36 South Views

JUN23

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TLC

I've just finished reading a very interesting book, Premonition by Michael Lewis. It was about the coordinated response to pandemic preparedness in the USA and what actually happened during the Covid pandemic.

I was struck by the parallels between preparedness for a pandemic and that of a portfolio.

The CDC were basically asleep at the wheel, as far as I could gather, and any policy they had was put in place to monitor and observe any crisis that might emerge.

Risk managers are put in place to monitor and observe risk without having much of mandate to mitigate it.

The real experts in the real-life story basically said that there is no ONE silver bullet that could be implemented to thwart a pandemic/crisis but a number of varied strategies which they dubbed "targeted layer containment" or TLC.

In portfolio risk mitigation there is no one silver bullet which can save a portfolio in a crisis but a series of strategies which I would also label under a similar acronym.

They described a fire at Mann Gulch which clearly showed how exponential systems work in real life, how unusual strategies are the only ones that worked and how people in general are not hardwired to understand the nature of the exponential function.

One of the only survivors burnt a fire ahead of him with minutes to spare before the rapidly approaching main fire reached him. He then ran through the flames and found a spot which had been burnt and settled there whilst the main fire burnt around him. It is now known as an "escape fire".

In portfolio management, survivors burn through some capital in tail risk hedging in preparation for the crisis (which in human affairs in inevitable) this should protect them in a crisis whilst it burns everyone else around them.

As the pandemic surged through America, politicians tried to understate the size and extent as well as the consequences. They basically said firstly it would never reach America and then when it did that it would die off naturally effectively following a negative exponential function not a positive one.

During the 2008 Global Financial Crisis we witnessed the exact same thing. Politicians and central bankers went out of their way to poo poo any idea that the current state of affairs was as bad as some people knew it to be and secondly that they had it contained.

The lesson learned here is the need for independent thought.

Social distancing was the most effective tool in containing the pandemic.

In portfolios, "social distancing" assets i.e., reducing their correlation, will have a massive impact in a crisis.

The last but probably most poignant fact was that nothing was really learnt post the crisis, nothing that was translated into effective policy.

In portfolio management, panic abounds in the crisis but the lessons are never learnt and implemented when calm returns.

Yes … experience is what we get just AFTER we need it.

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