

Bleeding edge innovation, and what we want in our tech portfolio



Introduction:

Despite an overload of overvalued stocks in the tech market, there are still some amazing investment opportunities hidden within the sector, this may come as a bit of a surprise to many of my readers, and let me start off by saying, from an investment perspective we have no current interest in big overvalued companies, Facebook, Amazon, Apple, Netflix, Google (the FAANG stocks) Tesla, Uber, Lyft, and many other big names in tech.

In my opinion these companies are a big part of the problem with over valuations because of their size and market share and almost the entire tech sector is in supper bubble territory partly as a result. It's not that we don't necessarily like the tech innovation or products of these companies; it's just that as an investment at this point in time we're not comfortable with them because of their extreme evaluations.

The majority of publicly traded companies in the tech sector are massively overvalued, trading at many multiples of what they should be, some of them don't even make a profit at all, and perhaps never will. But this doesn't mean that all companies in the sector are overvalued and not worth a look at as an investment, the state of the market in general does however mean we have extra due diligence in our research to find bleeding edge innovative tech companies suitable as investments.

One good thing about tech is that it's constantly changing and constantly innovating.

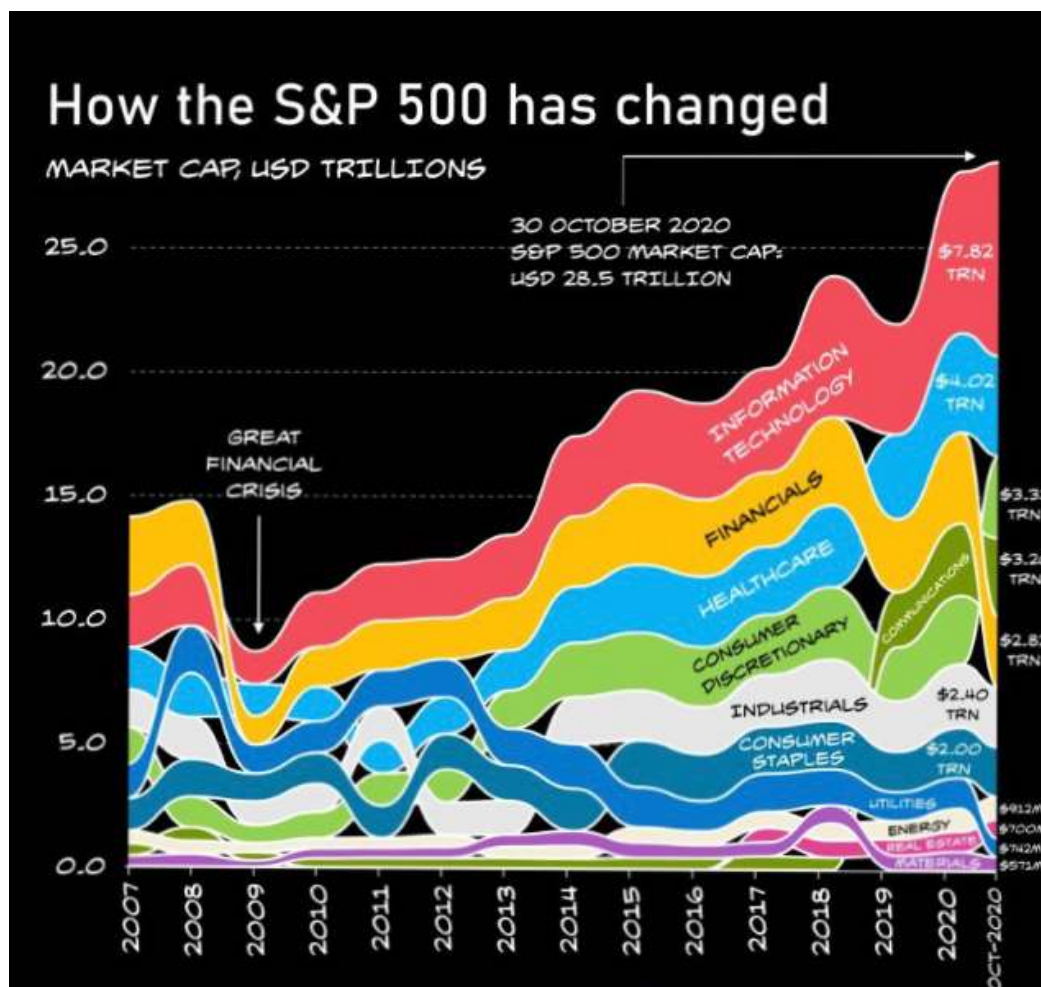
Technology is an industry that thrives on innovation, The speed of innovation requires tech companies to stay ahead of the game or risk being replaced.

Companies deploying disruptive technologies in the sector is what we look for as they will change the industry permanently. Some of these companies will eventually unseat and replace many of the big old incumbents.

The Tech market

Let's start off by looking at how the tech sector has changed over time as a percentage of the markets.

Today technology has grown by market share evaluation into arguably the largest sector in the S&P as shown here



While a lot of this evaluation is a sign of overbought and overvalued tech stocks, in the likes of the FAANG stocks (that we already mentioned), The S&P by market share over time shows us how the relevance of technology in our lives has changed over the last decade, and looking forward into the future it suggests this trend is likely to continue.

Personally I disagree with the current fundamentals in terms of tech being that important but, The market is showing us what the general consensus is in terms of the view of importance by the general public, that's important to note and pay attention to, in other words the market is showing us what the average person wants and values.

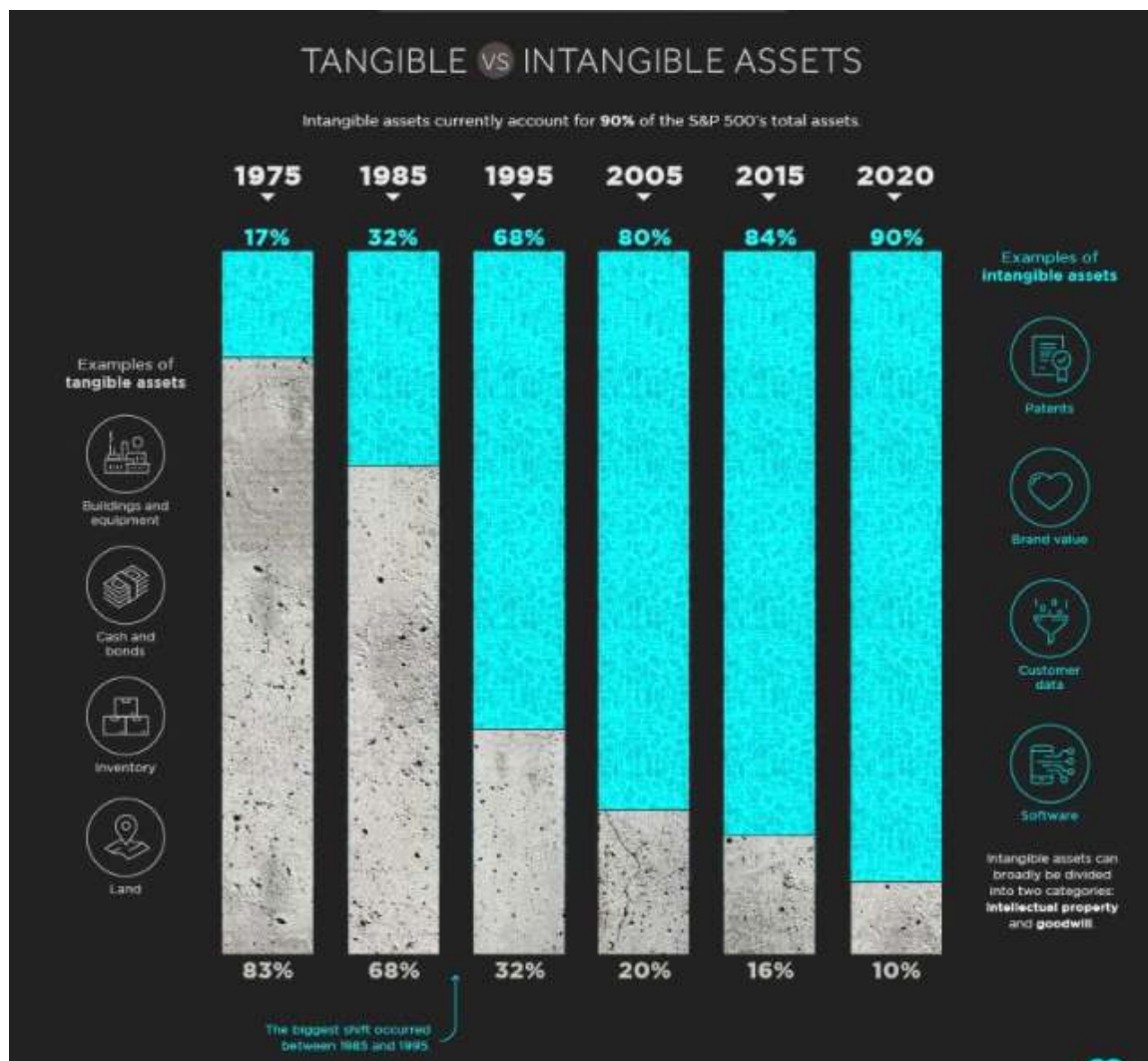
The relevance of tech innovation in our lives is not likely to change because of the many applications of tech in our day to day activities that we take for granted and even demand more of.

A few examples most of us can relate to wanting might be;

Faster internet, better graphics, faster computers, video calls without buffering etc, so since tech innovation is here to stay lets look at how we might best place ourselves to capitalize from the innovation in this trend. But first it's important to understand the distinction between tangible and intangible assets.

Tangible v/s intangible assets

This next graph shows not only how important technology has become in the markets but how the tangibility of assets in the market has changed, to me, the growth of intangible assets doesn't appear to make sense on a logical level, most tech is intangible as an asset which makes it possibly less desirable as an investment, yet intangible assets make up about 90% of the S&P in 2020 the majority of which is tech related.



We should consider intangible assets to be in a different class of investment to tangible assets.

On the one hand tangible assets are physical things like real estate, materials and minerals, they have intrinsic value regardless of the demand for them at any given time.

On the other hand intangible assets are often only of value during a specific window in time when demand is high, this is often relatively short lived and could be like trying to sell outdated software if you get the timing wrong, and we all know there's no market to sell windows 95, it has no value.

Whereas something physically tangible like real estate still has value even if your timings off and you can't sell it for the next 25 years.

This means that the timing has a lot to do with the value of technology investments, and that makes them harder to quantify, tech is very much attached to a specific window of opportunity in time, if it's too soon, it might not work, too late and you've missed the boat, this is true as an investor but even more so for the companies in the tech space. Constant innovation within a given company is key to success.

Missing the Boat and refusing to innovate;



As an example of missing the boat, most of us will remember the old Nokia phones and how before smart phones Nokia was doing great, these phones were very successful for the time, most of us probably thought, "this great company will be around for a long time" and then they slowly disappearedwhere did they go?....well....they completely missed how important smart phones would become, they didn't innovate in the smart phone sector at all, and now even though Nokia is still alive and trying to catch up rebranding itself as a 5G company, it's still struggling and may never get back to its former level of success.

This is largely because Nokia and its management became comfortable with what they were good at, at the time and refused to innovate and look for new trends, I guess they thought “smart phones will never catch on, who’d want one of those?” The rest is history.

I bring up Nokia as an example of what happens if tech companies don’t continue to innovate and I think some of the current big name tech company’s risk following down that road.

As examples I would include Intel and IBM, these two fit into the incumbents category, largely they have become reliant on the products that were successful in the past, they think these products are still great and they now have strong competition and are not innovating for the future, and its starting to cost them big time.

Intel for instance was until recently a big supplier to Apple for processors and chips, you know the slogan, “*Intel inside*” but this year its “*no Intel inside*”

Apple announced that it had changed suppliers for these components away from Intel and, they will use ARM components instead.

Apple did this simply because ARM’s innovations have become much more advanced and flexible than Intel’s, and Apple knows it must continue to innovate and develop its market in order to stay on top, Intel wasn’t giving Apple anything new to work with. (I’ll talk more about ARM later)

Mores Law and Exponential growth

Innovation in tech has always been of utmost importance, and since the late 1960’s or so the rate of innovation has doubled about every two years, this has become known as “Mores Law”

Moore's law by definition is the observation that the number of transistors in a dense integrated circuit doubles about every two years, and mostly this has proven to be correct.

But what we’ve seen in the last year or so is that innovation has been doubling even quicker than mores law, in some key areas of tech innovation has grown by many multiples in a matter of months not years, this we call exponential growth and its what we’re mostly interested in.

Our investment interest in tech



We have an interest in bleeding edge innovation driving disruption and advances in tech companies and the exponential change in growth that comes with it.

We are specifically interested in advances in semiconductors, artificial intelligence, (AI) machine learning (ML) and Blockchain,
We are excluding CRISPER and CRISPER based technologies, (biotechnologies) from our current investment interest as we are unsure of the ethics of DNA editing)

Our Guidelines for finding a good tech investment



When we analyze a tech company, it's stock and it's profit return potential, we want to understand its valuation-not it's share price-so that we can understand if the stock is over, or undervalued.

In addition to that we need to understand the companies products and or services, it's underlying technology, product strategy, product road map, intellectual property, go-to market strategy, the growth of the markets that's its targeting and the competitive landscape that the company is operating in. Understanding these things is critical to developing an investment thesis for any individual stock.

Let's look in more detail at this.

To find the type of investment returns we want, I look for a few things...

- **Is the technology doing something truly unique?**

Is this company's product or service a revolutionary upgrade? Or is it just a slightly better version of what already exists?

- **Is this company operating in a high-growth market**

In other words, is the company operating in a space that is growing rapidly? Or is it in a market that is stagnant or shrinking?

- **Does this company have a smart go-to-market strategy**

A go-to-market strategy is exactly what it sounds like. It's a company's plan to bring a product or service to market and scale that product. This question is especially important when investing in pre-product or pre-revenue companies. We need to fully understand the company's ability to sell its product or service to the market it is addressing.

- **Does the valuation make sense**

This last question is actually the most important one. We need to understand if a company is trading at a reasonable valuation. Even the best companies are not a good investment if they are trading at too high of a valuation. Investing at an irrationally high valuation in a fantastic company will still lead to investment losses.

That is an incomplete list. There's a lot more that goes into identifying a great technology investment. But at a very high level, those are the type of things I look for.

Since you've made it all the way through this write up, and hopefully gained an understanding as to what we look for when investing in technology, then your ready to look at our tech recommendations and do a little of your own research to see if you feel comfortable investing in them as well.

See you there

Francis Holmes

10th November 2020