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The domino effect, Amazon and coffee

There is a high degree of predictability in the creation of the pattern structure of dominos - if you get the basic principles right the pattern will flow as designed.

In the investment world dominos almost always fall unpredictably - and this is really what makes it so exciting. An action somewhere leads to a reaction somewhere completely different, sometimes predictable sometimes not. Further, while in dominos the time lag of the action is predictable with a high degree of certainty, in the real world the time lag is a variable difficult to predict. Sometimes the impact of an action can resonate for years.

Let me elucidate this with a stock example.

Amazon and coffee

Let's take Amazon - the success of Amazon is well documented and analysed, but the failures it is causing less so.

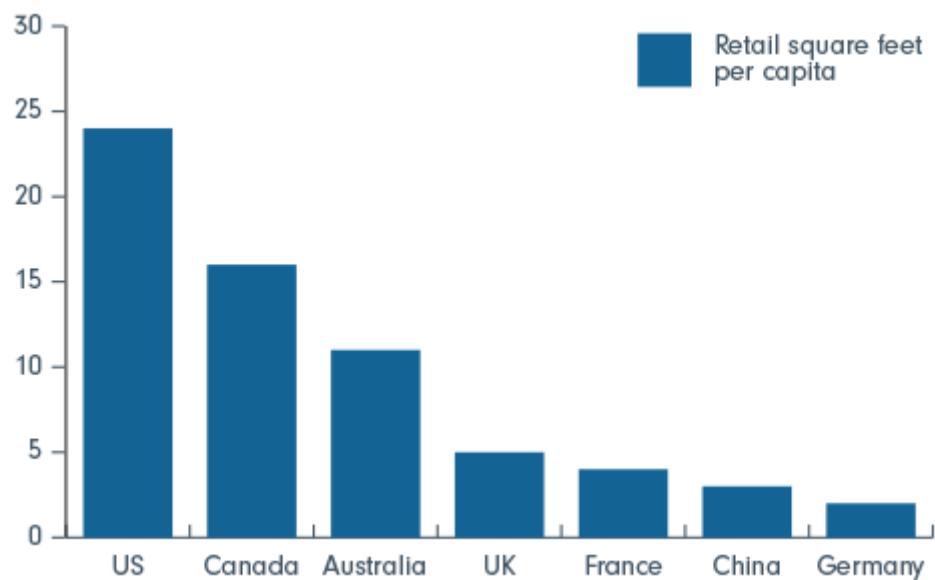
Online is changing customer behaviour faster than we can keep up. For example, when consumers order more online their propensity to visit malls decreases. The first domino to fall has been the health of the book store retailers. The second to fall has been the departmental stores, like Macy's - see the update of the stock price chart I showed you at my last visit down under.

Chart 1: Macy's vs Amazon

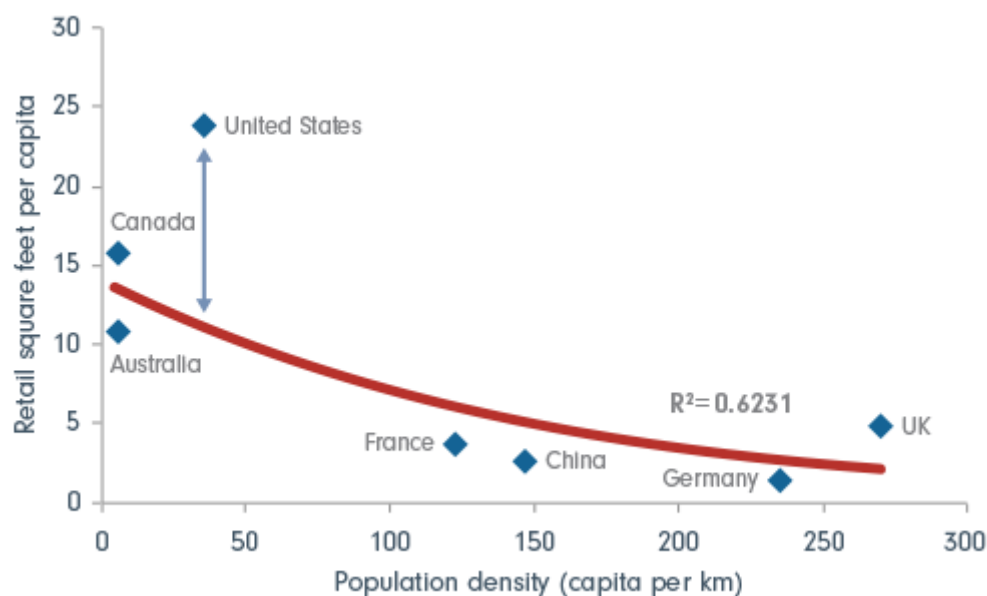


Source: Bloomberg data to the end of April 2017

The dominos soon to fall are suburban malls and their landowners, and the banks and institutions that have financed these malls and developments. Mall visits by consumers in the US are declining rapidly and we have a problem - look at the per capita mall charts in the US. There is a long way down back to the trend line.



Source: GGP (General Growth Properties) Investor Presentation, March 2017



Source: J.P Morgan using World Bank Country Population Densities, 8th May 2017.

Which brings me to an important domino - Starbucks and coffee consumption. Starbucks has been a solid growth stock which has more recently suffered a hiccup in growth. Trading at 29 times earnings (as per Bloomberg), I would argue that the market is still giving Starbucks the benefit of the doubt.

However, maybe the slowdown in growth has a more simple reason - you went to Starbucks store to buy your coffee while you were shopping in the mall - if you are going to the mall less often, you are probably also going to Starbucks less often. So the decline in same store sales could be actually more structural than cyclical.

This is really the fun part of investing - where you can observe the first domino fall and literally let your mind race to predict the fall of the domino not yet anticipated by the market. There is a lot of money to be made or more importantly saved in those endeavours.

As analysts, this is probably the most important component of our jobs - in a globalised world the speed at which these dominos are falling has just increased dramatically.

This is also where active management will always beat passive management - the underlying assumption in an index is that what is big today will remain big tomorrow. However, an active fund manager can choose to have all his holdings in Amazon and none in Macy's or Starbucks.

I would challenge you as investors to think about these dominos as Amazon now finally enters Australia. Analyse your behaviour and how it changes:

- Are you ordering more online?
- Are you and your friends going less to that neighbourhood mall? Are you drinking less coffee as a consequence? Are you driving less?
- If you go less to the mall, are you less likely to buy snacking chocolate (positioned as an impulse purchase near checkout) over gourmet special occasion chocolate (think Nestle's Kitkat VS Lindt)? Is there a saving of your petrol bill? Is car maintenance now lower as you are driving less?
- Should you try and get some of the money that you are spending on Amazon back through ownership of the stock? Etc, etc...

As Peter Lynch says - in his book 'One Up On Wall Street' - just analysing our own behaviours will give us all the investment ideas we need in a lifetime.