



Insights, Tacit Thought | Weekly Investment Insights

Value is in the eye of the beholder

Published on: 1 March, 2024 | Author: Investment Team

At Tacit we have maintained a focus on valuations throughout our 14 years of investing, as overpaying for assets can lead to significant losses. At times in the market cycle, we have had a bias towards companies that do not trade at expensive multiples, referred to as Value Investing, especially when we believe markets are over-optimistic and indiscriminate and following momentum. Those market conditions can lead to a permanent impairment of capital, which is not something we would wish for our clients. Looking for value is not a one size fits all approach, however, and there are companies which command a premium which is both justifiable and sustainable.

Tacit has based its long-term thinking on many academic papers which conclude that companies that grow at a faster rate than the market ultimately suffer from competition, pricing erosion, or diseconomies of scale. The theory states that they cannot continue to generate above-market returns over the longer term as their industry matures and sucks in capital, thus increasing competition.

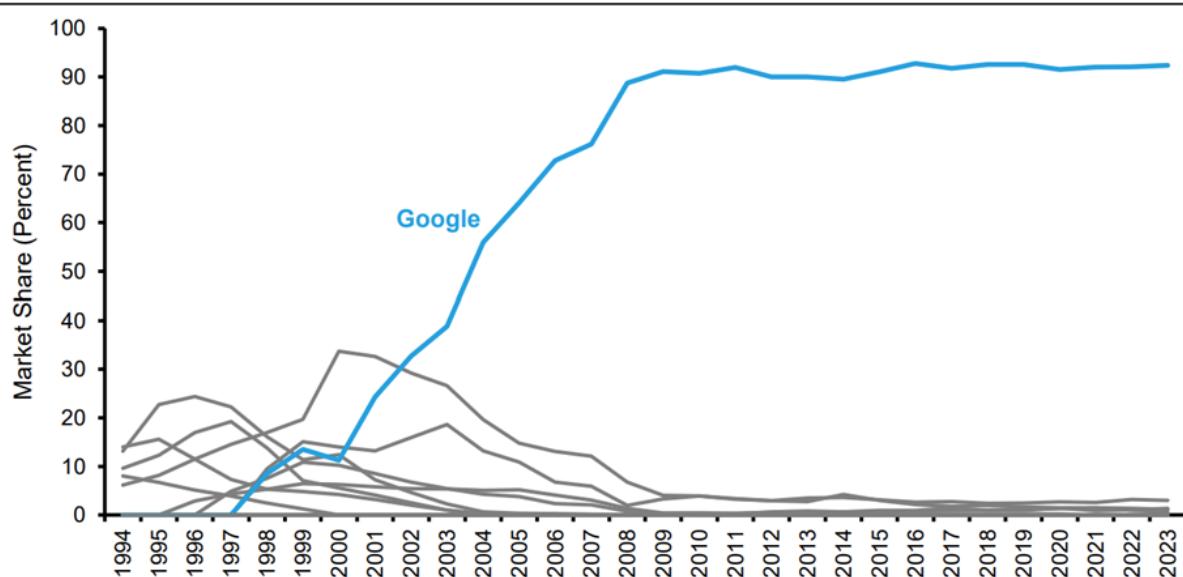
Fast growing companies generally experience a slowdown in their growth rates for several reasons: market saturation, increased competition, scale challenges as the business grows, diminishing returns on investment, shift in focus to less optimal products and services, and broader macroeconomic factors.

It is too simplistic, we believe, to exclude all expensively rated companies which have already delivered exceptional growth from our investment strategy. An over-reliance on Value Investing is highly likely to generate poor investment returns if it excludes all growing companies which have become expensive. Both growth and value stocks have a place in a balanced strategy, and, to us, value is relative to the alternatives available to investors.

At present for example, we firmly believe a cohort of global companies are benefiting from factors that previously were not relevant to the growth companies of yesteryear and that their ability to continue to grow is undiminished by their size due to the nature of their industry. This makes them more valuable than the average company.

Technology companies in this era of market evolution are the obvious examples of this phenomenon. Digital technology has become something of a self-fulfilling prophecy over recent decades and the global leviathans which now dominate their sector have become embedded in almost every aspect of human activity, globally. The chart below focuses on one ubiquitous example.

Exhibit 4: Market Share for the Internet Search Industry, 1994-2023



Source: Statcounter; www.dailymotion.com/video/x81fzhm; Counterpoint Global.

The chart shows quite starkly how certain growth companies have not been impacted by the normal factors which lead to competitive erosion over time. The networking effects of Google have led to its businesses becoming stronger and not allowing others to compete. Unlike standard product categories such as clothing or cars, the global nature of the internet has led to swift global adoption of their services which would historically have been achieved over many decades through mergers and acquisition of competitors. As artificial intelligence (AI) stimulates a further leg in the digital technology evolution, we expect the global leaders to extend their monopolistic positions and thereby their very rich valuations.

In our view, investors need to be nimble and forward looking rather than beholden to any one particular investment style. Current valuations are only one side of the valuation formula, earnings growth is the other.

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