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Melting Ice Cubes

by Richard Parfect

When the human mind is confronted with a completely unexpected situation or an event that has not been experienced before, then the brain immediately suffers what is known as a "startle effect". This was commented on by Sully Sullenberger; the captain of US Airways Flight 1549 that successfully ditched in the Hudson River in 2009 without the loss of a single life.

Pilots train for the loss of a single engine after take-off throughout their career; their mind is trained to expect it and repetitive training creates an almost "muscle memory" in terms of dealing with it. However, faced with complete double engine failure on climb out from LaGuardia with no apparent safe escape route to land on, Sully and First Officer Skiles's brains had to go through a process of recognising the double bird strike on their engines, diagnosing the problem, accepting the desperate situation and deciding on a course of action.

Initial recreations on flight simulations by the NTSB (US accident investigator) suggested a 50% chance of successfully returning to the airfield. However, that was assuming a completely unrealistic immediate diagnosis and response by the pilots. Once a more realistic 35 second delay was inserted into the simulations it was shown that a successful return to any airfield was physically impossible. Sully and Skiles were found to have made the correct decision to abandon the illusion of safety of an airfield return and instead to ditch in the Hudson (technically difficult, with unknowable survivability).

How is this relevant to business and investment? Well, the COVID-19 pandemic showed authorities to be suffering that "startle effect"; delays to lockdown implementation would be partly explained by an inherent denial of the situation. Initial expectations of a rapid return to normality were also subsequently dashed by events.

Business leaders were far from immune too. Whilst pre-planned disaster recovery action plans were a significant help in terms of rapidly enabling entire work forces to work remotely, the longer-term implications still appear to be too difficult, for some to comprehend.

In investment there is always a strong tendency to "talk up your own book". Just as one can anticipate the answer when asking a barber whether you need a haircut; it is probably not too surprising that landlords of large portfolios of office space will be dismissive of the prospect of a permanent change to work patterns. Similarly, some office tenants have been equally sceptical; David Solomon (CEO of Goldman Sachs), described home working as an "aberration".

Office working has its advantages where there is a specific purpose of physical attendance, however, to expect that society will return in full to routine pre-pandemic work patterns is like trying to put the genie back in the bottle. Workplace flexibility will become a key talent attraction and retention tool, in the same way as salary and medical insurance. As the work force is constantly fed from the bottom, over time the expectations of millennial workers will dilute and replace those at the top.

"ESG investing" is a movement that has gained enormous traction in the minds of business in the last couple of years. However, companies that attempt to turn the clock back and restore the business practices of life pre-COVID will be acting in direct conflict with the requirement to eliminate unnecessary CO_2 emissions. This will become particularly acute as pressure increases for companies to sign up to the Financial Stability Board's Task Force on Climate-related Financial Disclosures (TCFD); which is designed to improve and increase reporting of climate-related financial information for conducting business.

In the property market we have seen the dangers of that "startle effect"; Andrew Jones, the CEO of LondonMetric (who recently spoke at our 2021 Annual Think Tank) has referred to the owners of high street retail property as holding "melting ice cubes". This was the case even before the pandemic took hold and e-commerce penetration in the retail sector accelerated. We could now see a repeat of the dramatic structural change witnessed in retail property, with an upending of the office market. Those landlords (and tenants) that recognise and accept this, will have a much greater chance of successfully adapting their portfolios, repurposing them to alternative uses or cutting their losses earlier rather than expensively hoping for a return to life pre-COVID. Hope, without a plan, is never a successful investment strategy.

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Important notes

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