Today’s investor doesn’t have to look far to find someone predicting dire consequences just around the bend. Forecasts of impending doom have been around a long time. According to legend, Cassandra was a Trojan princess cursed by the god Apollo with the ability to see the future, but to have no one believe her. Among her many prophesies was her warning that the large wooden horse the Greek soldiers had rolled up to the gates of the city was dangerous, and if brought inside the protective walls, would lead to the destruction of Troy. When her advice was ignored, she tried to set the horse on fire herself, but was restrained by her fellow citizens – who thought she was insane. That night, the Greek warriors who had been hiding in the infamous “Trojan Horse” crept out and opened the gates to the fortress city to the rest of the Greek army, and Troy was indeed destroyed.

Not all forecasts prove to be so accurate. A wellknown children’s story tells of Chicken Little, who is struck on the head by a falling acorn. She flies into a panic and runs about crying out a warning that “The sky is falling; the sky is falling!” On her way to tell the king of the impending disaster, she meets a duck and goose who join her. Unfortunately for the gullible little troupe, they also meet a fox who offers to show them the way. He leads them into his den, and their world does indeed come to an end – although the sky has yet to fall. In one case, failing to heed a timely warning leads to disaster; in the other, following the forecaster of doom is a fatal error. But here’s the funny thing about financial predictions: whenever you hear someone making a prediction that seems to make a lot of sense, there’s probably someone else making an equally plausible case for an outcome that’s very different.

Here are a few plausible predictions making the rounds, accompanied by similarly plausible alternatives:

Prediction:

1. The Federal Reserve is planning to raise interest rates before the end of the year, putting the brakes on a weak and slowing U.S. economy. Or alternative: Normalizing monetary conditions with a small rate hike is the natural outcome of an economic recovery that has created millions of jobs and brought the unemployment rate from 10% in October 2009 to 5.1% in September 2015 (U.S. Bureau of Labor Statistics).
2. The Chinese economy has been slowing since 2010, from a reported GDP growth rate of 10.6% to an estimated 2015 rate of 7% (The World Bank). This slowing of the second largest economy in the world is posing a threat to a global economy already teetering on the edge of recession. Or
alternative: The earlier torrid growth of China’s manufacturing and export economy was unsustainable, and the current slowdown reflects a transition to an economy with a larger service component and a healthier and more sustainable domestic growth rate. A modern Chinese economy will be a big long-term positive for global growth.

3. Stocks are overvalued and corporate earnings are in decline as consumers pull back on spending. Or alternative: Stock prices are forward-looking. With housing in recovery, auto sales booming, unemployment low and falling, and cheap gasoline prices putting money in consumers’ pockets in time for peak holiday spending, stocks are pricing in expectations for growing profits ahead.

Which predictions are words of wisdom from a modern-day Cassandra, and which are simply the squawking of another Chicken Little?

Remember these predictions?

Prediction: Greece will be forced to exit the Euro, triggering a financial crisis and chain reaction that spreads throughout Europe, and eventually the world.

Outcome: Greece is still in the Euro, and while the people of Greece are certainly suffering through hard times, the rest of Europe has been largely unaffected.

Prediction: The outbreak of the Ebola virus will become a pandemic, shutting down travel and international commerce, leading to panic and bringing the global economy to a crawl.

Outcome: While a terrible tragedy for those affected, the feared spread of the disease did not materialize, and the global economy has not been harmed.

Prediction: A boom in housing prices and rampant sub-prime lending practices will contribute to a crisis that causes a massive recession and the near collapse of the global financial system.

Outcome: Okay, that one happened.

In the face of conflicting views, how well can someone tell what’s really likely to happen? Which predicted events will have the effect of an acorn on the noggin, and which will be the financial equivalent of an army of attackers inside the gates?

The research on human behavior suggests we are overconfident in our ability to predict what’s going to happen, and by extension, which predictions of others are likely to occur. Apparently we each have some Cassandra and some Chicken Little in us. We remember those times we were right about a potential hazard, but quickly forget all the times we were sure the sky was falling and it didn’t. We become overly confident about our ability to see trouble coming – and are subject to panic when things turn out to be worse than we expected.

Emotional responses to the daily barrage of warnings – some of which turn out to be prophetic and some of which quickly fade away – would not be as much of a concern if investors didn’t act on the wrong ones at the wrong time so often. In fact, measures of how positively or negatively investors are
feeling about the future are considered by many investment professionals to be uncannily accurate contrarian indicators – signals about what not to do.

Our view is that if we can learn anything from the past, it’s that investment decisions should not rely on guesses about what might happen in the future, but focus instead on responding appropriately to what’s actually happening right now. For more than twenty years, we have managed clients’ accounts with the goal of dispassionately evaluating the facts as they arise – and managing risk to capital if the facts unexpectedly change.

We believe using a disciplined process that responds to ever-changing conditions is the best way to navigate a future that doesn’t always follow the script. After all, as the late, great philosopher Yogi Berra put it: “It’s tough to make predictions, especially about the future.”

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