

Known unknowns and Unknown unknowns

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Humility is at the heart of sound investment.

This isn't a virtuous choice on our part, nor are we meek or particularly self-deprecating. It's simply a clear-eyed acknowledgment of the uncertainties of the world in which we invest.

We may have discovered a 'perfect' stock by diligent analysis of solid balance sheet facts but the potential for an event like the Alpha Piper oil rig disaster that destroyed the value of BP shares is ever-present for every company.

Holding a number of stocks rather than one – diversification – is first and foremost an admission that perfect stock selection is impossible, because otherwise it would lead to worse outcomes than just concentrating on the 'best' stocks.

If we acknowledge the uncertainty surrounding the stocks we know about, what about all the stocks we don't know about? The global universe of stocks is enormous. We cannot possibly know them all, much less be able to assess their relative merits and risks.

So, we readily concede that gaps in our knowledge exist, and we deploy client capital with specific expert managers in areas of the investment world that require the specialist knowledge we don't possess.

In reality, our acknowledgement of the unknowns of investment goes further.

Because there are some shocks such as war and pandemics that hit all stocks rather than individual stocks, we use 'Stabiliser' holdings such as gold and government bonds that may react differently when these major external shocks arise. But there is no ironclad law that says gold goes up when stocks fall, nor another that bonds go up when stocks fall. Their behaviour, like any individual stock, is unpredictable too in the short term.

On learning that investment is not a science, that relationships between stocks and other assets is not at all predictable, the response of some potential investors is to retreat. They seek certainty.

For example, the stock market gyrations of the pandemic caused all investors great anxiety. But for those that sold stocks for cash rather than staying invested, the subsequent rise in inflation has had a catastrophic impact on the buying power of that cash. The real value of cash HALVES every 13 years at an inflation rate of 5%. UK inflation may (or may not) have topped out last month at 6.827% over the last 12 months. As we wrote last week, UK inflation has averaged over 4% over the past century.

Others, lulled by the seemingly endless bull market in UK property for the last 45 years, may have sought certainty in property. But with affordability at record lows and prices falling at their fastest rate since 2009, this is also not a one-way bet.

At Tacit, we firmly believe that the attempt to avoid risk is illusory. There are no places of absolute safety, only relative safety. We understand this and embrace it. At any one time we are sceptical about what can be known about the future of any one company, market, currency, or asset. We know we cannot eliminate risk but use our experience to shape it. The job of matching the risk of a portfolio with the needs and requirements of our clients is as important to our process as finding the next best investment. The true value of Tacit Investment Management lies in our understanding and management of uncertainty rather than in dispensing Olympian wisdom.

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