



Investing – the attraction and danger of forecasting

By Warren Ingram with thanks to Nic Andrew of Nedgroup Investments for the information for this article

Investors love making predictions about the future. The investment term for these predictions is “forecasting”. This is often an interesting past time as it invites differences of opinion among professional and part-time investors alike. Since the outcome is unknown, almost anyone (speaking with a reasonable amount of authority) can come across as knowledgeable and insightful. Unfortunately, there is little evidence that anyone can really forecast with any accuracy over the long term.

Investors focus significant attention on forecasts

Some of the most common questions received from investors relate to views on the future price of gold, the level of the rand or interest rate expectations. Within the asset management industry, an inordinate amount of time is spent on forecasting by very well-qualified, well-paid, hard-working and experienced investment professionals.

Since so much time and effort is spent on this activity it is worthwhile asking how good are we at

forecasting?

The examples below demonstrate the skill (or lack of skill) of professionals at forecasting.

1. Interest rate forecasts

Interest rates are one of the most important inputs into most valuation models for investment professionals. The Wall Street Journal conducted a comprehensive study of top economists' forecasts over a 25-year period. The table below shows their six-monthly forecasts of interest rate movements, followed by what the actual move was.

Six month average forecasted direction vs actual direction of interest rates											
The Wall Street Journal Survey of Economists (12/82 – 12/08)											
Date	Forecast	Actual	Result	Date	Forecast	Actual	Result	Date	Forecast	Actual	Result
12/82	▼	▼	Right	12/91	▼	▼	Right	12/00	▲	▼	Wrong
6/83	▼	▲	Wrong	6/92	▼	▲	Wrong	6/01	▼	▲	Wrong
12/83	▼	▲	Wrong	12/92	▼	▼	Right	12/01	▼	▼	Right
6/84	▼	▲	Wrong	6/93	▲	▼	Wrong	6/02*	▲	▲	Right
12/84	▲	▼	Wrong	12/93	▲	▼	Wrong	12/02	▲	▼	Wrong
6/85	▲	▼	Wrong	6/94	▼	▲	Wrong	6/03	▲	▼	Wrong
12/85	▲	▼	Wrong	12/94	▼	▲	Wrong	12/03	▲	▲	Right
6/86	▲	▼	Wrong	6/95	▲	▼	Wrong	6/04	▲	▲	Right
12/86	▲	▲	Right	12/95	▼	▼	Right	12/04	▲	▼	Wrong
6/87	▼	▲	Wrong	6/96	▲	▲	Right	6/05	▲	▼	Wrong
12/87	▼	▲	Wrong	12/96	▼	▼	Right	12/05	▲	▲	Right
6/88	▼	▼	Right	6/97	▼	▲	Wrong	6/06	▲	▲	Right
12/88	▲	▲	Right	12/97	▲	▼	Wrong	12/06	▲	▼	Wrong
6/89	▲	▼	Wrong	6/98	▲	▼	Wrong	6/07	▼	▲	Wrong
12/89	▲	▼	Wrong	12/98	▲	▼	Wrong	12/07	▲	▼	Wrong
6/90	▼	▲	Wrong	6/99	▼	▲	Wrong	6/08	▲	▼	Wrong
12/90	▼	▼	Right	12/99	▼	▲	Wrong	12/08	▲	▼	Wrong
6/91	▼	▲	Wrong	6/00	▼	▼	Right				

Source: Legg Mason and The Wall Street Journal Survey of Economists.
 This is a semi-annual survey by The Wall Street Journal last updated 31 December 2008.
 *Benchmark changed to 10 year Treasury.

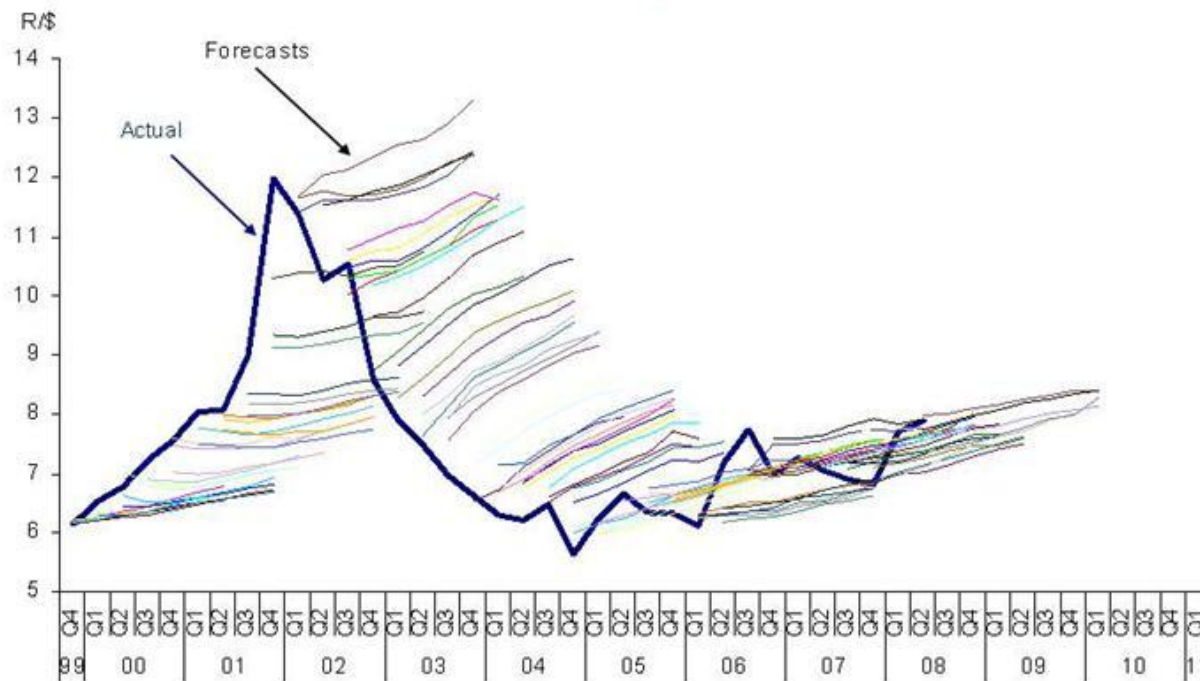
The economists' predictions were very poor - wrong almost two thirds of the time. In fact, if you had simply randomly guessed 'up' or 'down' you probably would have done better. This does not mean that economists are not intelligent or hard-working. It simply shows how difficult it is to predict interest rate

moves because the world is constantly changing and there are so many unknown variables.

2. Rand forecasts

The second example, as illustrated in the graph below, shows a number of economists' rand forecasts at different points in time over the last decade. The graph paints a very clear picture. Economists have always expected a slight depreciation of the rand irrespective of whether it was trading at R6, R8 or R12 to the dollar. This has sometimes been proved optimistic, sometimes pessimistic and even occasionally (but not very often) accurate. Rand forecasts are also a very popular input into many financial models.

Rand forecasts – not that helpful



What this proves is that people can only really be relied on to make the wrong forecasts consistently. Anyone who confidently predicts the direction of the rand or the next change in interest rates is almost certain to be wrong. You should assist people like this by telling them that the following quote by Lao Tzu, a 6th century Chinese poet who said, "Those who have knowledge don't predict and those who predict, don't have knowledge."

If these forecasters are impervious to your good intentions and try to argue with you using statistics, you can tell them that "*Statistics... are like a lamppost to a drunk... they're used more for support than illumination.*"

- Alfred Edward Housman

Infrastructure: is not about demand – it is all about supply

By Warren Ingram

There was a great deal of skepticism about Gautrain when the project was announced. Since the first phase was launched, nearly a month ahead of schedule, the Gautrain was carrying approximately 80,000 passengers per week. Post the World Cup, the train service has stabilized at about 50,000 passengers per week with bus passengers at about 4000 passengers per week and showing steady growth. After 100 days Gautrain had already transported the 1 millionth passenger, who is one of the regular commuters from Rhodesfield to Sandton. These initial commuter numbers are close to 100% more than predicted and certainly far more than the skeptics anticipated.

The main rail line is still on track to be completed by mid-2011, and the commuter numbers should again exceed expectations. Many of the people I speak to who don't live in Gauteng are amazed when I tell them how reliable and efficient the airport link is. It is the only way I travel to the airport and, so far, I have only had good experiences. The service is comparable to any other commuter rail service in the world and is certainly going to have a dramatic impact on transportation in Gauteng. The number of regular road users will decline while the number of small businesses that cater to commuters will increase dramatically. In addition, the property market around the train stations will change dramatically. Being relatively close to a train station will add value to your home provided you are not right next door to the station. Properties that are currently considered out of the city will become attractive areas to live in. Areas north of Pretoria and East of Midrand will attract buyers who are looking for larger homes 'in the countryside'. You will be able to live 30 minutes' drive north of Pretoria and could realistically work in the Johannesburg CBD. The commute from Hatfield station to Park station will take 42 minutes. In contrast with road transport, you can use this time productively to work or

read.

In my view, Gautrain provides a shining example of how real infrastructure development can dramatically improve our lives. The real point of these projects is that you simply need to build high quality, safe and reliable transport infrastructure and the commuters will come.

Short Term Insurance

By Paul Rushforth

In our ongoing commitment to provide the best service possible to our clients we have invested in a new policy and client administration system. This will enable us to communicate more effectively with you and have a clear and immediate view of your policy as needed. You will notice that your schedules will look different (and better) as you receive them and will also contain more information than was previously the case, should there be any incorrect or missing information please advise us so we can make the corrections. We trust you will experience the enhanced service levels immediately, however should you have any difficulties please make us aware immediately so that we can address them. We will now be able to communicate all documents electronically, if you prefer, if you would like us to amend your policy to email correspondence please send an email to natasja@galileocapital.co.za with your name and preferred email address and she will update your file.

GALILEO NEWS

STILL GROWING!

We are very pleased to announce that Lezanie Barnard had a healthy baby boy, Gerber, on 6 January. In addition Yolande Botha is expecting a boy on 17 March, so the Galileo family is certainly growing quickly.

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GalileoCapital (Pty) Ltd

Fountain Grove Office Park
Hyde Park

Phone: (011)502-8800

Fax: (011)447-6937

Web: www.galileocapital.co.za

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