Lindsell Train

Who Wants to be a Billionaire?

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What are we to make of the Forbes Billionaires List? This is the magazine's guide to the, currently, 1810 billionaires of the world – average personal net worth of $3.6bn. The list, which updates in real time, puts us face-to-face with these worthies.

In particular some might wonder what to make of the list in the context of Oxfam's January 2016 report which claims just the 62 wealthiest people on the planet own more than the bottom 50% of the population put together – that's 3.6 billion souls. But here it is perhaps relevant that Forbes includes no royalty or heads of state. The List thereby excludes kleptocrats, or otherwise politically-garnered wealth. What I guess is if Forbes did (or was able to) reveal all those fortunes accrued by dictatorial rapacity or bureaucratic legerdemain there would be fewer gripes about those who have feathered their nests by honest toil, or even by the turn of Fortune's wheel.

But maybe not. And I myself am going nowhere near any discussion about the morality of it all.

(But if you're interested in such questions I'd direct you to economist Deidre McCloskey's retort to Oxfam a couple of years ago. She pointed out that if all the wealth of those wealthiest of the wealthy was expropriated and distributed to the poorest half of the world's population it would amount to a one-off payment of $428 each. Nice to have for those living in poverty, but unlikely to be life-changing. As McCloskey said – *"Charity won't help poor people very much. What does help poor people and has massively helped poor people in the long run is the massive expansion of income."*)

No, what I'm interested in is if any investment conclusions can be drawn from a review of the Forbes list. What does it say about how wealth is being created and preserved in the 21st century? So I took a look at the top 100 billionaires and how they made it.

The good news for humanity is that the biggest group of the top 100 billionaires – 25, a quarter of them - made their money from Technology. Broadly defined and including pharmaceuticals (and in this and a number of cases below I have used my own, rather than Forbes', definition of what constitutes a given sector). Of the 13 richest in the world today, 8 are tech-guys. Including Gates, Bezos, Zuckerberg and the Google founders. By the way, had it occurred to you that the name Zuckerberg translates as "Sugar Mountain"? Grimly appropriate if you are of a redistributionist persuasion. But it must be right that the greatest rewards are for those who conceive ways to help fellow humans live longer, more productive (so we all don't have to work so hard) or more socially fulfilled lives. Of course these tech billions represent largely "new money" - money that may prove to be ephemeral; just as ephemeral as technology companies themselves. The first Forbes World Billionaires list back in 1987 contained no Internet fortunes (of course) and its richest Tech players, Ross Perot and the Hewlett Packard founders, have dropped out of today's top 100.

The dominance of tech-money at the top of the 2016 list is confirmed by what strikes us as a historically significant fact. This is that at end-July 2016 the top 5 most valuable companies in the world, by market capitalisation, were all US technology ones. Namely – Apple, Alphabet (Google), Microsoft, Amazon and Facebook. This is the first time this has ever been the case; even back in the 2000 bubble General Electric was still in the top 5. Over the last decade other entrants to this rotating club have included Big Oil and US and Chinese banks. Exxon is still thereabouts – just about the same market cap as Facebook – though its shares have gone nowhere since 2007. But Citibank, the biggest bank in the world in 2006 would now have to treble in value to get back into the top 5. History teaches that not all the current 5 tech giants will maintain their rank even in 5 years time. But it would be a big surprise to me if the top 5 of 2021 was made up of anything but tech companies.

On this point of flux in Technology fortunes it is worth highlighting the one, so far, obvious counterfactual. Which is Bill Gates. Gates with his current stash of $75bn has been the richest man in the world for 17 of the last 22 years. Co-founder Paul Allen and long time CEO Steve Ballmer are also comfortably entrenched in the top 100. Although extrapolation from individual stories is risky I'm tempted to conclude from this persistence that embedded software operating systems offer investors like us more predictable and sustainable participation in wealth creation than chip or gadget designers. I'm tempted, because at LT we have meaningful exposure to this type of software company. For instance, Scott Cook, founder of tax software firm Intuit may be "only" billionaire #959, but his business has been growing since 1983 and we think its best years are still ahead. Software as a Service means Intuit can help its small company customers in ways inconceivable in 2003, let alone 1983.

Reverting to the 2016 List. There are 5 fortunes in the top 100 derived from natural resources. With Mukesh Ambani of India's Reliance Industries placed highest at #36. I imagine 100 years ago a far higher proportion of the world's wealthiest would have been oil and mining barons. Things really do change over time - whatever Thomas Piketty says. Actually what Picketty says is that R is always greater than G (r>g is the formula at the heart of his book, which, no, I have not read). Here R is the rate of return to capital and G is growth in output. And if it is always the case that r>g, then, Piketty argues, the owners of capital, the rich, will forever be getting richer than the proletariat, or those with no capital. But in the real world we can all observe that if the nature of the capital on which your average plutocrat earns his return is made redundant - commoditized or replaced by new technology - then he can quickly get poorer than his grandfather, even if his name was Rockefeller.

The next smallest cohort in the 2016 top 100 is Real Estate, with 10 – amongst who is not the Donald. According to Forbes he sits at #324. (By the way, followers of UK politics may be surprised to learn that at 70 Trump is 3 years older than Jeremy Corbyn. Beware angry old men.) In 1987, when Forbes produced its first global rich list, Real Estate provided more like 20% of the wealthiest, double today, with the top 2 slots of all held by Japanese property developers. Again it is instructive that real assets – metals and land – no longer dominate the List in the 21st Century. Now intellectual property prevails. Harry Potter has famously created more wealth for his author than owned by the British monarch. Mind you the persistence of a Grosvenor in the top 100 underlines the importance of the advice given to me by my father - hang on to London property.

There are 11 out of the top 100 fortunes made in financial services. Here are a handful of corporate raiders and hedgies – brilliant or lucky, or both. For instance, Ray Dalio, founder of Bridgewater Associates, who describes himself as a "professional mistake maker" and a great learner from his mistakes. Not a bad definition for those of us lucky enough to get paid for trying to make sense of the markets. There's Abigail Johnson, scion of the family that founded Fidelity who has a heavy responsibility as CEO of the asset manager, as steward of $2 trillion of client assets. That's 4x more AUM than Schroders, LT's largest fund management holding. New CEO at Schroders, Peter Harrison, should be thinking big – there's plenty of scope yet to grow that venerable franchise. The famously long term view of billionaires #317, Bruno Schroder and family with their controlling stake, mean the company has every chance to build on its investment flair, global distribution and balance sheet.

I was surprised that the next most populous sector is Retail, with 12 of today's top 100 billionaires, although admittedly 4 of these are Waltons. It was well said recently that the Waltons made their money by saving US citizens money, while Bezos has made his by saving Amazon customers what has become an increasingly valuable commodity: Time. Amongst the others are the founders or families responsible for Zara, H&M, Aldi, Lidl, Boots/Walgreens and Uniqlo. Many of these are fun places to shop and despite digital there is every reason to believe that stores people actually enjoy visiting will continue to prosper. Retail will thrive as a form of entertainment, rather than a utility. Take Philip Green and wife, sitting in at #204 on the Billionaire List. This ranking has everything to do with the continuing funkiness of Topshop, rather than the goings-on at BHS. As to my personal take on Philip Green's lifestyle, I find it hard to improve on Cole Porter's lyric from Who Wants to be a Millionaire?:

"Who wants to journey on a gigantic yacht? Do I want a yacht? Oh, how I do not."

Then there are the 17 who have built fortunes from Industry in general. They are led by Buffett, who is gradually slipping down the billionaire rankings, though still in the top 5, as he donates big blocks of his wealth to charity. The Koch brothers are both in the top 10 too. Their family business is the second largest private company in the US, with over $100bn annual revenues, derived from an eclectic range of basic products and services, such as oil refining, paper and pulp and Lycra. Maybe you need a single good idea to build a multi-billion fortune, but to diversify as widely as possible if you want to keep that fortune over generations?

But outside Tech the biggest grouping of billionaires is those who own consumer brands, with a definite tilt to luxury goods and booze. This is of more than passing interest to us, of course. There are 20 of them, led by the L'Oreal billions, with Arnault's glittering collection of treasures at LVMH not far behind. BMW, Chanel, Gucci and Luxottica have also made fortunes for their owners. Reading the recently published investment letters of Marathon Asset Management I noted their quotes from Johann Rupert, chairman of Richemont, on the attraction of investing in luxury brands:

"Anniversaries, birthdays and girlfriends are always going to be there."

Or himself quoting Coco Chanel : *"Money is money is money. It's only the pockets that change. We've got to find those pockets."*

Or Rupert's business philosophy, one that all these luxury billionaires have implemented: *"The only way we know how to maintain a sustainable competitive advantage is to grow the brand equity...because that brand equity creates demand and will result in pricing power."*

In beer, Budweiser and Heineken lead. The Bud billions now accrue to 3 top partners of 3G Capital, Ambev's private equity backers. Between 2005 and 2011 Ambev's operating margins increased by 1,000bps, or a whole 10%. Cost cutting your way to billions. But there is a different approach at Heineken, where we are invested. Here there is a commitment to creative and expensive marketing. So successful and influential is its work on brand building that the industry joke says that Carlsberg's marketing department is actually in Amsterdam, not Copenhagen. Again Heineken is known for its maniacal focus on product quality. For instance think on this - every single batch of Heineken beer brewed globally has to have samples taken and sent back to Amsterdam where it is tested for product quality, across 71 metrics. Why that attention to detail? Well, as the company says; "Emerging Market customers are not second class citizens." And the result of this approach? Heineken has 14 #1 or 2 market positions across Asia, compared to 5 for its nearest rival. Heineken may never enjoy profit margins as high as Ambev's, but it's run to survive and thrive for centuries to come. And maybe, therefore, deserves a lower discount rate than a peer that puts a higher premium on short term profit maximisation.

Other billionaire-creating consumer brands include Nike, Lego and Red Bull – the latter the youngest in the top 100, established as recently as 1987. Confectionary confirms its reliability too, with 3 Mars and a Ferraro Rocher in the top 30.

Anyway, we must always learn any lessons we can from those smarter or more hard-working than ourselves. For instance – Tech will make you more quicker but with greater risk, while brands are wonderful long term repositories of value.

But while we are enjoying life's true wealth - Summer sun, family holidays - we should keep all this money-making in perspective. Take it away Cole Porter:

Who wants an opera box, I'll bet? – I don't

And sleep through Wagner at the Met – I don't

Who wants to corner Cartiers too? - I don't

And I don't 'cause all I want is you.

Nick Train, Portfolio Manager

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