

The Illusion of Precision ... & SQ Updates

If you read Alex's latest [Market Note](#), you know we're all about Cones of Probabilities.

The idea is that we'll never know the *exact* likelihood of a future bet with any real precision, so we should orient *how* we invest around this philosophy.

I like how Alex put it (emphasis added):

"We don't need to predict the future. We just need a framework that allows us to effectively understand what's going on now and what that means for the future."

Not needing to predict the future is relieving because it's impossible. I'm reminded of one of my favorite Jeff Bezos quotes when an interviewer asked Jeff, "*What do you think will happen in the next 5-10 years?*"

Here's Bezos's response:

"A better question is: ``What's not going to change in the next 10-20 years?" What won't change is people's desire for lower prices and faster delivery."

Bezos didn't try to predict *the future* of consumer behavior. Instead, he examined *what historically worked* and predicted that those conditions would last over the next 10-20 years.

We possess the frameworks to make fundamental predictions about businesses like Christensen's [Jobs To Be Done](#) or Emerson's [Mousetrap](#).

Yet all the mental models in the world can't save us from the fact that the future is messy, predictions are futile, and precision is an illusion.

There are two things we can do in light of this revelation:

- 1) Stop looking forward and instead look backward**
- 2) Shorten our prediction/precision hurdle**

We'll explain these two options later, but first, let's see *why* predicting the future is futile.

Illusions All The Way Down

I finished the book "Everything is Obvious" on my return flight from Denver, CO. If you haven't read it before, buy a copy.

The book's point is that what we perceive as common sense is a crutch for our inability to make sense of a complex world.

Take this thought from one of the first few chapters (emphasis mine):

*“What we don’t realize, however, is that **common sense often works just like mythology**. By providing ready explanations for whatever particular circumstances the world throws at us, **common sense explanations give us the confidence to navigate from day to day and relieve us of the burden of worrying about whether what we think we know is really true, or is just something we happen to believe.***

*The cost, however, is that **we think we have understood things that in fact we have simply papers over with a plausible-sounding story**. And because this illusion of understanding in turn undercuts our motivation to treat social problems the way we treat problems of medicine, engineering, and science, the unfortunate result is that common sense actually inhibits our ability to understand the world.”*

The same thing happens when we make Excel models and forecast 5-10 years into a business’s future. We paper over the reality of business with a “common sense” DCF model.

Businesses are what Michael Waldrop calls Complex Adaptive Systems. One of the chief attributes of Complex Adaptive Systems is the inability to predict, with any degree of certainty, the system’s future state.

As Waldrop notes in his book “Complexity” (emphasis mine):

“Complex systems are more spontaneous, more disorderly, more alive than that. At the same time, however, their peculiar dynamism is also a far cry from the weirdly unpredictable gyrations known as chaos.

In the past two decades, chaos theory has shaken science to its foundations with the realization that very simple dynamical rules can give rise to extraordinarily intricate behavior; witness the endlessly detailed beauty of fractals, or the foaming turbulence of a river.

*And yet chaos by itself doesn’t explain the structure, the coherence, the self-organizing cohesiveness of complex systems. **Instead, all these complex systems have somehow acquired the ability to bring order and chaos into a special kind of balance**. This balance point—often called the edge of chaos—is where **the components of a system never quite lock into place, and yet never quite dissolve into turbulence, either**. The edge of chaos is where life has enough stability to sustain itself and enough creativity to deserve the name of life.”*

Waldrop just described financial markets.

More Data =/ Greater Precision

I’m a fan of Cliff Sosin at CAS Investment Partners. Cliff is a long-term fundamental investor. He’s one of the few that invests along legitimate 10-year time horizons. CAS has generated ~29% IRRs despite this year’s 65%+ drawdown.

Cliff spends most of his time studying historical business analogs and consumer logic/behavior. Backwards-looking, as he calls it.

Anyways, here's his thoughts on [trying to predict the future](#) from a 2017 Graham & Doddsville interview (emphasis added):

*“The fundamental issue is this: **there are limits to the amount you can forecast the future.** Nonlinear dynamic systems [read: Complexity] are subject to inherent forecasting limitations.*

Think weather forecasting, because it is nonlinear you just can't forecast accurately more than a few days in advance even as the amount of computing power and the data quality explodes.

The economy and businesses are even worse because they are under-specified nonlinear dynamic systems. It's totally impossible to refine your predictions past a certain pretty rough point.”

In other words, there's a point when an investor has all the information they need to make their best guess. The next incremental bit of information adds almost no value. In fact, the folks at Lux Capital argue that more information causes *negative* incremental returns.

Check out this bit from Lux Capital's piece [“Marginal Stupidity”](#) (emphasis mine):

*“**There is a point at which complexity begets further complexity with no increase in productivity,** essentially leveraging a collective “tax” on everyone to maintain an ever more complicated bureaucracy for no value.*

*Thus, Tetlock and Tainter converge from disparate paths to what might be dubbed a “theory of marginal stupidity.” While education is extremely valuable, and more information and complexity is generally good for decision-making and societal productivity, **there is a turning point where further information or complexity can befuddle us and simply raise costs without any concomitant value.”***

As we mentioned earlier, there are two core ways to combat the illusion of precision and prediction:

- 1) **Stop looking forward and instead look backward**
- 2) **Shorten our prediction/precision hurdle**

Let's examine each of these tactics.

Looking backward allows us to spot long-standing human trends and tendencies. It's Taleb's “Lindy Effect” idea. Something that's lasted *this long* will continue to last *at least that long*.

Only by studying historical consumer patterns can we identify trends and patterns that *might* work over the next 10-20 years.

The second thing we can do is **shorten our prediction/precision hurdle**. This is the biggest mistake I've made as an investor over the last 12-18 months. It's easy to project 5-10 years in the future when all stocks go up. We extrapolate price action onto human/consumer psychology.

Peloton is an excellent example of this phenomenon. At its peak price, we all assumed every American, even the morbidly obese, would put down the hamburger and pick up the Peloton. We expanded our prediction hurdle decades into the future based on short-term information.

Choose Your Fighter

Great investments possess *at least one* of the above illusion remedies. It's either deep conviction in the historical tendencies of consumers/businesses to choose a particular product or service.

Or you believe that if a company survives the next 1-2 years, it will be worth 5-10x more than it is today.

If you can find both remedies in one investment, check the Crazy-Hot scale because you [found a unicorn](#).

I've stuck a Post-It note on my desk with the phrase:

“Look backwards and shorten your prediction/precision hurdle.”

You'll say “no” to more investments, and that's the point. It's frustrating and frustrated me over the last few weeks (ask Alex!). But it's critical if we want absolute outperformance without buying value traps.

Some Updates on Square/Cash App (SQ)

There's been a few exciting developments in one of our **Strategic** holdings, SQ.

Square Partners w/ Leading Accounting Software Firm Sage Group

First, Square announced a [partnership with Sage Group](#) (SGE.LSE) to integrate SQ's POS system into Sage's online accounting software for SMBs (think Quickbooks).

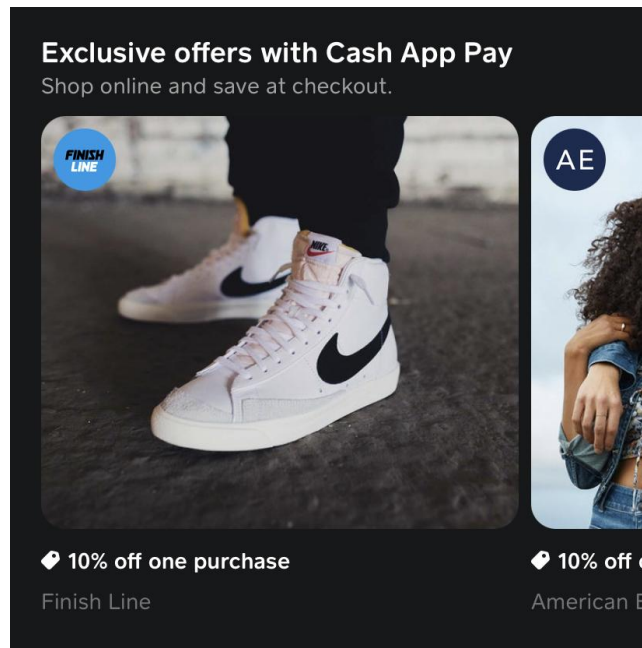
The integration substantially reduces consumer adoption friction and makes Square an easier sell for SMBs. I wouldn't be surprised if the company reported higher-than-expected revenue growth after this integration.

Cash App Pay Expands Beyond Square POS & Terminal Sellers

Then there's the Cash App news. Cash App users can [now make online payments via Cash App Pay](#) to merchants *outside* Square's seller ecosystem. Currently, I can use Cash App Pay to shop at **Finish Line, American Eagle, Tommy Hilfiger, ThredUp, and JD.com**.

All without leaving Cash App.

I can also pay through a Cash App Pay button on each company's website. Users could only use Cash App Pay on Square terminals or online Square merchant partners.



The news brings a host of benefits, including

- More Cash App users to the platform
- Increased average annual spending
- Expand gross payment volume
- Capture a more significant percentage of eCommerce transactions

And, most importantly, **provide Cash App with actual purchase data to sell merchants on Cash App Boost.**

The more purchase data Cash App has on its consumers, the more valuable its Cash App Boost platform becomes to merchants.

Because of Cash App Boost, I've switched 75% of my personal spending to my Cash App card. And the more targeted they get with offers, the more I'll transact.

The move is a shot across the bow to Venmo, PayPal, and Apple Pay, which boasted Payment Options at the POS.

It'll be interesting to see how Apple reacts, given that [they just allowed](#) Cash App Cards on their Tap To Pay feature.

The Most Interesting Job Postings on Cash App

Every week, I scan Cash App's latest job postings. It's a great way to understand where the company's moving and what they want to do.

One job posting piqued my interest with the title ["Block Tax Product Specialist."](#)

Check out the listing below.

Job Description

Cash App is offering a better way to file your taxes as an alternative to traditional online DIY tax preparation systems. As a Tax Product Specialist in our Charlotte, NC office, you will oversee the planning, design, development, and execution of our tax product offerings to keep the tax software up to date with the most recent tax law changes. You'll work closely with our engineering and product teams to bring product designs to reality, making sure the product is implemented accurately and handles all supported scenarios. You will support QA of the product for behavior and accuracy, and help to resolve product-related issues identified by our members.

This position is ideal for a seasoned tax product specialist or tax analyst looking for an opportunity to influence and improve a tax product that is accessed by millions of users, as part of a rapidly growing software company.

You will:

- Create and review help text, help center articles, product requirement docs (PRDs) and other materials to ensure customers can file their taxes with ease
- Research current tax laws to ensure the accuracy of calculations and forms for various federal and state filing scenarios through PRDs, regression testing and test scenario creation
- Work with SWEs and QEs to make sure requirements are implemented accurately
- Verify the product as it is being developed to ensure it provides a great user experience, including intuitive data entry and relevant help
- Answer questions about the tax code, including "what if's" that arise during design and development of the product
- Analyze XML for tax return accuracy

Free filing is a great way to capture millions of taxpayer refunds onto the Cash App platform.

Then there's the "[Merchant Advisory Manager](#)" role, which seeks to expand Cash App Pay's merchant reach and provide Cash App with more purchase data. Check out the description below.

Job Description

The purpose of the role is to partner with the NA sales organization to help Afterpay 'Win with Customers' and 'Scale Actionable Insights' through world class data & insight, with a focus on action and driving outcomes. This includes how we use data, insight and research to better understand our customers, and in turn help merchants understand more about Afterpay customers and broader BNPL industry trends.

We need to position Afterpay as a customer and data led organization – the best in the BNPL industry – and one that helps its partners become smarter, data-driven and customer focused. Our success will be measured by growing our share of wallet among our customers and Afterpay Share of Checkout for our merchant partners.

The key focus for the role is to leverage data to better understand our customers, merchants and market, and position that to our merchant partners to drive actionable insights and create meaningful relationships.

Finally, there's the "Block Ads, Incentives, And Rewards Account Manager" position. This is the growth engine of Cash App's advertising business, which, if executed correctly, can add *hundreds of millions* of high-margin profit dollars.

Check out the job description below. Gets you excited, doesn't it?

Job Description

The Ads, Incentives, and Rewards Account Manager owns key merchant accounts for Cash App's emerging and scaling business lines. Our ambitious team is commercializing some of our most beloved products like Boost, builds effective relationships with the largest players in the retail industry, and drives critical results across Cash App's most important business lines. We are looking for an experienced Account Manager to drive growth and retention for some of our top merchant relationships.

The Ads, Incentives, and Rewards Account Manager will also partner closely with our cross-functional team to help turn Cash App Boost and upcoming products into the most sought-after shopping platform in the U.S. You'll collaborate with cross-functional colleagues in Product, Analytics, Marketing, Design, Legal and Engineering. You'll drive strategy and execution for critical relationships, help innovate and iterate at the cutting edge of our incentivized shopping business, and have a meaningful impact on Cash App's core business.

You will:

- **Own partner relationships:** Lead partnerships that both achieve our goals and meet our partners' objectives. Manage our portfolio of partners to ensure we succeed in meeting our joint objectives.
- **Drive optimizations, expansion and renewals:** Ensure we retain existing partners by devising data-driven strategies that will meet and exceed partner goals. Upsell and cross-sell to compound partner success and add strategic value to their relationship with Cash App.
- **Report, analyze, and tell the value story:** Work with our reporting and analytics folks to tell the value story to partners and demonstrate how we're helping our partners win.
- **Lead cross-functional initiatives:** Establish yourself as a subject matter expert for our ads and incentives products. Provide critical market feedback to improve our product. Help drive efficiencies and improvements that accelerate our timelines.

Thoughts on Adding To SQ Here

SQ's stock is down ~36% from our original cost basis and now maintains a ~3% notional position in the book. In the coming weeks, we'll get that to *at least* 5% notional.

The company trades at >9x EV/Gross Profits, its second-lowest valuation ever (March 2020 reached 8.5x). SQ also sports the cheapest EV/GP amongst its competitors:

- PayPal (PYPL): 9.88x
- Apple (AAPL): 14.71x
- Visa (V): 15.87x
- MasterCard (MA): 15.93x

Interestingly, SQ is estimated to generate over 2x higher revenue growth CAGRs at 24% versus an average of ~9% for its peers.

I hope y'all have a great weekend. Go spend some money using Cash App. It's "investment research," after all!

Your Value Operator,

Brandon

Portfolio Moves

Buys

- **BOUGHT BACK** Ethereum (ETHUSD) Short
- **BOUGHT** Starter Tactical Long in Desktop Metal (DM)
- **BOUGHT** Mean Reversion Long in Gold Futures (GCZ2022)
- **BOUGHT** Long Wheat Futures (ZWZ2022)