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Strategies for surviving in a polycrisis world

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Over past six months, investors have been confronted by escalating levels of uncertainty. Global markets have recorded their worst start to a calendar year since the inception of the MSCI World Index in 1970, delivering a total US dollar return of -20.5% (-16.6% in ZAR) over the first half of the year and -16.2% (-6.7% in ZAR) in the second quarter. Even traditional safe havens like US bonds have not offered sanctuary, while cash rates remain negative in real terms in most parts of the world. However, our sense of escalating uncertainty is not only driven by the dislocations that we are witnessing in global markets.

The continuing war in Ukraine has made it clear that we need to consider the possibility of living in a world marked by escalating (and potentially expanding) geopolitical tensions. While the situation in Ukraine may be top of mind, China's geopolitical ambitions are not far behind as a potential source of future disruption. In the shorter term, it is hard to ignore the extent to which the conflict in Ukraine impacted supply chains and has also raised issues around global food and energy security. This set of worries follows on the heels of the COVID-19 pandemic, which many parts of the world are still grappling with. Europe's heavy reliance on Russian gas now appears to be a potential strategic blunder and, regardless of the outcome of the war, many countries are likely to rethink their energy policies into the future. Locally, of course, it is difficult to mention energy without swiftly digressing into a discussion on Eskom and protracted loadshedding. While spiralling energy costs have driven inflation to levels not seen in over forty years in the US, ongoing extreme weather events remind us that climate change is real and again underscores the urgency of addressing our energy crisis (this time, from a sustainability perspective). And while COVID-19 and its many variants may slowly be edging off the global stage, monkeypox seems to be eyeing the limelight...

Enter the polycrisis

No wonder words like polycrisis are creeping into our vocabulary. Multiple intersecting systemic crises that spill across boundaries and that have devastating effects, are rapidly becoming a feature of the complex environment in which fund managers are expected to operate. As these crises often interact with each other in ways that are hard to predict, they are adding to the complexity and volatility investors need to navigate on a daily basis. Noise and uncertainty amplify the risk of emotional investor responses, selling at the worst possible time and reinvesting well after the price recovery is underway.

Despite the many warnings about the dangers of market timing, investors still succumb to emotions, vacillating between the perceived need to act and being frozen by the fear of making the wrong decision. And once out of the market, it is always tempting to sit on the side lines and wait for uncertainty and volatility to subside. This approach has been proven many times over to do a disservice to investors in the long run, eroding rather than enhancing returns.

Here is the kicker, though: very few of the issues mentioned above are likely to be resolved soon (and for some, perhaps, never), and as in the case of COVID-19 and monkeypox, one kind of crisis may simply be replaced by another. Regardless of the technical definition of the current state of affairs, one can reasonably conclude that uncertainty (and excessive market noise) has become a staple of our world. Investors aiming to avoid all periods of market upheaval may end up spending more time out of the market than being invested. Thus, we require a more pragmatic approach to living in a polycrisis world. Rather than aiming to avoid the market turbulence that is sure to lie ahead, we would like to propose some strategies that can help investors to survive in such a hard-to-predict world.

Don’t bet on binary outcomes

In our view, such an environment underscores the importance of not taking bets on binary outcomes. Positioning your portfolio for a singular outcome is likely to be fraught with risk, especially since outcomes are so hard to predict. It also highlights that lazy or formulaic investing, based on what’s worked in the past, is unlikely to succeed. If there is anything that we have learnt over the last few (pandemic) years, it is that there are always investment opportunities, no matter how uncertain the world may seem – and this is especially true when investors sell in a panic, often in response to an immediate crisis.

Such opportunities may, however, appear counterintuitive, unpopular, unusual or often out of keeping with what has worked well to date. With reversals, upheavals and disruptions all being possibilities, your investment portfolio should be positioned to benefit from multiple drivers of return, and this is why we believe a benchmark-agnostic approach is a crucial element of building an investment strategy. If the opportunities of the future look substantially different to those of the past, it also follows that they may not be part of the main indices or dominating the narrative of the day – yet.

Don't underestimate the importance of price

We have always held that the entry price you pay for an asset is a key determinant of the returns you are likely to realise going forward. However, as we have seen over the past few years, prices can sometimes diverge from fair value for protracted periods and may even be rationalised as being justified by participants. The antidote to falling prey to irrational exuberance is to question the prevailing narratives, and to remember that if you are tempted to invest in something "at all costs" or you are driven by the fear of losing out, it may be a sign that you are overpaying.

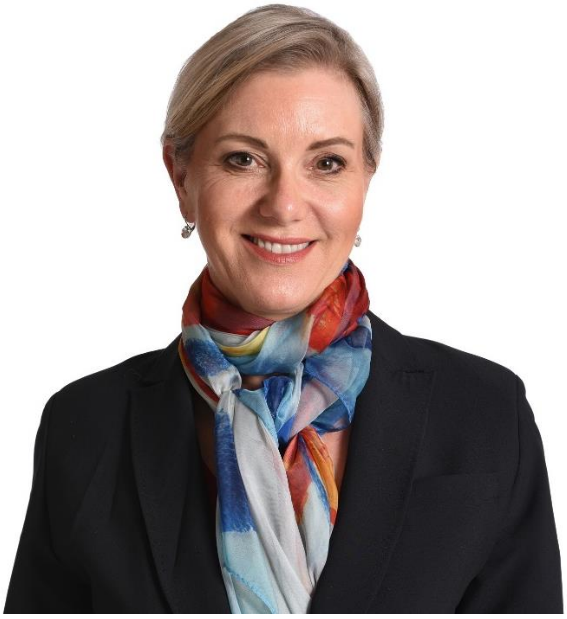
Construct client portfolios to help manage destructive behaviour

Having a diversified portfolio has always been a key investment principle, but we believe investors who are likely to succeed in a turbulent world will be the ones who construct their portfolios in such a way that they are robust at multiple levels. This includes not only geographic and asset class diversification, but also diversification in manager styles. By its very nature, the polycrisis cocktail is designed to dissuade many from investing, but, as we have often seen in the past, some of the best opportunities are made at the times of greatest uncertainty. Knowing that your investment portfolio is diversified and is positioned to benefit from a variety of opportunities, may be one of the most important tools for managing investor behaviour going forward.

Partner with differentiated thinkers

Setting aside our reluctance to act is not easy and becomes less easy in the face of escalating noise and uncertainty. It is here where we believe partnering with differentiated thinkers could offer investors material advantages as part of a blended portfolio strategy. With the environment ahead possibly looking substantially different to that of the past, intelligent curiosity and openminded thinking are required to unlock the opportunities on offer. Crises can provide the prospect of lowering your investment risk in what feels like a high-risk environment by taking advantage of market reaction and volatility to buy at attractive long-term levels. Far from being different for the sake of it, acknowledging that significant shifts are taking place in the global investment arena and questioning the common narratives represent an antidote to the comfort of crowds, which seldom offer shelter during a crisis.

Glacier Research would like to thank Anet Ahern for her contribution to this week's *Funds on Friday*



Anet Ahern

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Anet has over 35 years of experience in investment and business management. After starting her career at Allan Gray in 1986, where she fulfilled various roles in trading and investment management, she worked as a portfolio manager at Syfrets, and later BoE Asset Management, where she was CIO and CEO. She also spent six years at Sanlam, where she was the CEO of Sanlam Multi Manager International. Anet joined PSG Asset Management as CEO in 2013.