

PREDICTIONS ARE FOR LOSERS

DINOKENG: Questions most frequently asked of professional investors include; “what is the rand going to do?” or “where are the markets going?” and “should I switch my investments to cash because I don’t want to lose money?”. We would all like to know what is going to happen to our investments, however there are very few good answers to these questions. Simply put, no one has any real idea of what is going to happen to the rand or the stock markets. If you need to make investment decisions, the solution to the problems posed by unpredictable investments is to navigate around them.

PROFESSIONALS CANNOT MAKE ACCURATE PREDICTIONS

In a recent Financial Times article, (1 August 2010 “*The Long View*” by Spencer Jakab) the author quoted Ned Davis Research showing how poor markets performed when analysts were at their most positive. When analysts expected their companies, as a collective, to grow their profits by 15% or more, the stock market dropped by an average of 12% in the following year. When analysts expected company profits to grow by 5% or less, the stock market averaged growth of 18% in the following year. Equity analysts are usually intelligent people who are highly focused on their chosen industry. In addition, they have an incredible work ethic which drives them to be experts in their field. In other words, they have a better chance than most of predicting what is going to happen with their companies and even they have a horrible track record with their predictions. This might be an indictment of analysts or it might prove that there is no way that we can expect people to make reliable forecasts. You might be right on the odd occasion but this would be due to luck rather than skill.

CHANGE THE GAME

If the best and the brightest cannot reliably make predictions about their narrow fields of expertise then it makes sense to structure your investments so that you don’t need to rely on their forecasts. The best way to do this is to create a plan or structure for your investments that eliminates time sensitive decisions. That means you should ensure that every investment decision you make is not restricted to a limited timeframe. For example, if you decide that you want to invest in a particular share, make sure that you can hold the share for period ranging from 3 to 7 years. This will allow your share the time to appreciate in value and as we have seen, this could happen at unexpected times.

As an example, if Apple was listed in South Africa and you decided to buy the shares because you feel the iPad is going to be an absolute raging success. More to the point, you feel the iPad is likely to blast Apple shares into the stratosphere. You should plan to hold your Apple shares for an extended period in the event that something delays the positive effects of the iPad on Apple’s share price. It often happens that your initial investment case is right, but other factors cause the share price appreciation to be delayed. In this instance, you do not want to be in a position where you have to sell out your Apple shares because you have other commitments that force your hand. The money you invest in the company should be allowed to remain there until your view is vindicated or until you realise you have made an error in your investment case. Unfortunately most people buy shares after reading an analysts’ report that predicts a particular price within a specific timeframe. If you had bought your Apple shares because you had read an analysts’ report and you believed the prediction (or forecast as they like to call it) you might have bought the share with the view that you could sell it within 24 months which might be far too early.

CURRENCY TRADING

I particularly dislike currency trading as an investment option for private investors because of the enormous effect that timing has on your decisions. There are so many factors that influence the movements of currencies over the course of a day that it is nearly impossible for a private investor to make money consistently over time. To make matters worse, most currency trading platforms offer you the option of trading with debt; this exponentially increases the effect of timing on your decisions. If you have made a particular investment decision that is not working out, you might need time for the markets to trend in your direction. If you are unlucky enough to be trading with debt, it might be impossible for you to wait and any time that you do spend waiting for the markets might increase the pressure on you exponentially. The pressure will be even greater if the markets move against you even more. I think currency trading works for large institutions that have the balance sheets and complex trading systems to allow them to wait for the markets. It is my firm view that you are simply gambling your money if you start currency trading as a novice, especially if you do this with debt as you have almost no chance making reliable forecasts.

TIME IS YOUR GREATEST ALLY

As a private investor, one of your greatest advantages is that you can sell your investments when you decide, not when some panicky investors force you to do so. This means you will have many great opportunities to buy fantastic investments when others sell them at ridiculous prices. The luxury of time is not available to professional investors who have to provide capital to their clients at their behest. It is one of the reasons why great investors like Warren Buffett do not like investing in funds. A great investor knows that he can choose fantastic investments but he does not know when those investments are going to realise their potential – this means he needs to give them time.

If you make investment decisions that rely on predictions (forecasts) that are time sensitive, you are more likely to lose money over time. This does not mean that you will have no successes but these will be largely due to luck and these will invariably lead to future losses. Rather rely on sound investment research that gives your investments the necessary time to realise their value – this is the key to repeated investment success.