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## Why doing nothing is an option when it comes to your investments?

By Craig Gradidge, as published in the Business Day on 14 April 2020

“Why is doing nothing an option?” asked my client the day after Nhlalhla Nene was surprisingly fired as Finance Minister, and the local stock market was crashing. As an executive in a large organization her instinct was to respond to a crisis with some action. So when my response to her question about what to do in her investment portfolio was “I do not think we should do anything now” she was uncomfortable. Surely we should do something? She demanded an answer to her specific question “why is doing nothing an option?” Below is an expanded and more considered version of my answer to her then and is relevant given the challenges investors currently face.

Financial markets can be classified as complex adaptive systems (CAS). A CAS is a system in which many independent agents (investors for example) interact leading to emergent outcomes (a market crash) that are often difficult to predict simply by looking at the individual interactions. There is also no centralized control mechanism that governs system behavior. These systems also adapt to changes in other systems (political, social, etc). This concept of a system interacting with other systems relates to the study of ecosystems, and it can sometimes be difficult to separate the system from its ecosystem. Understanding parts of the system (or ecosystem) does not mean that one understands the entire system.

An easy way to explain a CAS is to look at traffic patterns, especially during peak traffic. The traffic system has a set of explicit and implicit rules. On the way to work in the morning there may be an accident along a route. Every driver is an agent in this system and is thinking and acting independently. Upon hearing the news of the accident, drivers on that route start making decisions about how to react. Some continue driving on the route hoping it will be cleared by the time they get there. Others choose an alternative route. Some drivers are listening to a radio station which does not report the accident and carry on their normal route. Add into the mix taxi drivers and those drivers who have urgent meetings or emergencies that require them to travel that route. As each of these agents make independent decisions, patterns start to emerge. As these patterns emerge, agents may modify their decisions, and cause other patterns to emerge. The best strategy for a driver in this scenario cannot be known upfront. If she takes an alternate route that many others have taken, then she is equally delayed. Drivers who ‘do nothing’ are making a decision (informed or not) and contributing to the patterns that emerge from all the decisions taken that morning. Imagine the mess if this accident happened on a day that it was raining hard enough to cause traffic lights along the route to stop working.

Complexity results from the inter-relationship, inter-action and inter-connectivity of the elements within a system and between a system and its environment. This implies that a decision or action by one part within a system will influence all other related parts but not in any uniform manner.

Serena Chan in her paper on complex adaptive systems states “complex adaptive systems function best when they combine order and chaos in an appropriate measure.” This suggests that financial markets require some investors to do nothing and behave in a more calm and measured manner for the system to function.

Does this mean investors should never do anything about their portfolios given that markets are always somewhere along that continuum between chaos and order? Certainly not, times like these are a good test of the robustness of a portfolio. Investors should certainly look at how their portfolios have performed, relative to a suitable benchmark. Now would not be a good time to make changes, but it is certainly a good time to assess their portfolios and note any strategies that should be reviewed at a later stage.

Markets are incredibly volatile now because of the Covid-19 fallout globally, and South Africa’s downgrade to sub-investment grade. It is difficult to implement decisions in such an environment as the delays during implementation could see investors lock in permanent losses. The JSE has lost over 10% in one trading day in March and gained over 6-7% on other days. This is not the environment in which to be implementing switches to one’s portfolio.

On my way to work recently I found myself stuck in a traffic jam due to an accident on William Nicol Drive. I did not have the energy that morning to think of alternative routes to take and carried on towards the accident. Fortunately, the traffic department arrived on the scene at some point and started directing traffic. I got to work a lot faster as a result of that intervention as affected traffic from our direction was prioritized. Global authorities are on the scene of the current economic crash and are affecting patterns in the market. Investors may, as a result, do well if they simply stay the course for now.

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