KAMES CAPITAL

THE UNAPPRECIATED DEFLATIONARY POWER OF TECHNOLOGY

A characteristic of this cycle has been persistently low inflation. This has coincided with the rise of global, capital-light deflationary tech giants. Coincidence?

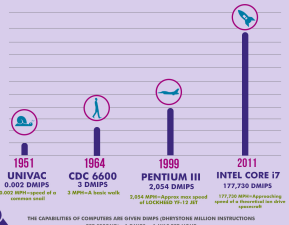
INFLATION OR DEFLATION?

This is the question investors want answered more than any other. Apparently.

As equity analysts, we don't know the answer. We are bottom-up stock pickers, so deciphering and appropriately weighting the multitude of macroeconomic factors influencing government bonds is beyond our remit. But there is one thing we are very sure of. **Global tech platforms are causing deflation and the size and scale of their deflationary impact is increasing year-on-year.**

REASON#1 COMPUTING POWER

"Moore's law is that overall processing power for computers will double every two years".[1]



Other technologies such as renewable energy, robotics and battery technology are also tracing a path of relentless price decline. Whilst they may not follow Moore's law (although they are indirectly influenced by it) many are at tipping points where rapid adoption makes unequivocal economic sense.

REASON#2 BUSINESS MODEL INNOVATION

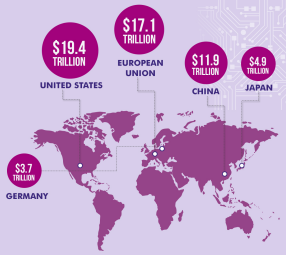
Disruption is synonymous with lower prices because for incumbents to be displaced, new entrants have to offer something better. For any consumer, 'better' means lower prices for the same thing or more for the same price. Whatever way you look at it, this is deflation. And when the consumer expects this to continue it becomes structural deflation.

REASON#3 STOCK MARKET EVOLUTION

Farm mechanisation, railroads and even industrial conglomerates (via bureaucratic efficiency) each had their way of exerting deflation on the economy. It's hard to argue, however, that any of these had the same reach, scale and deflationary impact as the technology giants of today.

Combined Big Tech Mkt Cap values it as one of the largest economies on earth by GDP[2]

$5.1 TRILLION LISTED BIG TECH



Their global scale, combined with their rate of change, is unprecedented. By simply comparing what they offer, and the number of people they offer it to, in 2018 versus 1998 or even 2008 we can intuitively see how much deflation they have caused.

HEADING FOR A POLICY ERROR?

Every year the Federal Reserve holds its annual Economic Policy Symposium at Jackson Hole to debate and discuss long-term policy issues. Given the emphasis they place on inflation, it seems logical that they would be attempting to measure the deflationary impact of technology. However, from what we can gather, the subject of technology-driven deflation did not feature in any of the presentations over the entire week in August 2017.

WHERE TO FROM HERE?

We will leave the inflation and interest rate predictions to the economists and continue investing in businesses that create long-term value for our clients. We like businesses that exhibit structural growth, high returns on invested capital and attractive free cash flow relative to their valuations.

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co-manager, Kames Global Sustainable Equity Fund

1 http://www.mooreslaw.org/
2 IMF World Economic Outlook Database

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