



It's tough to make predictions, especially about the future – Yogi Berra

Welcome to the Summer Edition of the SF newsletter. With the start of the year upon us, the financial sections of the newspapers and investment magazines are full of stories from experts about what to expect from markets in the year ahead and the best places to invest your money. Therefore, what is the Media really up to when they publish these types of articles and how well did the forecasting community go over the past 12 months. Thanks to a number of articles from Jim Parker, a career financial Journalist, we have been able to put together a montage to give you some insight.

Note, we are not trying to poke fun at the assorted experts who make predictions. Rather, the world is a very uncertain place where predicting short-term future changes in business and credit conditions is hard. While, predicting how other market participants will respond to those changes is harder still.

It is just a fact you are far better served by maintaining a high degree of skepticism about the value of the short-term forecasts made no matter how rationale or appealing their position may be.

From all the team at SFFP, we wish you all a great 2010.

Shooting Stars

Ordinary investors do not often appreciate it, but there is a cosy relationship between the media and the brokerage industry. They both want you to believe certain individuals have uncanny powers of divination.

For stock analysts, promoting the illusion of omnipotence is helpful because it justifies their fees and keeps people trading. For the media, the myth certain remarkable individuals can reliably forecast stock prices is helpful because it provides endless "gee whiz" stories to keep the ads apart.

Just look at *The Australian Financial Review's* recent annual supplement on the StarMine Awards¹. StarMine is a research company that measures the performance of stock analysts, based on the returns of their buy/sell recommendations and the accuracy of their earnings estimates.

Every 12 months, the newspaper publishes many colourful league tables and profiles of that year's "guru" analysts, interwoven of course with paid advertisements placed by the winning institutions.

Never mentioned is what the league tables showed last year or the year before — because to do so would be to recognise the accuracy record of the forecasters rarely extends beyond a 12-month period.

For instance, in the 2009 list of top 10 stock pickers, only one individual was also in the 2008 roll of honour. In the 2008 list, there was only one name that appeared the year before.

The question arising from all this is just what are investors supposed to do with these league tables? Building portfolios around the stock calls of this year's shooting stars would appear to be a hazardous business given the limited chance of them appearing on the following year's top 10.

As one fund manager told the AFR, "As a payer of institutional brokerage, you do wonder some days what you are paying for." And that's really the point. No matter how smart individual stock analysts may be. No matter how much they know about the companies and sectors they follow. No matter how much shoe leather they wear out trudging from briefing to briefing, they are in the end hostage to unforeseen events.

Making short term investment forecasts is a haphazard business and an unnecessary one. Good investment management is not about making this or being on first name terms with the CEOs of listed companies. Good investment management is about building diverse portfolios around risk factors that have a long-term relationship to return and being mindful about costs and taxes — two things within the control of the investor.

¹StarMine Awards, *The Australian Financial Review*, 27 Nov 2009.

INSIDE THIS ISSUE:

1. It's tough to make predictions, especially about the future
2. Shooting Stars
3. From Cacophony to Symphony
4. 'Tis the Season to be Silly
5. What happened at SF in the December quarter

From Cacophony to Symphony

Sometimes it is hard to make sense of day-to-day noise in stock prices, particularly when news is thin on the ground. However, that does not stop lots of people from trying to discern predictable patterns in the racket.

Building coherent narratives out of random stock price movements, often under the pressure of constant deadlines is the job of journalists and research analysts. The most successful ones make it all seem perfectly rational and predictable. The ability to communicate the idea 'this happened in the market because that happened' is most brilliantly demonstrated when circumstances change two or three times in the space of a day or two. Let's take a look at a recent example.

In early October 2009, the media reported markets were anxiously awaiting the Reserve Bank of Australia's interest rate policy meeting. There was a feeling the RBA was on the brink of raising interest rates and thereby becoming the first central bank to do so in the wake of the global financial crisis.

On the Monday ahead of the RBA meeting, the Australian share market fell by 0.6%. One journalist quoted dealers as saying there was a fear an early rate hike could shake market confidence and curb the recovery.¹ Sure enough, newspapers on the morning of the bank's meeting were full of dire warnings of what would happen to asset markets if the RBA started to withdraw stimulus too early.²

As it turned out, the RBA did raise the cash rate that day to 3.25%. What did the Australian share market do? It closed up 0.4%. According to an analyst quoted by Dow Jones, the rate rise could actually be seen as confirmation of the strength and resilience of the Aussie economy.

However, the story didn't end there. Not only did the RBA's "surprise" rate move fail to derail the Australian market, it actually triggered a global rally. The Wall Street Journal reported: "A surprise interest rate increase in Australia reignited confidence the global economy is recovering from recession, sparking stock market rallies around the world and lifting gold prices to record highs."³

You see how these rolling interpretations work. You keep changing the narrative to suit the changing circumstances. The trick is to make it all seem perfectly obvious after the fact. "This happened because that happened."

The fact is stock prices move for all sorts of reasons and trying to provide neat and immediate explanations is a treacherous business. Therefore, the narrative of why stock prices rise and fall on any day changes because new information is always coming into the market. No sooner has the journalist carefully constructed a watertight story out of one development, than something else happens and the whole edifice springs a leak.

Stock prices also can move for apparently no reason at all, or at least for no reason the media takes notice of. It could be because a large institution is liquidating a portfolio or because of arbitrage activity between the physical and futures market or because of options expiries. It may just be because someone is selling a large parcel of one stock to fund a purchase of something else.

The bad news for harried journalists and market analysts is they have to try and orchestrate all the random noise that constitutes messy day-to-day reality into a fascinating, elegant and seemingly pre-ordained symphony. Every day, they have to start all over again.

¹ *Australian shares fall 0.6%, banks skid on rate talk*, Reuters, 5 Oct 2009

² *Housing disaster looms if rates rise*, The Australian, 5 Oct 2009

³ *Australian rate rise spurs stock, commodity rallies*, The Wall Street Journal, 7 Oct 2009

⁴ *Shareholders say not one good thing in Telstra proposal*, Australian Associated Press, 15 Sept 2009

⁵ *Australian shares up 2.4%, banks surge*, Reuters, 16 Sept 2009

T'is the Season To be Silly...

The official term in the trade for an article that wraps up the year just gone and previews the one coming is the "year-ender" - quick precooked write-ups that involve little research and can fill the white spaces during a quiet period.

In the old days, you could get away with saying just about anything about the outlook in your year-ender, safe in the knowledge few people would remember what you wrote 12 months later. Then the internet came along and thanks to Google, the "Silly Season" predictions of journalists and economists are on show for perpetuity.

It is safe to say market and economic predictions for 2008 are unlikely to make the greatest hits collections of the forecasting fraternity. Hardly anyone saw the train wreck coming. As for 2009, the record is a bit better. Many people predicted a pick up in risk appetites, although few picked the turn and not many got the magnitude of the rebound right.

A year ago, the overwhelming consensus was the Australia economy would join the rest of the developed world in recession in 2009.

Forecasts for unemployment stretched from 7 to 9%. Commodity prices were set to collapse, the Australian dollar would remain out of favour and the share market would stage only a tepid bounce.

The pessimism was on display in a half-yearly survey of economists published by *The Age* newspaper in early January.² The year-end prediction for the S&P/ASX 200 index was around 4100, or about 20% below where the index finished.

The Australian dollar was forecast by a panel to go sideways all year. As it turned out, the \$A was one of the best performing currencies of the year, gaining more than 30% against the US dollar.

Economists were also gloomy about Australia's terms of trade and unemployment. The former was projected to fall by 11%. It actually firmed slightly over the year. The latter was expected to rise to 8% or more. It reached 5.8% in October, before declining.

As for official interest rates, The Age survey of economists predicted cash rates would level out at 3% by mid-year and stay there. Instead, the Reserve Bank raised them for an unprecedented three consecutive months from October. And the market is priced for further increases. Australia avoided a recession, which no-one predicted would happen.

Over the coming weeks, get set for another round of "year-enders". Reporters will be on the phone to economists and analysts, filling out spreadsheets with consensus calls on share prices, favoured sectors and individual stocks, interest rates, currencies and economies.

It is fun. It fills a hole in the holiday editorial schedule. But whatever you do, don't take these things seriously. That is why they call it the Silly Season.

¹ 'Share Forecasts and Tips for 2009', *Daily Telegraph* online, 29 Dec 2008

² 'Wildfires Set to Burn On in 2009', *The Age*, 3 Jan 2009

³ *Reserve Bank of Australia, Statement on Monetary Policy, Nov 2009*

What happened at SF in the December Quarter?

1. After a year working part-time with Strategy First and while he finished his University degree, Rhys Phillips officially joined SF. Rhys will take up a role in the Para-planning team assisting the advisors so we are sure you will get to speak to him across the course of the year.

2. As part of a new 3 Year Business Plan, SF finalised our value proposition:

At Strategy First, we offer genuine fee for service financial planning.

We only charge fees for the services we deliver.

We recommend investments and strategies based purely on your needs.

This is a relationship *focused on achieving your* financial goals.

No commissions, no conflicts of interest, just independent advice.

This will now be incorporated into all of our documents, website, emails etc.

Naturally, we welcome any feedback you may have.

3. SF officially became a paperless office on 1 January 2010, which brought us one step closer to becoming an environmentally neutral business. Special thanks to Anneliis and Casey for their involvement to make this a reality.
4. Patrick Anwandter attained SMSF Specialist Adviser accreditation with SPAA, the leading SMSF adviser membership group. This reflects the hard work Patrick has undertaken improving Strategy First's specialist SMSF knowledge.
5. On the personal front, David and Kate Price welcomed a baby boy, Callum David Price, into the world on 13 October 2009. From all reports and despite the normal sleep deprivation, all are doing very well.

