WARNING: The editor general has determined that reading this column could expose you to sarcasm, irony, and other forms of humor.

Sweet—But Deadly

By Ralph Wanger, CFA

One of the most important parts of an investment analyst's job is identifying long-term trends that will affect a company or industry over a long period of years. This practice is often called "thematic investing." You'll have succeeded if you discover that a market favorite is now on the wrong side of technological change or new government regulations. It's important to be on the right side of a long-term trend.

CHANGING TASTES

Examples abound of popular companies being surpassed by new technology or new ways of doing business. IBM in the 1970s had an absolute lock on computer technology, so much so that the government expended vast resources on antitrust suits. IBM managed its way through the lawsuits, but when the personal computer was invented, IBM lost control of its customers. IBM had based its market on controlling the decision process of company presidents buying million-dollar mainframes, but when $1,000 PCs were developed, the buying decision was moved downstream to the data-processing managers. These mid-level managers had been scorned by the IBM salesmen and were only too happy to switch to a new brand.

In the 1960s, the retail industry was dominated by Sears. Sears had an elaborate management system staffed with many highly skilled people. When the discount stores appeared in the early 1970s with very lean management teams, Sears couldn't adapt. Walmart became the leading retailer, boasting astonishing growth for a 20-year period. Now, Walmart has gone flat because Amazon and other online retailers have revolutionized the industry.

When I started in the business in the early 1960s, the largest holdings in our portfolios were electric utilities stocks that offered a combination of well-covered dividends and above-average growth. I remember discussions with analysts as to whether Commonwealth Edison would grow at 6% or 6.5% over the next 10 years. It seemed like an important topic at the time. When government regulation pivoted away from allowing consistent returns on capital, it became a much more volatile environment. Electric utilities were downgraded from stable growth to very cyclical companies, and the industry became much more difficult to follow.

Two other trends started in the 1960s. My boss's wife came back from the grocery store once with some bottles of a hot new product called Diet Rite Cola. After taste tests, we bought a lot of Royal Crown Cola stock. The stock was a big winner. Furthermore, it was an early signal of a low-calorie food trend.

In 1964—seven years after the American Cancer Society made the announcement—the Surgeon General announced that smoking caused lung cancer. The anti-tobacco movement was born! After getting medical opinion on board, it was time to inform the public and develop a popular movement. Once popular opinion was organized, government regulators and Congress finally moved. Actions included high-cost excise tax, restrictions on advertising and product labeling, and class-action litigation.

Because the tobacco companies were large and profitable—everybody smoked cigarettes—a titanic battle took place over several decades to regulate the industry. The tobacco companies defended themselves, but public opinion was against them. Many portfolio managers refused to own tobacco stocks—not because the companies became unprofitable, but because the portfolio managers could not stand the level of public criticism. Today, the incidence of smoking is greatly reduced.

A BITTER SUGAR PILL

Social activists currently are using the same strategy that worked with tobacco to go after the sugar industry. Then, it was lung cancer; now, it is diabetes. A century ago, diabetes was a rare disease, but now it is a pandemic. Type 2 diabetes and obesity are strongly linked, and both are caused by bad eating habits. Sugar is considered a primary culprit (see, for example, *The Case Against Sugar* by Gary Taubes). On 4 January 2017, an important lawsuit was filed by the Praxis Project in collaboration with the Center for Science in the Public Interest (CSPI) against Coca-Cola and the American Beverage Association demanding that they stop their misleading advertising around the consumption of sugar-sweetened drinks. Praxis and CSPI claim that sugary drinks are the number one source of the added sugar in the American diet that causes diabetes, heart and liver disease, obesity, and tooth decay. Current trends project that half of Latino and African-American children will develop Type 2 diabetes in their lifetimes! Unchecked, this would be one of the worst public health catastrophes in history.

Whether or not this particular lawsuit prevails, popular opinion on the dangers of sugar will prevail sooner or later. Analysts might do well to evaluate sugary soda stocks carefully. The same logic applies to children's breakfast cereals, as major brands may come under attack. When social trends are against a company, investors need to be alert.

The irresistible demand of public opinion has forced universal male suffrage, women's suffrage, prohibition (and its repeal), civil rights, and anti-tobacco laws. Sugar may be the next big crusade. Investors should keep this in mind when looking at food companies and pharmaceuticals.

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