

The Real Value of Predictions

By Ken Robinson, CFP
The Monitor Group

At this time of year, investors are besieged with messages telling us what to do with our portfolios. Whether it is a magazine, newspaper, or television show, journalists capitalize on our temptation to make fast and easy profits. Many viewers tune in hoping to discover a "new strategy" to replace the failure of the last "expert" they followed. Why don't you hear about these failures? Highlighting failed predictions or miserable outcomes doesn't sell magazines or airtime.

Predictions?

Here's a sample of what some so-called "experts" were saying during the first quarter of 2003:

- "I suspect that 2003 will end up being the fourth consecutive down year for the first time since 1932."

Quotation attributed to Jeremy Grantham, "Is The Bear Market Over?" Smart Money (January 2003).

- "I do not believe a long-term investor will make money in this market because it is a secular bear market."

Quotation attributed to Felix Zulauf, "On the Money—Roundtable Part II," Barron's (January 27, 2003).

- "If we see 8% this year, that will be good." *Quotation attributed to Edgar Perter, "Trading Ranges Keep the Bulls In," Wall Street Journal (April 21, 2003).*

Forget the expert predictions! In 2003, the S&P 500 index finished the year up 23 percent. If you attempted to time the start of the market turnaround based on such predictions and you missed it by only three months, your annual return for 2003 would have been reduced by almost 50%!

Rankings?

Most newspapers and financial publications also provide mutual fund performance rankings at the end of each year. They do so ostensibly to provide "investment advice" for investors. These rankings are based solely on short-term performance. Unfortunately, short-term data provides *virtually no predictive value* for future performance. As a result, readers are led down a dangerous path by these rankings. Why is that?

In the majority of cases, these "falling stars" get to the top by placing huge bets on a few individual stocks, gambling on an individual sector, or rolling the dice with a risky market-timing strategy. Such tactics are extreme gambles. They are not the result of prudent disciplined investing. *This sort of activity should not be part of any long-term investment strategy.*

Here's the proof in some not-so-remarkable, but all-too-familiar, examples:

	Annual Ranking of all Domestic Stock Funds							<i>Average Rank</i>
	1997	1998	1999	2000	2001	2002	2003	<i>in subsequent years</i>
Munder Micro-Cap Eqty K	1	2643	212	2454	124	1595	182	1202
Kinetics Internet	2600	1	5	2906	1499	1850	1555	1563
Van Wagoner Emerging Gr	2904	2008	1	2713	2911	2912	836	2343
Munder Fram Health Y	2362	2369	604	1	2441	2809	694	1981
Wasatch Micro Cap	193	1075	768	60	1	780	618	699
Prudent Bear	2878	2903	2905	129	325	1	8601	8601

*Data obtained from Morningstar Principia

What will happen to the economy and markets over the next year? Despite all the confident predictions made by so-called "experts", no one knows. The most prudent investment strategy is to maintain a carefully designed, well-diversified portfolio, and remain fully invested across multiple non-correlated asset classes, despite negative short-term events. **This may sound like a broken record, but maintaining this strategy is crucial to the success of any long-term investment plan.** The short-term "noise" of the markets and the media can distract you from your goals. Therefore, it is very important during a time like this to stay focused and disciplined. The Monitor Group did not invent modern portfolio theory or the time-tested principles of wealth creation and preservation, but the application of these principles continues to yield superior results for our clients.

Ken Robinson is a Senior Planner of The Monitor Group, Inc., a fee-only financial planning firm located in the Tyson's Corner area of McLean, Virginia. As a nationally recognized wealth management firm, The Monitor Group provides investment and financial planning services to more than 190 high net worth client families in Northern Virginia, Maryland, Washington, DC and across the country.