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What's The Market Going to Do?

(Hint: The Economy Won't Tell You)

The mid-twentieth century economist and wit John Kenneth Galbraith is most often credited with the observation that the only function of economic forecasting is to make astrology look respectable.

As anyone who has been around economics for any length of time will cheerfully acknowledge, the waxing and waning of the economy defy consistent anticipation. Indeed, the five years since the Lehman bankruptcy suggest that the more dramatic the next zig or zag in the economy is going to be, the less the economic fraternity will have any clue that it's coming. This is equally true whether the drama is for good or ill: economics missed the productivity gains from the rise of the Internet as completely as they did the looming subprime mortgage crisis.

Why, then, do the financial media constantly agonize over every slight movement up or down in dozens of economic indicators from new home sales to the balance of payments, and from manufacturing capacity utilization to the producer price index? A cynic will respond that in a 24-hour financial "news" cycle, no datum is too trivial or meaningless to be reported, and there's probably a grain of truth in that.

But I think the larger truth is that we labor under the delusion that if we can somehow figure out what the economy is going to do next, we can then proceed to anticipate how the markets will respond. We study the economy, in other words, not as intellectual entertainment for its own sake but as a predictor of markets. This is one of those rare ideas in finance where both the premise and the conclusion are wrong **for reasons entirely independent of one another.**

The premise is "If we can figure out what the economy is going to do next." We can't—no one consistently can; that's what Galbraith was trying to tell us in his own acerbic way—and therefore in some sense the conclusion we draw from the fallacious premise will be wrong no matter what it is.

But what's really interesting here is that even if we *could*, just once in our investing careers, anticipate the economy in the short/intermediate term, **we would still have no earthly reason to suppose that we had a handle on the trajectory of the equity market's next important move**. For a convincing if anecdotal demonstration of this truth, we need look no further than the stupefying disconnect between U.S. GDP and the equity market since the trough of the Great Panic.

The equity market bottomed out at 677 on the S&P 500 in March 2009, anticipating (as it often does) the end of the recession, which the National Bureau of Economic Research says took place in June of that year. Let us suppose that sometime (indeed, any time) between March and June you asked me what GDP growth was going to be in the next four and a half years, **and by some miracle, I knew.**

I would therefore have answered that GDP growth through 2013 was going to range between one and two percent a year, and that unemployment (not that you asked) would never get under seven percent.

In response to that forecast of an agonizingly slow economic recovery, you'd have been well within your rights to say, "Well, if that's true, this market can't possibly be going meaningful up any time soon, because you're describing an economy that's virtually on life support. I'm going to stay in cash until the economy gives me much stronger signals."

Those signals still not forthcoming, in all likelihood holding cash is where you'd still be, with the result that you'd have missed one of the great market recoveries not just in our time but of all time, as the S&P 500 soared from less than 700 to just the other day grazing 1,800. And even that ignores dividends.

In the event equity prices went up in response to the same forces which have always driven them: in this case the dramatic (and in many respects record-setting) post-crisis increases in corporate earnings, cash flows, dividends and cash positions. Looking back on this historic upsurge, we see above all that stocks rose not in response to the economy but in spite of it.

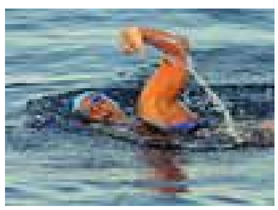
Yet as important as this observation may be, it is almost completely irrelevant to the narrow point to this little essay, which is simply that if you came out of the Great Panic asking the economy to tell you what the market was going to do, you got skunked. I believe—and I suspect your financial advisor does too—that you should assume this was not a fluke.

Long-term, goal-focused, patient, disciplined investors learn over time to tune the economy's current peregrinations out. (Indeed, in the fullness of time we learn to tune *all* current events out.) Because what we discover—usually through painful trial and error— is that not only won't the economy tell us what the markets are going to do. The economy won't even tell us what ***it's*** going to do.

You can't outwit fate by standing on the sidelines placing little side bets about the outcome of life. Either you wade in and risk everything you have to play the game or you don't play at all. And if you don't play you can't win.

JUDITH MCKNAUGHT
Paradise

TRY, TRY, TRY



In September Diana Nyad became the first person to swim the 110 miles between Havana, Cuba, and Key West, Fla., without the use of a shark cage. She established another record by reaching her target in just under 53 hours.

What makes this story so remarkable is that at an age when most people are retiring from their jobs and slowing down the pace of their lives, Nyad decided to do something that many people half her age were unable to accomplish. Diana Nyad is 64.

A competitive swimmer from childhood until the age of 30, Nyad attempted the Cuba-Florida swim on four previous occasions. Each time weather, injury (jellyfish stings), or both contributed to her inability to reach the opposite shore.

With each failure she held on to the determination to try again ... someday. More than three decades passed before Nyad finally reached that day.

Diana Nyad says, "We blink and another decade passes. I don't want to reach the end of my life and regret not having given my days everything in me to make them worthwhile."

Having a vision is not enough. It must be combined with imagination, determination, faith, hope and passion. It is not enough to just stare up at the stars ... we must become the stars that the stars shine down on.

VICTORIA JUNE

FIND A RECIPE FOR SUCCESS

A sixth-grade girl was running for the post of secretary of her elementary school class. A major part of her campaign was a speech to be given to her classmates, but she had no idea what to say. So she asked her mother for ideas.

"Well, you love to cook," her mom said. "Why don't you look in a cookbook?"

It was the stupidest idea she'd ever heard, but desperate, the young girl followed her mother's advice. Then, flipping through the pages, it hit her: Why not write a recipe for what would make a good class secretary? Two cups of good handwriting, one cup of dependability, and so on.

Jan Block, now a management coach, won the election. But she also learned to look in unusual places for creative solutions.

First Draft

The most beautiful people we have known are those who have known defeat, known suffering, known stuggle, known loss, and have found their way out of the depths. These persons have an appreciation, a sensitivity, and an understanding of life that fills them with compassion, gentleness, and a deep loving concern. Beautiful people do not just happen.

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