OUTSIDE THE FLAGS

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Interesting Vs Actionable

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"Prediction is very difficult, especially if it's about the future."
—Niels Bohr, Nobel laureate in Physics

A hallowed media tradition in this season is to provide a neat summation of the 12 months just gone and to ask experts to share their "outlooks" for investment markets in the year ahead. How much faith should you place in these forecasts?

One way of answering that question is to look back 12 months to see what the media's favoured forecasters were expecting for the year just gone—in this case, 2018.

So, for instance, a survey of economists, published in February 2018, said the only direction for Australian interest rates in the approaching year was up. In fact, the majority saw cash rates as rising by at least a quarter percentage point.[1]

As it turned out, the Reserve Bank of Australia left its cash rate unchanged at 1.5% throughout the year. By December, with the housing market slowing and income growth stagnant, many of the same economists had pushed out their expectation for the first local interest rate rise until 2020.

How about currencies? What will happen to the Australian dollar in 2019? While it's an amusing parlour game to speculate on foreign exchange movements, there is very little evidence of anyone being able to consistently get these things right.

Back in January 2018, in the annual Fairfax Business Day survey of economists, the average forecast for the Aussie dollar by the end of the year was 75 US cents. As it turned out, the currency ended the year well below there at 70.5c.[2]

Similarly, equity market forecasts are typically wide of the mark. The median forecast for the S&P/ASX 200 in 2018 from the annual Fairfax survey was for a rise of 2.3%. By the end of the year, the index had fallen nearly 7% in price terms.

In previous years, the same panel have been overly pessimistic. For instance, in 2013, the consensus forecast was for a rise in the index of about 3%. As it turned out, the market that year rose 15% in price terms, or nearly 20% on a total return basis.

Now, with another change in the calendar year, the focus turns to speculating about possible developments in 2019. There is plenty of material for the media to work with, including a range of opinions about the outcome of trade tensions, Brexit, interest rate cycles, geopolitics and commodity prices.

Of course, there is nothing wrong with having an opinion about any of these issues. What many investors often don't appreciate, however, is that all those opinions and forecasts and expectations are already built into prices.

The news that moves prices changes every day. And even if you were able to forecast events, you still need to anticipate how the market will react. So, what might seem an obvious call based on today's information might look unrealistic six months later.

In truth, even the economists who participate in media surveys about the outlook for the coming year will admit that their forecasts rest on a myriad of assumptions, any one of which can quickly come undone. Ultimately, there are just too many variables and inputs and noise to make market forecasting anything other than an educated guess.

The conclusion for most investors from all this is that while today's world news is often interesting, it is very difficult to build a sensible investment strategy by using the news to forecast movements in currencies, interest rates and share prices.

An alternative is to focus on what is actionable, rather than what is interesting. Actionable issues include how you allocate your investments across various asset classes like stocks and bonds, property and cash, how you diversify your investments across sectors and countries and currencies, the attention you pay to fees and taxes, and whether you regularly rebalance your portfolio. Unlike geopolitical and economic news, these are all things you *can* control.

As much as the media might want to pretend otherwise, the truth is no-one knows what the future will hold. That's the bad news. The good news is that as an investor, you can ensure you are as prepared as you can be for whatever might occur.

"Outside the Flags" began as a weekly web column on Dimensional Fund Advisors' website in 2006. The articles are designed to help fee-only advisors communicate with their clients about the principles of good investment—working with markets, understanding risk and return, broadly diversifying and focusing on elements within the investor's control—including portfolio structure, fees, taxes, and discipline. Jim's flags metaphor has been taken up and recognised by Australia's corporate regulator in its own investor education program.

For more articles, visit Dimensional's client site at *my.dimensional.com/insight/outside_the_flags*

1. 'The Only Way is Up: Brace for a Rate Rise this Year, Most Economists Say', Sydney Morning Herald, 2 February 2018.
2. 'How the Business Day Economic Panel Sees 2018', Sydney Morning Herald, 3 February 2018.