Prediction and an Investment Plan

My undergraduate training was in economics. Economists are paid to make forecasts or predictions about what is likely to happen. I have never worked as an economist. My career involved firstly, sales and marketing and then I turned my investing hobby into my career after undertaking and then teaching in a post-graduate qualification in investing.

Over a lifetime of investing – now 52 years and counting – I have learned that predicting markets cannot be done with any consistency and precision. I have seen time and time again that even expert forecasters get the future direction, let alone the extent, of market moves correct less than half the time. This is worse than pure chance.

What makes many expert forecasters sound convincing is that they are very good historians. Historians have all the facts and are able to select and string them together very logically to explain what happened in the past and why it unfolded as it did. They then move on from this base to make a prediction about the future.

Can you see what is wrong here? It is that any competent historian can tell us what happened in the past and to explain very convincingly why it happened. Their qualifications as historians are no proof of forecasting ability.

It is easy to miss this point when they segue into predicting what will happen going forward, based on their just demonstrated ability to explain the past. The problem is that explaining the past and predicting the future are two quite different skills and the ability to explain the past is no guarantee of ability as a forecaster, or should I say fortune-teller.

Predictions are based on facts that are strung together in a highly selective manner. It is not their qualifications as historians or forecasters that are important, it is their investment results. As readers will know, I am one of the few investment teachers who publish their audited investment performance each year from the top of the market in 2000 on my website. The next time you are listening to someone give a prediction about the market, ask will they disclose their audited investment returns over at least one complete bull-bear market cycle. Good luck!

The real problem with asking so-called experts to predict the market is that you are asking the wrong question.

I don't even attempt to predict the market. What I do is quite different. I try to imagine all the things that might happen. I don't assign probabilities to them – that is prediction; it can't be done. It would not be valuable anyway.

Having worked up a list of possibilities, the question I ask myself for each one is what I will do if it were to happen. Then for each possibility, I mentally rehearse taking the action I have determined I would take. This is very powerful and highly effective if carried out fully.

Not long ago, in the 1980s bull market one of my possibilities was a severe sudden fall in the market. I ransacked history for big falls and lit on the 14% one-day fall on Wall Street in the crash that led to the Great Depression of the 1930s. I pondered what I should do if the market suddenly fell by maybe twice that extent in one day – 28%. As you know, I was a bit too pessimistic, but no matter, it served the purpose. My planned action was to sell everything into the first bounce following the fall. I remember that when it happened in October 1987, I was totally calm. I knew what I had to do and waited for the market to settle; I remember that one of my stocks had a buyer at $3 and a seller at $9 that day. However, a rally came the next day and I sold everything in about 15 minutes. When I say “everything” I was about 25% invested, 75% in cash. 1987-88 was my worst year as an investor, but it could have been far worse but for my knowing what I had to do and my mental rehearsal having made it so easy to calmly carry out my strategy.

That last sentence, of course, implies that you have a strategy and an investment process. I was only 25% invested because I had assessed the phase of the market - we were in *rampant speculation*. So, I had implemented my strategy to phase my way out of the rampaging bull market. In other words, I was following a disciplined process based on the rules and guidelines in my investment plan, which is set out in my book *Building Wealth in the Stock Market*. As the phases of the market changed, I had methodically moved through my strategy.

It took me a long time to develop that plan. Before I could commit it to paper and make it complete I undertook a post graduate education in investment. Not only did I obtain the qualification, but subsequently taught in the course, following the important precept that if we want to know and understand something deeply, teach it! Believe me, this is very powerful. I learn something every time I prepare a presentation on investing skills.

Of course, formal education is only the start. What is required is wide reading and study. I have for most of my career read at least one book every month about investing techniques, history of financial markets, biographies of investors as well as reading *The Australian Financial Review* every day from the early 1960s. By far the greatest part of my time working at investing is spent reading.

All of that effort goes toward developing a ***written*** investment plan. To do that requires years of acquiring knowledge, thinking, testing then revising and polishing. I said a written investment plan because frankly if it is just in your head, you are fooling yourself. It is only when you come to writing it down will you expose the gaps and logical inconsistencies.

How will you know when your investment plan is complete? That is really quite simple: in any situation you encounter and are wondering what you should do, you should be able to open your plan and find the answer written there. I am not kidding; I have done this myself many times when agonising over a situation – reach for my copy of *Building Wealth in the Stock Market*.

So, that is what is required to be a self-directed investor. My guess is that only a handful in every thousand investors will do this. They are the people I am trying to teach through my books and my members website. For most people, a disciplined buy-and-hold approach is more appropriate, but that is not my skill area.

To read more of my work

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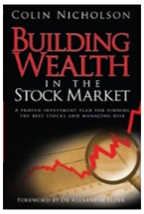

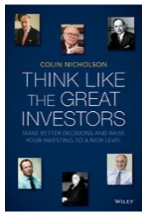

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