April 2014

The Perils of Predictions

For the first quarter of 2014, the S&P 500 had a total return of 1.8%. Although this number does not keep up with last year's 30+% increase, multiplied by 4 quarters it would imply an annual return of 7.2%; well within the range of "good" years and materially better than inflation. So, why are some investors disappointed with good results? Too often, our emotions about the stock market are defined by our expectations instead of by reality.

As you well know, whenever we are asked, "Where do you think the market will be by such-and-such a date?" We respond with, "We just don't know". Over the long-term we are bullish, as the stock market is a barometer of the U.S. economy, and if we believe that the U.S. will continue to grow over the years, so too should the market. Even Warren Buffett questioned in his 2013 annual report, "Indeed, who has ever benefited during the past 237 years by betting against America?"

Not surprisingly, Mr. Buffett also agrees with us concerning the folly of short-term market predictions. Again, from his last annual report, "Forming macro opinions or listening to the market predictions of others is a waste of time. Indeed, it is dangerous because it may blur your vision of the facts that are truly important."

Now, you may ask, "What about people who have called the market correctly"? The most infamous recent example of this is Nouriel Roubini, who correctly predicted the recession of the last decade. A closer look by Gregg Easterbrook *(political/financial/sports author, and contributing editor to both The New Republic and The Atlantic)* earlier this year reveals that Dr. Roubini is simply persistent, not prescient.

> New York University economist Nouriel Roubini became a media darling and a player on the big-bucks lecture circuit after his 2006 prediction that a housing bubble would cause a recession proved correct. Does that make him a seer? Roubini had predicted national economic misfortune many times before and been wrong, and he has continued to predict it since, again being wrong. If you endlessly predict the clock will strike midnight, you will be right once a day.
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> In 2010, Roubini said big banks would nosedive further as they lost another $1 trillion on mortgages; instead, big banks have recovered spectacularly. In 2011, he told NPR there was "more than a two-thirds likelihood of another recession, and if it happens, it will be severe, with 12 to 13 percent unemployment." Growth since 2011 has been close to the historic norm, with unemployment now at 6.7%. In 2012, Roubini predicted the entire global economy would collapse in 2013. Instead, the United Nations says global economic growth was 2.1 percent in 2013.

Our reminder on the perils of predictions comes immediately after a fantastic year in the stock market is no accident. We simply want to remind our clients, and ourselves, that the historic returns of the previous year have no bearing on the returns for this year. This is why we write, almost every quarter, about how we continue to strive to identify industries and companies that are profitable in all kinds of economic environments. We attempt to determine appropriate values for those companies, and invest in them when the stock price is materially below what we believe the true value to be. There is no magic in that, and there is no timetable, there is simply work.

As always, we thank you for your trust and support, and if you know of anyone who might benefit from our steady, fundamentally-based approach to investing, please contact us so that we might be able to help them as well.

Craig, Howard , Elizabeth & Ward

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