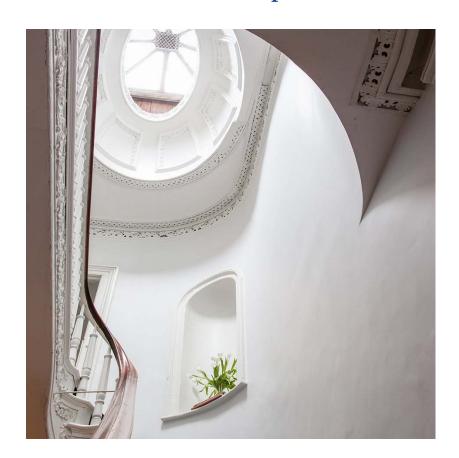


Market News...is it Boring, Misleading or Irrelevant?

# White Paper



First Zurich Trust AG

Investors need.... Nerve, Patience & Courage!



#### Life is more secure now than it has ever been!

Uncertainty has been reduced to levels that previous generations would find incredible. Their lives were plagued with disease, famine, war, floods, religious manias, and social upheavals. No wonder the ancients erected massive temples and performed endless sacrifices. It was all an effort to reduce the terrifying uncertainty of life.

In the modern world, risk has been squashed and repressed wherever it appears. The big exception is in our **savings**, which formally of us is now the riskiest part of our lives. When we try to preserve our wealth, we immediately become helpless victims of an implacable fate. Two hundred years ago, N.M.**Rothschild**, the greatest banker of this day, said that it was ten times harder to preserve wealth than it was to make it in the first place. Not much has changed.

# How to Invest in the Market and Stay Sane

Unfortunately, we have to take risks. We have no choice, because the cost of not doing so has become immense.

Safety guarantees no loss. If we want a reasonable prospect of real returns, we have to invest in the market and that means having to cope with uncertainty. As J.M.Keynes, the great economist put it in the 1930s: "The modern holder of quoted equities requires much more nerve, patience and fortitude than from the holder of wealth in other forms". The purpose of this paper is to instil in you, that Nerve, Patience, and Courage. The evidence is clear: it is worth it and anyway, we have no choice.

It seems to us that the greatest enemy of successful investment is "Events". We are all participants in an endless parade of happenings, which, being human, we continuously try to integrate into our world view. There are too many events for us to treat them critically, or test them for relevance. With our wealth at stake, we adopt a semi-conscious policy of worrying about as much as possible, and discounting as little as we can- especially if it sounds alarming. **D.Kahneman's** excellent book "Thinking, Fast and Slow" shows how we instinctively default to the most recent or striking piece of evidence, and that our urge to leap to conclusions overwhelms our better, rational selves.

Modern media make the problem much worse, of course. "News" is crafted to grab our attention; it is not created spontaneously by the world.

So, if news and events are our enemies, how do we cope with them? The first step is to regard them with the suspicion they deserve, and to be more discriminating in how we react. From the investor's point of view, most events can be put into one of three categories: a large proportion is simply **irrelevant**, even though it may look vital and pressing; some is **misleading**, sending us haring off in the wrong direction; but some is boring, underreported and very helpful.

The rest of this paper will concentrate on giving examples of all three types of events in the hope that it will help fellow investors make some money and ignore the siren calls enticing them onto the rocks. It may also help them sleep better at night.



## **THE IRRELEVANT**

Most financial news is irrelevant and can be safely ignored. Especially pointless are the frequent predictions of things that cannot be predicted. The forecasting records of even the best economists are very poor. We know this, but we still listen to them. We would be better off assuming that the economy does OK most of the time. Experiments show that in complicated matters mean reversion is a better tool for prediction than listening to experts.

Similarly, the huge amount of effort devoted to interpreting short-term market movements is largely pointless. The market is not a person; it does not have reasons or intentions. Its wanderings are the residual of countless opposing forces. It is not "Trying to tell us something". Its meanderings may well provide us with opportunities to buy or sell, but it is much easier to behave rationally if we do not believe that a fall in prices betrays some hidden horror. Similarly, a rise in prices does not mean that Santa Claus is on his way.

A great deal of political, social, and global reportage is irrelevant to us too. We are trying to be good investors, not emperors. We are not responsible for the big picture; we only have to buy what we really like. Very often a story will draw us in. We become "experts" on matters such as Greek public finance but which assume a disproportionate importance in our minds because we keep hearing about it. We are unwilling to write off this tediously won knowledge, so we think it must be important. The point is not that everything is irrelevant, but that most investors are too exposed to random buffetings by forces.

### THE MISLEADING

Being somewhat contrarian, having a preference toward "leaning against the wind," as Keynes put it, is a characteristic of all good investors. This can make them difficult at home they need understanding wives and husbands—but it helps them make money. For the contrarian, nothing is more exciting than a misleading news item.

Good news is routinely presented as bad. For example, China's decision to raise rates to combat inflation is generally received badly. It is all a matter of having a sensible time scale. It is right to take some pain now if the eventual consequence is positive. The crisis in Europe has been a perfect example of this. Imposing German fiscal discipline on a whole continent was always going to be a gradual, lengthy process. The point is that we are heading in the right direction, but almost all commentators focus on how painful each step is.

Occasionally things are worse than they look. The most obvious examples come from the financial sector. An increase in write-offs and a rise in bankruptcies are signs that the healing process has started.

It is always darkest before the dawn, and the successful contrarian is aware how misleading conventional opinion can be.

#### **THE IGNORED**

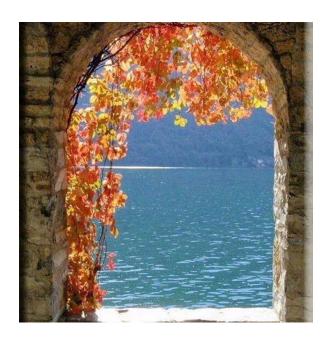
We are not arguing that the successful investor should ignore everything and hide away from all worldly contact. The point is that the world as it is presented to us is misleading, unsettling and deeply unhelpful from an investor's point of view. We should be aware of this bias and remember that the really useful news is often ignored.

The news we are fed has a strong negative and sensationalist tilt. As the great American historian **D.Landes** has pointed out, ultimately the only satisfaction the pessimist has is to say, "I told you so". The optimist is always on the lookout for the right kind of news. On the whole, things work out in the end because people adapt their behaviour. This is something that conventional analysis has a big problem with: It presents a static picture of a world in which unsustainable behaviour is always extrapolated until we run off the edge of the cliff. In the real world, people just do something else or invent something. The extrapolation fallacy is especially common in financial matters. It is obvious that America is never going to run out of dollars. The naive extrapolators cannot see this.

Conventional news ignores the benign adaptations which help us survive, because they are gradual and quiet. This is especially true of our responses to price signals—perhaps because, on the whole, the news media find companies opaque and hard to understand. Investors would be well-advised just to assume that big price changes will always lead to changes in supply and demand, and look for the early evidence for this in companies' behaviour. The most glaring example of this is America's imminent self sufficiency in hydrocarbons, and the discovery of huge new oil fields in Brazil, Canada, and Australia, combined with a sharp increase in the efficiency of energy use. These changes are all the consequence of the human energy released by high oil prices over several years, but the massive implications are only gradually being recognised.

Technological change is underplayed too, because its consequences are also gradual. To take one example among many: we have barely begun to understand the implications of the internet for a wide range of service industries. Can high streets and malls survive in anything like their current form? Do professional services have to be carried out in high wage countries? Do we have to travel to work? It does not take any specialised technological knowledge to play this game: the inventions which set these changes in motion were made years ago.

# IT IS ALWAYS DARKEST BEFORE THE DAWN, AND THE SUCCESSFUL CONTRARIAN IS AWARE HOW MISLEADING CONVENTIONAL OPINION CAN BE.



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