

AVOID THE PREDICTION ADDICTION

1968 was a great year. New Zealand won a gold in rowing at the Mexico Olympics, The Beatles recorded "Hey Jude", the United States at long last passed the Civil Rights Act and an expert biologist at Stanford predicted the end of humanity.

Well, perhaps that last item wasn't so great.

In 1968, Paul Ehrlich also wrote a best-selling book called *The Population Bomb*. Drawing on his observations with other animal species, the premise of the book was simple. The world was already overpopulated and still growing exponentially. The earth didn't have enough resources to feed humanity. The result was inevitable. There would be mass starvation leading to nuclear world war, resulting in even worse environmental damage and more starvation.

Testing the Predictions

We have a natural tendency to trust experts. They usually have impressive credentials to their name and they surely must know more than we do. But while experts can often explain in great detail about what has already happened, it's an open question of how accurate they are at predicting what will happen in the future.

We know this because we can easily test their forecasts for accuracy. Whenever an expert makes a prediction about the future, you simply write it down and check later whether it came true.

Philip Tetlock, noted academic and author, has made a living out of testing the accuracy of forecasts. He conducted a study that included 82,361 expert forecasts. To make the analysis simpler he grouped the forecasts into three possible alternatives.

Groupings were based on whether the forecast was for:

1. The status quo remaining;
2. More of something; or
3. Less of something.

So, how impressive were the experts at picking which of those three options the future had in store? Well, not very as it turned out.

Tetlock found that experts performed worse than they would have if they had simply assigned an equal probability to all three outcomes. In other words, experts were poorer forecasters than random dart-throwing monkeys. Further, Tetlock found that the more famous the forecaster, the worse they were at forecasting!

If this is true of general social sciences, ***how much better do you think experts will be at predicting the share market?*** I'll tell you. ***They're rubbish.***

If you think about it, the price of a share is already a prediction of the future profits of a company. What's knowable is in the price. To predict shares beyond a general trend is the equivalent of trying to predict a prediction. That doesn't sound like an easy task and it's not.

An advisory firm in the US grew tired of the poor quality of forecasts made by so-called experts and decided to test how accurate they really were. They called the test the "**Guru Grades**". They eventually tracked 68 gurus and graded 6,582 market forecasts. They found the average 'guru' made the right call only 46.9% of the time.



Despite forecasting records that make circus fortune tellers look good, market crises, like the one we are currently experiencing, still attract guru economic predictions in their droves. *For example:*

- *Goldman sees 15% jobless rate and 34% GDP decline*
- *White House Economists Warned in 2019 a Pandemic Could Devastate America*
- *Coronavirus forecast to cut UK economic output by 15%*

Of course, these predictions could turn out to be true. Or, they could turn out to be overstated, or even understated.

But what is a fact is that ***they are merely predictions, guesses if you will, about an uncertain future.***

Perhaps Paul Ehrlich was one of these early “gurus”. After publishing his theories about overpopulation, he made a bet based on his predictions. The basis of the wager was that Ehrlich could select \$1,000 worth of five metals he was sure would become more expensive, as the economy went into collapse because of overpopulation. The bet was that if in 10 years’ time the metals were worth more than \$1,000 then Ehrlich would be paid the difference. However, if in 10 years’ time the metals were worth less than \$1,000, Ehrlich would pay the difference. The bet was finalised in 1980.

To give Ehrlich credit, at least he wagered on his own prediction. Ten years later though.... he wrote a check for \$576.07. It turns out that in the 1960s, 50 out of every 100,000 global citizens died of starvation. By the 1990s that number was 2.6.

It has been over 50 years since Paul Ehrlich wrote *The Population Bomb* and, fortunately for all of us, his expert prediction about the end of humanity was, shall we say, premature. And it certainly wasn’t reflected in the performance of the share market as measured by the S&P 500, which has increased by about 10,700% in that time.

Fortunately, good investment outcomes don’t depend on guru predictions.

Instead, they are achieved by:

1. having a plan,
2. adjusting the plan as required to stay on track, and
3. staying disciplined.



This is where we are privileged to work with you in formulating a plan specific to your needs and working with you over time to ensure it remains relevant and that by remaining disciplined, you maximise your wealth.

While we are in lockdown in our respective bubbles for now, and therefore are unable to meet in person, the Rede team remain available and committed to supporting you through this and future unpredictable challenges, maximising the opportunity for you to achieve your future goals.