Weekly Digest

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Risky Business

Spring seems to have come and gone since the last missive a couple of weeks ago, with Arctic winds sending the thermometer back down to zero even in London. As you might imagine, this was not a great time for our central heating boiler to break down. A visit from a suitably masked repair man revealed that not only was it reaching the end of its useful life, but it is also prone to leaking carbon monoxide. Even though the boiler lives in its own private cupboard with an external air vent, the verdict was swiftly reached that it had to be shut down, with the insurance company further declaring that it was “beyond economic repair”.

The point of this story - other than, perhaps, to elicit a modicum of sympathy - is to give an example of risk assessment and its involvement in decision-making. In this case, the potential outcome for me and my wife was death from carbon monoxide poisoning, which, set against the inconvenience of lugging convector heaters from room to room and wearing an extra sweater, as well as the cost of installing a new boiler, made the decision a no-brainer. Even so, I can also imagine a situation where someone who was not in such a fortunate financial position might be tempted to keep a faulty, death-trap of an appliance running. There have also been high-profile commercial cases of rented properties where landlords have skimped on maintenance to forge some extra bucks, but with tragic consequences and, ultimately, liabilities in the form of fines and compensation that massively outweighed any incremental profit. There are some corners that should never be cut.

In today’s Covid world, governments and individuals are also having to make some serious risk assessments. It’s pretty clear that many people who know they have Covid are not isolating because they cannot afford to. I am not here to pass judgement on them or on the government for not making it financially viable for them to isolate. It’s just another example of economic forces overpowering what might be deemed to be more appropriate behaviour for the current situation.

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The main risk assessment conundrum, though, concerns vaccine safety, particularly vis-à-vis the AstraZeneca (AZ) vaccine. There has been a veritable hokey-cokey approach to policy in recent weeks, especially in many European countries. Governments and health authorities have wrestled with weighing the risk of blood clots against the protection provided both to individuals and (in terms of creating herd immunity) to the population in general. Although I don't believe any official has said as much, I can't help feeling that if there were sufficient supplies of alternative vaccines available that currently appear not to carry any side-effect risks, the AZ vaccine would be quietly retired, or at least taken back to the lab for more trials and some tweaking. But there are not, at least not in the UK, certainly, and so last week I, too, became one of the human guinea pigs in this extraordinary real life clinical trial.

Even before any vaccines had been approved, I cited two examples of when vaccines had had documented negative effects. The first was the polio vaccine, which, when initially administered in the United States in the 1950s, caused thousands of cases of polio and a number of cases of paralysis and death. It turned out to be the result of a faulty virus deactivation process at one of the manufacturers. The second was the development of narcolepsy in children and youths who were given a vaccine to combat H1N1 bird flu in 2009. The most frequent and best documented occurrences were in Sweden, but in the UK, too, one in fifty-five thousand recipients developed narcolepsy as a result (Public Health England study, as reported on the NarcolepsyUK website). In this case, no fault on the part of the manufacturer was ever established. Vaccines, it appears, can be just as capricious as viruses when it comes to how they react with human genes.

Interestingly, though, it is clear that governments recognise the "greater good" of accelerated vaccine programmes when needed. In the UK, for example, Glaxo SmithKline, the developer of the H1N1 vaccine was given an indemnity by the government against any legal proceedings in the event of potential side effects (proof of negligence notwithstanding). Even so, it appears that extracting compensation from the government is not exactly straightforward either. Meanwhile, in the United States the National Vaccine Injury Compensation Program was introduced in 1986 to protect manufacturers from litigation. There was deemed to be a real risk that nobody would be prepared to develop or manufacture vaccines owing to the threat of crippling litigation.

From an investment perspective, then, we never expected vaccine rollout to be straightforward. Indeed, we would not be entirely surprised if new challenges lie ahead. But we believe that investors will continue to look beyond the short term noise and the highly emotive reporting and focus on the risk-adjusted benefits.

There is another up-and-coming field of technology where I can see exactly the same arguments being played out, and that is "autonomous vehicles", or self-driving cars. Supposedly these will be the panacea to traffic congestion, as well as allowing current drivers to relax on the journey or even have a nap instead. All the statistical analysis suggests that autonomous vehicles will be safer than those driven by flakey humans (who, we already know, are poor judges of risk). But who is going to be to blame when somebody does die in an accident? The software company that analyses the on-road data? The manufacturer? The companies that provide all the cameras and sensors that make such technology possible? This has all the makings of a liability minefield, and leads me to the personal conclusion that (unless governments step in with some kind of backstop), widespread use of autonomous vehicles is a lot further off than the bulls would have you believe. But I'd like to be wrong on this!

Bringing this all back to the day job, investing, at its heart, is all about finding the right balance between risk and reward. A neighbour related a story to me over the weekend about a young relative who had recently lost 100% of the capital he had put into his "investments". Clearly these must have been of a highly speculative nature, possibly involving options or some other form of leveraged trade. That's why our industry remains obsessed with "risk-adjusted returns" as a measure of performance, although more through

the lens of volatility as a definition of risk. There is a well-established trade-off between volatility and returns, with asset classes that exhibit higher realised volatility tending to deliver higher returns over time. But it's only one measure. Warren Buffett famously describes "permanent loss of capital" as the biggest risk an investor faces. Indeed, in checking this assertion, I found a website with no fewer than thirty-six quotes from prominent investors saying much the same thing.

In any case, in investing as in life, we need constantly to assess the trade-off between the risks we are taking and the opportunities and rewards they might deliver. With that in mind, I am going to copy the conclusion to the latest Monthly Commentary publication that I also write (with apologies to those who have already read it).

"In military circles, it helps to know what one's objective is when embarking on a campaign, rather than just turning up for a random fight. Once the objective is defined, a strategy can be put in place. But there will always be unplanned events that require a responsive action, and those fall into the realm of tactical decisions. Long-term investing requires similar discipline. Clients' objectives are different. Some want to maximise their gains to build wealth, while others are more inclined to preserve what they have already accumulated. Yet others will need income upon which to live. Once the objective has been identified, a portfolio is built in line with a predefined Strategic Asset Allocation (SAA) benchmark, which will also take into account volatility and the risk of capital loss (drawdown). The icing on the cake, as it were, is delivered by a combination of Tactical Asset Allocation and stock selection, by which we strive to deliver returns better than the SAA benchmark. Long-term performance records illustrate that we have been successful in this objective.

However, periods when market returns are being driven by companies that might not meet our quality thresholds can be more challenging. Yes, tactically, one can always lower the barriers to entry to some degree, but that is difficult, if not foolhardy, across a whole portfolio. This is when it becomes more important than ever to remain focused on the longer term objective, and to continue to deliver returns that we believe to be sustainable over longer economic, market and investment cycles."

Last week's Economic Highlights

FTSE 100 Weekly Winners

JD Sports Fashion Plc	11.2%
AVEVA Group plc	10.3%
Persimmon Plc	9.2%
Anglo American plc	8.5%
Pershing Square Holdings Ltd Public Class USD Accum.Shs	8.2%
Hargreaves Lansdown plc	8.1%
Intertek Group plc	8.1%

FTSE 100 Weekly Losers

Flutter Entertainment Plc	-1.4%
Royal Dutch Shell Plc Class A	-1.3%
Aviva plc	-0.9%
BT Group plc	-0.8%
Standard Chartered PLC	-0.4%
Barclays PLC	-0.1%
Royal Dutch Shell Plc Class B	0.0%

FTSE 100 Index, Past 12 months

Source: Factset

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