Capital*Management* PARTNERS, LLC

100 Corporate Place, Suite 306
Peabody, MA 01960-4721
www.cmpadvisors.com

Tel (978) 535-8989
Tel (888) 535-8989
Fax (978) 536-4068

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Most of us like to buy, and we hardly ever think about selling anything. In the world of retail consumerism, this usually means our houses accumulate stuff until we can't stand the clutter and cart carloads off to the local secondhand store.

Stock investing might be much the same way, except the clutter is less obvious to the naked eye. We buy what we think will look best in our portfolios, much as we think about how nice that blazer will look when we wear it. Stocks can sit around gathering dust, and figuring out how (and when) to sell a stock is the hardest part of investing. We know from "Other People's Money" (Danny DeVito played Larry the Liquidator) that buggy whip makers are no longer relevant in our economy, but how do we decide to get rid of companies that are destined to join them on the ash heap?

The intuition that capitalism mutates over time was observed in Marx and Engel's *Communist Manifesto* (1848), though Marx's "enforced destruction" implied that eventually capitalism would destroy itself. Joseph Schumpeter, an Austrian-born economist took up the concept in a six-page long chapter he wrote titled "The Process Of Creative Destruction" in his 1942 book *Capitalism, Socialism and Democracy.* Schumpeter was skeptical of creative destruction's role in the economy, in that not only just dead wood but the "flying buttresses" that held up capitalism itself could be destroyed. Despite his own skepticism, creative destruction became a major doctrine of the Austrian school of free-market thought.

If we look at just one trend in our economy – the rise of the internet – we can identify a number of examples of creative destruction at work. The internet has changed how we receive the news of the day, and even how reliable that news is (think "fake" media). The decline of printed newspapers in favor of social media-based news sources has forced traditional newspapers to create new online models to support themselves. Even the doyenne of news – the New York Times Company (NYT) – is barely worth $4 billion today, no more than it was worth 13 years ago.

Entertainment has seen a similar shift away from three TV networks and our local movie theater. The rise of companies like Comcast (CMCSA), Netflix (NFLX) and its competitors have not only changed how we get our TV and movies but has even changed our viewing habits. Binge watching was not even dreamed of 20 years ago, and few households in America still watch network TV via rabbit ear antennas on their sets.

The transportation and lodging industries are in a similar state of upheaval as more flexible ride hailing services and online short-term home/apartment rentals have become popular and often less expensive. Taxis were once a cartel largely enforced by public regulation, and in many cities internet-based ride hailing services have taken away their market. The value of a New York taxi medallion has dropped from more than $1 million to less than $400,000 as their market share has declined to about 25% of all hired car ridership. The taxi medallion owners keep appealing to the city to enact regulations to help them recover their market, but consumers have clearly expressed their preference.

Now that we have seen one of history's greatest innovations – the internet – displace and change many existing industries, it is time to think about what the future may hold for many of the new businesses that have been enabled by the internet. It can be argued that the very act of creating a whole new business or industry lays the seeds of its eventual demise.

Most new businesses (and indeed whole industries) center on a great invention. Once they become established, they spend more money and resources defending their original great idea and perhaps not paying attention to the creative forces that will replace their businesses someday. The most successful of these often derive tremendous profits from that great idea. It is how the leaders of those businesses choose to use this new capital that may determine when the seeds of destruction will sprout and send the business to the buggy whip department.

The law of large numbers often limits the future growth of a successful business. Apple (AAPL) has made the smartphone into a must-have product for most well-to-do people in the developed world, who have gladly paid high prices for them. Those high prices mean high profits but expanding the market to cash-poor emerging market consumers will likely put pressure on those profits. Similarly, Facebook (FB) now has 2.2 billion regular monthly users – 29% of the planet's population – and adding more low income users could mean their advertising model will be less attractive to advertisers. Both companies have essentially picked the low-hanging fruit in their businesses, and future growth may be slower and provide lower incremental profits.

One way to extend the life of a business is to take the profits from that original great idea and reinvest them in new businesses and products. To the leaders of the business, especially the founders this is generally a more attractive idea than simply paying out profits as dividends. The notion that the inventor of a great product can do it again seems obvious, but that original success may have had more to do with circumstances and timing. Alexander Graham Bell was one of many inventors who contributed to the telephone and making the telephone truly useful and ubiquitous required more work after Bell was done. It is rare to see one inventor or company make a transformational invention.

There are many examples of companies who have used the cash from their profits to develop new products and invest in other businesses without producing a good return on investment from it. Microsoft (MSFT) serves as a poster child for this, as their original managers sunk capital into a number of low return products and businesses while their extensions of the original Windows and Office franchises continued to produce good returns. Perhaps the most notable error was Microsoft's 2014 purchase of Nokia's (NOK) cellphone business for $7 billion – most of which was written off their books within two years. The passing of the torch to a new generation of managers at Microsoft has coincided with the development of a strong cloud services business and better returns overall.

The seeds of destruction are unpredictable, and a second act is possible. The companies I mentioned above may continue to have bright futures for many years and succeed with new iterations of their businesses. The alternatives usually are not palatable to most business leaders – break-ups, mergers and even bankruptcy are often the consequences of failing to respond to new challenges in business. Perhaps the late Andy Grove (who ran Intel (INTC) at one of its most successful times) said it best:

"Only the paranoid survive."

Thomas E. Dexter, CFP®

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