

THE GROUNDWORK — ARTICLE 02

Why Invest at All?

Risk premiums and the cost of doing nothing

In the previous article, we introduced **beta** — the return you earn simply by owning a diversified portfolio of assets. We argued that beta is the single most reliable engine of long-term wealth creation, and that it is available to anyone at near-zero cost. But we skipped a more fundamental question, one that sounds almost too simple to bother with: *why invest at all?*

If you have savings sitting in a bank account, you are already making an investment decision. You are choosing the safest possible asset — cash — and accepting whatever return it offers. For most of history, and in most currencies, that return has been lower than the rate at which prices rise. In other words, the default choice is not neutral. Doing nothing has a cost, and understanding that cost is the first step to making a better decision.

The Erosion Problem

Cash feels safe. It is denominated in the unit you spend, it does not fluctuate in nominal terms, and in most developed economies it is guaranteed by the state up to a certain amount. These are real advantages, and they matter. Cash is the right home for money you need in the short term — rent, payroll, emergency reserves, near-term obligations.

But cash has a silent problem: **inflation**. Inflation is the rate at which the purchasing power of money declines over time. If your bank account pays 3% interest and inflation runs at 4%, your money is shrinking in real terms by 1% per year. You have more nominal dollars, but they buy less. Over a decade, that 1% annual erosion compounds into a loss of purchasing power of roughly 10%. Over twenty years, nearly 20%.

This is not a hypothetical scenario. It is the lived experience of savers in most major economies over most of the last century. There have been periods when cash did well — particularly when central banks held interest rates well above inflation. But those periods have been the exception, not the rule. The structural tendency of modern monetary systems is to produce a positive rate of inflation, which means the structural tendency for cash holders is a slow, quiet loss of value.

Cash feels safe because it does not fluctuate in nominal terms. But in real terms — measured by what it can actually buy — it is almost always losing value. The question is not whether you can afford to invest. It is whether you can afford not to.

Why Risky Assets Pay You More

If cash quietly erodes, why do other assets do better? The answer is not magic or luck. It is compensation for discomfort.

Consider a simple thought experiment. You have £100,000 and two options. Option A is a bank account paying 4% per year, guaranteed. Option B is a portfolio of diversified assets that you expect to return 7% per year on average, but in any given year might return +20%, -15%, or anything in between. If you do not need this money for ten years, Option B is almost certainly the better choice. But it does not *feel* better. It feels worse, because of the uncertainty. The stomach-churning year when you are down 15% will test your resolve in a way that a steady 4% never does.

That discomfort is real, and it is exactly why the extra return exists. This is the **risk premium**: the excess return that risky assets must offer in order to attract capital away from the safety of cash. If risky assets did not pay more than cash on average, no rational person would hold them. People would keep everything in the bank, demand for risky assets would collapse, their prices would fall, and their future expected returns would rise until the premium was re-established. This self-correcting mechanism is why the risk premium exists, and why it has persisted across every market, every asset class, and every era that we have data for.

The risk premium is not a reward for being clever. It is a reward for being patient. For enduring the discomfort of not knowing what your portfolio will be worth next month, in exchange for a higher expected value ten years from now. It is the single most democratic source of wealth creation in financial markets: available to everyone, proportional to the risk you are willing to bear, and requiring nothing beyond the discipline to stay invested.

Not All Risk is Rewarded

An important distinction: the risk premium compensates you for **systematic risk** — the kind of risk you cannot diversify away. Owning a broad basket of equities exposes you to the risk that the entire stock market declines. That risk is systematic, and it pays a premium. Owning a single stock exposes you to the additional risk that *that specific company* fails. That risk is idiosyncratic, and it does not pay a premium, because you could have eliminated it simply by diversifying.

This is a critical point. Holding a concentrated portfolio — a handful of stocks, a single sector, a single country — exposes you to risks for which you are not being compensated. You are bearing more uncertainty than necessary without a higher expected return to show for it. Diversification does not just reduce risk; it eliminates *uncompensated* risk. What remains after diversification is the risk that markets actually pay you to take.

Diversification does not just reduce risk. It eliminates the risk you are not being paid to take. What remains is the risk premium — the only risk worth owning.

The Cost of Doing Nothing

Let us put some numbers to this. Suppose you have \$100,000 in savings. You leave it in a bank account earning 4% nominal while inflation averages 3%. After 20 years, your account balance is roughly \$219,000. But adjusted for inflation, your real purchasing power is only about \$121,000. You have gained \$21,000 in real terms over two decades.

Now suppose you had invested that same \$100,000 in a diversified beta portfolio earning a real return of 4% above inflation — a reasonable long-term assumption for a balanced risk parity portfolio. After 20 years, your real purchasing power would be approximately \$219,000. That is nearly \$100,000 more in real wealth, from the same starting amount, with no active management, no stock picking, and no market timing.

The gap between those two outcomes is the **cost of doing nothing**. It is not a fee anyone charges you. It is not a loss that shows up on a statement. It is the quiet opportunity cost of leaving capital in the lowest-returning asset available, year after year, while risk premiums compound elsewhere.

This is equally true for companies. A business holding \$2 million in surplus cash at a bank deposit rate is making the same implicit choice. If that capital is not needed for twelve months or more, a disciplined allocation to a diversified beta portfolio could meaningfully improve returns on reserves — without the governance complexity of active management.

The Role of Cash

None of this means you should invest everything. Cash has an essential role in any financial plan, personal or corporate. It provides liquidity for near-term needs, a buffer against unexpected expenses, and the psychological security of knowing that not everything is subject to market fluctuation.

The question is not whether to hold cash, but **how much**. Most people hold too much. They keep twelve months of expenses in a current account when three to six months would suffice. They leave a corporate treasury earning deposit rates when half of it has a time horizon of two years or more. The excess cash — the portion that is not needed for near-term obligations — is the capital that risk premiums are waiting to reward.

At Desert Frontier Beta, our model portfolios deliberately include a cash allocation. In the Desert Frontier Beta portfolio, cash typically represents 30% of the total. This is not an oversight — it is a design choice. Cash serves as a tactical reserve and a source of stability. But the remaining 70% is deployed across risk-premium-bearing assets, working to compound wealth over time. The balance between safety and growth is exactly what portfolio construction is about.

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Getting Started: The Power of Regularity

One of the most persistent barriers to investing is the feeling that you need a large lump sum to begin. You do not. Some of the most effective long-term wealth creation comes not from a single

large allocation, but from **regular, disciplined contributions** — investing a fixed amount each month, regardless of market conditions.

This approach, sometimes called dollar-cost averaging, has two advantages. First, it removes the paralysing question of *when* to invest. Markets might be high, they might be low — over time, your average entry price smooths out. Second, it builds the habit of saving and investing as a single, automatic process. You are not making a decision each month. You are executing a plan.

Whether you are allocating \$500 per month from personal income or directing a quarterly surplus from business operations into a model portfolio, the principle is the same. Consistency matters more than timing. Time in the market matters more than timing the market. And the earlier you start, the more time risk premiums have to compound.

The Bottom Line

Investing is not gambling. It is not speculation. It is the act of putting capital to work in assets that compensate you for the discomfort of uncertainty. The risk premium is the reason investing works. It has existed for as long as financial markets have existed, and it is available to anyone willing to accept short-term variability in exchange for long-term wealth creation.

The alternative — holding everything in cash — is not a safe choice. It is a slow, invisible transfer of wealth from savers to the monetary system. The cost of doing nothing is real, it compounds, and over a lifetime it is enormous.

In the next article, we will go deeper into the mechanics of risk premiums — what they are, where they come from, how they differ across asset classes, and why a portfolio that harvests multiple risk premiums simultaneously is fundamentally more robust than one that relies on a single source of return.

*This article is part of **The Groundwork** — a series by Desert Frontier Advisors covering the foundations of beta investing. Next in the series: **Risk Premium Explained**.*

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