Forecasting and Prediction

Continuing on the theme of reading the articles that are different to those most beginners read, I came across one that I heartily agree with recently in *The Weekend Australian Financial Review* on 14-15 August 2010. It was in the Smart Money section and is part of a series titled *Second Opinion* by Peter Haggstrom (managing director of Independent Strategies) and Bill Raffle (independent adviser with Bennelong Private Wealth).

They begin by suggesting that the investment advisory industry has four species:

1. **Economists**. They can be good at analysing long term trends and can explain the past very convincingly. This gives them no credentials for forecasting the immediate future, but they are there to ***sell*** you what you seek to know.

2. **Product sales people**. They pick up on the trends identified by the economists and spin you a story suggesting it is a good time to ***buy*** their investment product.

3. **Forecasters**. They have a wide background in the industry. They tend to report the predictions made by other people, perhaps pulling many forecasts together as some kind of average or consensus view. Consensus is a dangerous tool – if it is a consensus of fools, then it is definitely of zero use and may be dangerous. They are also usually doing this to try to ***sell*** you something.

4. **Trading Types**. Some technical analysts are prime suspects. They use all kinds of methods, including so-called "inside" information. They are also often trying to ***sell*** you something, but may also be trying to show how clever they are.

The nemesis of all four groups of crystal ball gazers is the sceptic who insists on methodically comparing the previous predictions to what actually happened. This is nasty. Who wants to let history interfere with a good prediction? It is the only way to uncover that the latest prophet has made myriad predictions and now only talks about the few that turned out to be right. Make enough predictions and anyone can be right sometimes by sheer fluke.

The writers then relate the prediction sequence for a very well-known forecaster, who will remain nameless here. They end their story with the most entertaining sentence in the article: *This* [heroic quick-fire changes in predictions] *equates to a flying pig doing a 9g turn in front of your eyes and then offering you a financial product, naturally with a guaranteed return.*

Haggstrom and Raffle then offer some advice to readers:

1. Take no notice of forecasts and predictions at any time. Do you think for a moment that if they were that good at forecasting, that they would tell you? This is their point. Mine is that another reason to take no notice is that we human beings have an abysmal record in predicting the future, perhaps beyond what is just about to happen in the extremely short term. In fact, listening to these jokers can actually screw up our minds. Personally, I try very hard not to listen to forecasts and if I cannot avoid it, I listen as a sceptic and question everything I hear.

2. Remember that there is a big time lag between what happens in the market and what happens in the real underlying economy. The stock market is a leading indicator by up to twelve months. When the market turns up or down, the real economy will turn up to a year later.

The writers finish with an invitation: [if you] *find some expert with a Midas touch not currently known to the market ... let us know and we will put all our money with them*. My bet is they are not holding their breath waiting for your call.

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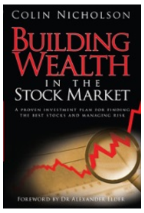

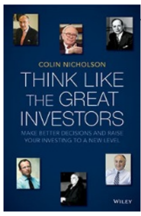

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