Insights, Tacit Thought | Weekly Investment Insights

The Lindy Effect

Published on: 2 May, 2019 | Author: Investment Team

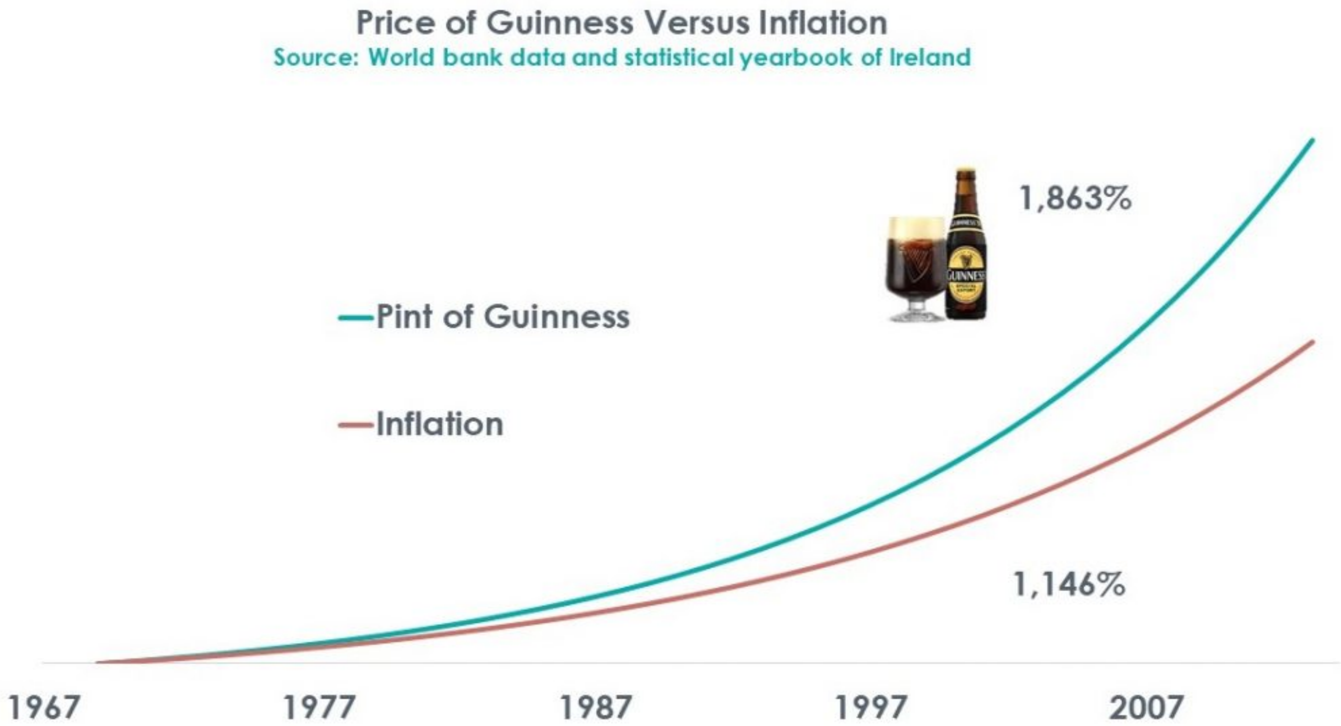
For a company to have sustainable cashflows, it needs to have a contract with its customers. This contract can be literal or metaphorical. If you rent out a property and have a long-term contract with the tenant, there is some certainty that you will receive your rental income in full and on time. However, contracts can be broken. Having a literal contract does not guarantee sustainable cashflows. It does however put the odds in your favour.

Metaphorical contracts are rare and harder to break because they are formed out of habits and convenience. Buffett once said, “the chains of habit are too light to be felt until they are too heavy to be broken”. Any company that can tap into these habit patterns is likely to have metaphorical contracts with its customers. Over time, habits passed from generation to generation can create a “Lindy effect”. Coined by the French polymath Benoit Mandelbrot, the Lindy effect states that the longer a story, idea or brand has survived, the more likely it is to survive in the future.

A 100 years from now, it is very likely that students will still study Shakespeare, children (and adults) will still enjoy Disney cartoons and a Patek Philippe will still be a family heirloom worth more than it was in the past.

One of our largest holdings, the Finsbury Growth and Income Trust, invests in companies with metaphorical contracts. Many of these companies are also “Lindy”. Its largest holding – Diageo, owns well known brands like Smirnoff, Johnnie Walker and Guinness. Let’s take a closer look at Guinness.

Guinness brewed its first ales 260 years ago in 1759. Over the last 44 years, the price of a pint of Guinness has increased by 1,862% while inflation has increased by 1,146%. In this period, the number of competing alcoholic beverages has also increased and yet Guinness has managed to increase prices above inflation without hurting sales. No one is contractually obliged to drink a Guinness, however many people do so regardless – an example of a brand that has metaphorical contracts with its customers. The compounding effect of time transforms this metaphorical contract into the Lindy effect.



As with any other rule of thumb, the Lindy effect is not perfect. Changing consumer tastes and increased competition through the internet has severed the metaphorical contracts between some brands and their customers. A prime example of this is Marks and Spencer. Just like a tenancy contract, metaphorical contracts can also be broken.

Investing is less about certainties and more about probabilities. A company with metaphorical contracts whose products are “Lindy” does not guarantee success but it certainly reduces the probability of failure.

Important Information: Any views, insights, or commentary are for general information only, do not constitute personal investment advice or research, and are intended for UK residents. They may not be appropriate in all jurisdictions. While sourced from information we believe to be reliable, we make no guarantee as to accuracy or completeness. Past performance is not a guide to future results, and the value of investments can go down as well as up.

Regulatory Disclaimer: Tacit Investment Management is the trading name of TIML Limited (No. 9228395), part of Tacit Holdings Limited (No. 10611211). Both companies are incorporated in England and Wales, with the registered office at 14 Hanover Square, London W1S 1HN. TIML Limited is authorised and regulated by the Financial Conduct Authority (FCA ref. 670184) and approves and issues this communication under Section 21 of the Financial Services and Markets Act 2000. Please note, tax and estate planning services are not regulated by the FCA.