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Getting a read on uncertain markets - recommendations - by Michele Wood

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Michele Wood

Valbridge Property Advisors

Recently, I saw a headline reporting a 136% rise in people seeking readings from online psychics, no doubt caused by the acute uncertainty that we all find ourselves in over the past 12 months. Uncertainty leads to anxiety, and in times of anxiety, we seek comfort and assurance. Over that time we have seen in commercial real estate a corresponding spike in demand for forecasting, predictions and value projections. It's only natural. But it's likely not all that useful.

So, what might be useful to not only self-soothe our personal and professional selves in times of turbulence and uncertainty, but to help us position for the future? Often, the best insight comes from unexpected places and visionaries emerge from unlikely origins.

Below are three recommendations that will help us navigate the current economic environment and will almost certainly feel like a beacon of light in some of the dark days we have been experiencing.

Thinking in Bets: Making Smarter Decisions When You Don't Have All the Facts. Annie Duke. Penguin Random House 2018.

One of the passages in the first chapter "Life is Poker, Not Chess" reads, "Game theory is the modern basis for the study of the bulk of our decision-making addressing the challenges of changing conditions, hidden information, chance, and multiple people involved in the decisions." I read that in May 2020, having seen headlines that same week reporting changing conditions, hidden information, and chance in the economic climate. Fast forward to the beginning of 2021, and we are still surrounded by changing conditions and vulnerable to hidden information.

One of the best ideas presented in the book, particularly for those of us in commercial real estate investment, valuation or development, is the idea of a "premortem" exercise for complex decisions. As relates to CRE decisions, the task is basically to do "negative visualization" on the project wherein you analyze as many things as possible that can go wrong. Doing so not only triggers you

away from confirmation bias (i.e. “this is a good investment because...”) but allows one to address weaknesses in a deal or a property’s characteristics and build in protections or remedies.

There’s a reason why the book was a bestseller, and you may even pick up some fun tips for your weekend poker game along the way.

The (Mis)Behavior of Markets: A Fractal View of Financial Turbulence. Benoit Mandelbrot. Basic Books 2004 (update reprinted post-financial crisis)

What caught my eye was first the use of the word “fractal” associated with words like “financial” and “markets.” A fractal, for those of you who didn’t have as many nerd friends in high school like I did, is a “curve or geometric figure, each part of which has the same statistical character as the whole.” Visually, think of a tree, which has branches that grow out from the trunk in a visual way similar to the way smaller branches grow from the large branch, down to the smallest ends of branches.

Mandelbrot’s ideas are counter to the predominant “Efficient Market Hypothesis,” or “EMH” theories of the 20th century, as well as the “random walk” school of economists. While many now use his theories and models in their risk management modeling, many still miss his central idea, which is that volatility can be seen to cluster in market events, and “black swan” events, though increasingly factored into models, often fail to consider what happens when more than one extreme event happen back-to-back, as they sometimes do.

“On October 19, 1987, the worst day of trading in at least a century, the index fell 29.2 percent. The probability of that happening, based on the standard reckoning of financial theorists, was less than one in 10 to the 50th power—odds so small they have no meaning. It is a number outside the scale of nature. You could span the powers of ten from the smallest subatomic particle to the breadth of the measurable universe—and still never meet such a number.” How do you model for THAT? Well, you can’t. But, you can look at the patterns in the market and make intelligent conclusions from those about your risk exposure.

One line that struck me as relating particularly to valuation: “The prime mover in a financial market is not value or price, but price differences; not averaging, but arbitraging.” This seems especially pertinent in the past 12 months when so much “value” has moved, but there is much opportunity in arbitraging certain assets and positions.

Antifragile: Things that Gain from Disorder. Nassim Nicholas Taleb. Random House 2012.

Taleb’s name is likely known to you, and you have certainly seen his most famous concept, that of the “Black Swan,” invoked countless times this past year. Antifragile is one of the books, in addition to The Black Swan that make up Incerto, the collection of Taleb’s works investigating concepts like uncertainty, probability, risk, etc. in a cohesive collection.

I read The Black Swan when it came out in 2007 and it is one of the few books in my life that defined a “before” and an “after.” When Antifragile came out years ago, I bought it, but it sat on the

shelf unread until the title captured my attention in the thick of the COVID months—things that GAIN from disorder? Disorder was all around and very few people were focusing on what was gaining, and what was gaining seemed uncertain to last (residential real estate sale trajectory, demand for distribution space, etc). What could he mean?

This book took longer than the others to finish because I kept having to pause to really soak in the concepts. Like *Black Swan*, the ideas seemed to touch all aspects of life: healthcare, diet and exercise, financial decisions, politics and business.

The basic idea of something that is antifragile occurred to me years ago. I toured the site of “Biosphere 2” in Arizona, an artificial environment fully enclosed and designed to mimic ecological systems on earth for study as potential use in alternative environments like space. In the “ocean” room were fully grown trees, but they were all deformed and irregular looking. The guide explained that one of the lessons they learned from that room was that trees need wind blowing, and blowing fairly hard, regularly, for their trunks to strengthen and grow properly. That is a perfect example of antifragility: the stressor, as long as it is not tornado-strength, benefits the tree, and the tree suffers in its absence. Our bones and muscles are like that too—they atrophy in the absence of stress.

Taleb spends 425 pages outlining evidence for this idea, examples from all aspects of nature and human enterprise, and does so with breathtaking scholarship and background. He takes aim at economists, business writers, colleges and college professors, doctors and more. It’s great fun.

The implications for some of the ideas explored in these texts, as well as the countless works that were cited and influenced these authors are boundless. Volatile times are anxious times. But they are the opportunities to clear the forest of the endangering underbrush, to create fertile soil for the new to germinate.

Michele Wood is director of research at Valbridge Property Advisors, Houston, TX.

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