself is inevitable. The chemistry of the human brain remains largely unchanged through the ages. People as far back as Plato understood that emotions can trump reason. Emotions are hard to control, because they are a survival mechanism that doesn't necessarily have the individual in mind. They work across a large number of trials to keep the species alive. Over millions of years, more mammals survived by letting emotion override reason than those who didn't, so emotion was selected.

Naturally, we remain vulnerable to the same biases and errors of judgement as people in the past. Extremes of fear and greed and the corresponding effect these have on market prices is here to stay.

In many ways, value investing is a bet on the past. It assumes that things will not deviate too far from historical norms. On average, this strategy works well because people's reaction to events often exceeds their actual importance.

The key word here is *often*. On rare occasions throughout history, the reverse happens and the actual importance of a new piece of technology is greatly understated. This is the domain of the growth investor.

A well-known example of this is the internet. A lesser-known example of this is GPUs (graphics processing units).

GPUs were originally added to computers and video game consoles to accelerate the rendering of images with millions of pixels. By 2005, GPUs were produced in such large quantities that they became a commodity. Commodities lack pricing power, so the price of GPUs naturally fell. In 2009, cheap GPUs were, for the first time, linked together to run neural networks (artificial brains of sorts). A cluster of GPUs could accomplish in a single day what traditional processors took several weeks to complete. Today, these neural networks are being used to train the self-driving cars of the future. At the end of last year, engineers at Google used neural networks to solve a 50-year-old problem in biology that has significant implications for drug discovery.

In the early days of the internet and the World Wide Web, no one could have predicted the impact it would have on society. Similarly, GPUs were intended for improving the rendering of pixels, not solving autonomous driving or drug discovery. The point of this is that new technological developments often have second-order effects that can destroy entire industries while creating new ones.

As stewards of your capital, having one foot planted in the past and the other in the future is the rational approach. Being too enamoured with the future inevitably leads to investing in growth traps, where companies that promise growth that never materialises.

At the other extreme, being too drawn by the past blinds you from changes in the economy that can both create and destroy wealth. This is just one of the reasons Tacit portfolios have a balance between investments that are cheap in the context of history, such as Asian exposure, and those which look to the future (e.g. Scottish Mortgage Investment Trust).