



The 2nd, 3rd and 4th derivatives

Investing is easy – buy an asset for less than you sell it for. Same could be said for football. Score more goals than your opponent in the allotted time. But we all know that there are lots of rules associated with both investing and football which makes it a little more complicated. Explaining the offside rule for one; games that go to extra time and penalties in cup games but not in league matches; VAR; handball. From an investment angle - understanding risk; portfolio construction; requirements for income; compounding; price volatility; time horizons real returns and so on. What initially seems simple actually isn't.

To make outsized investing, it is often said that you have to be ahead of the market – for instance, buying into online retailers at the expense of high street retailers, or buying into renewable energy at the expense of fossil fuels, and this is sound, logical advice. But this might not meet with your objectives – such as income, time horizon, or a lower tolerance for risk (depending of course what you are defining as risk for instance) and so on.

High definition movies for instance are seemingly a recent invention, but Sony have been making them since 1987 (that's over 30 years ago....!) Are the returns best achieved today when high definition TV and associated industries are everywhere, or are they 30+ years ago when the technology was revolutionary and the risks high? Remember, when the video cassette was invented, there were two competing technologies – VHS and Betamax. Betamax was the better technology by all accounts, but VHS won.

One of my favourite investment quotes from Warren Buffett goes along these lines “the reason why someone is enjoying the shade today is because someone planted a tree a long time ago” and this is, in essence the title of this article. We don't know why the person planted the tree. It could, for instance be a fruit tree and the person that planted it wanted to reap the rewards of the fruit. It could have been planted to be chopped down when considered mature to provide 2x4 for the building industry. It could have been planted so eventually it could be used for firewood. The shade element is the second derivative of the initial reason the tree was planted, and the shade might actually be worth more than the initial reason for the tree to get planted.

The denim clothier – Levi Strauss - became both famous and incredibly wealthy due to the great gold rush on the West Coast of America in the 1870s. Miners and prospectors needed hardy clothing as the job they were doing was very tough on what they wore and Levi Strauss supplied the need – especially considering there were tens of thousands, if not hundreds of thousands of people digging away for their fortune. The second derivative at work again. The gold rush eventually died, but the denim

industry – 150 years later still goes strong. Many investors use the line of “invest in the picks and shovels rather than the gold miners” as a way to represent investing in the second derivative.

I recently read that the cost of pets has risen dramatically this year due to the covid-19 pandemic. Demand has gone through the roof as more people spend more time at home and supply hasn't caught up, so the economic law has changed the price to reflect an equilibrium. Many breeders of dogs have seen the price of their litters treble or more over the last couple of months, and I'm fairly sure if you went to a pet shop there wouldn't be many cats, rabbits, gerbils in stock either. I'm not sure if you can professionally invest in dog breeders in the capital markets, but you can certainly look at the second, third or fourth derivatives.

- If there is greater demand for pets...
 - by default, there is greater demand for pet food
 - there is greater demand for pet accessories (leads, toys, litter trays, clothing, poop bags)
- If there are now more pets in the general population...
 - there is greater demand for the services of veterinarians
 - Vets will need to buy more medicines / drugs / scrubs / grow their practices
- Pet insurance is pretty much essential when you consider the cost of repairing a complex fracture being between £4,000 and £6,000

We do not have a pet in our home, but from conversations with friends that do, I wonder if the number of shoes / slippers sold has increased due to the amount that get eaten? I wonder what the increase in pet hair vacuum cleaners sold have been? I wonder if there has been a shift to wooden / tile / laminate flooring from carpeting due to pet accidents? What about air fresheners? Pet shampoo? The list goes on.

But there is also the other side of the equation. Being as more time is being spent at home, the demands from dog walking services for instance has fallen significantly as more people are taking their pooches for walks themselves rather than outsourcing it. Friends have also provided anecdotal evidence that these services are increasing their price charged per hour to offset the fall in demand so as to maintain revenue numbers. I wonder what will happen when (if) everything returns to normal?

This article could easily have been about the shift to conduct business using Zoom for instance at the expense of face to face meetings and all the ancillary effects – hotels, restaurants, airlines; or eating in versus going out; the rise of Netflix subscriptions being as the cinema is no longer a viable option; home improvements or so on. This paragraph shows there will always be winners and losers. Economies are constantly changing, markets are constantly changing, consumer demands are constantly changing. Some trends are short-term (my kids no longer play Match Attax for instance) and some trends are longer-term. Remember, a dog is for life, not just for Christmas.

Market Snapshot (27.11.20 – 04.12.20)

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FTSE 100	6550.23	↑2.87%	UK	0.30	↑7.14%	£/\$	1.3440	↑0.98%	Brent Crude	\$49.03	↑1.57%
S&P 500	3699.12	↑1.67%	US	0.94	↑11.90%	£/€	1.1100	↓0.28%	Gold	\$1837.70	↑3.06%
NIKKEI 225	26751.24	↑0.40%	Germany	-0.55	↑6.90%	€/€	1.2120	↑1.30%			
DAX 30	13298.96	↓0.28%	Japan	0.03	↑0.00%	£/¥	139.9800	↑0.97%			
CAC 40	5609.15	↑0.20%									

Figures quoted are in local currency
Source: FE Analytics & Financial Times

Week Ahead

Monday – Euro Area: ECB President Lagarde Speaks
Tuesday – Germany: German ZEW Economic Sentiment (Dec)
Wednesday – US: JOLTS Job Openings (Oct)
Thursday – UK: Manufacturing Production (MoM)
Friday – US: PPI (MoM) (Nov)

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