

Simple Answers to Complex Questions

This article was originally written in December 2002, but is equally relevant to today

There are some dangerous types at large in the financial markets. Most people never recognise them. They are the gurus who are peddling simple answers. Of course, most people love simple explanations and their corollary, simple predictions.

This is so pervasive at times that I have come to cringe when anyone starts off by telling me he or she is going to apply the KISS principle. While they think KISS means “Keep It Simple Stupid”, it really means that “I Keep It Simple, because I am Stupid”. The implication is that if you swallow that stuff, then you too are not behaving intelligently.

One of the things that the KISS brigade does is to look at the past and develop simple explanations for what has happened. These explanations are often based on co-incidences that are not statistically proven to be cause and effect. Often the facts are twisted or carefully selected to fit tidily into their perfect picture of the past.

Where the smoke and mirrors trick comes in is that, having convinced you they have a plausible, simple explanation of the past, they then present an equally simple prediction of what will happen in the future. This is a huge trick. Just because I can explain what happened in the past, does not mean that I can predict the future. Analysing what is known is one thing, but fortune-telling is another.

Last month I sat in the International Federation of Technical Analysts Annual Conference in London and listened to several speakers propound the KISS principle. Their proposition was that they had gone back through the last century and identified the point where the market turned up at the end of bear markets. Then they tried to locate a military victory that coincided with that time.

Then they pull the rabbit out of the hat. Markets hate uncertainty. Therefore the bear market will continue until President Bush annihilates Iraq. Their thesis is that the moment that victory looks certain, the markets will take off in the next bull market. One of the presentations even gave the most simplistic one paragraph explanation of the military situation and predicted that it will come in either December or February, taking into account only the weather and the dates of religious holidays in the Muslim world.

If you are inclined to believe this stuff, even for a moment, it is time to take a cold shower. The world is a far from simple place. Economic, political and cultural systems are highly complex. They have myriad interacting variables and the relationships between those variables are shifting constantly. The greatest minds in the world are still trying to scratch the surface in terms of building a model of these systems.

The first thing that I want you to take away from this article is that nobody knows when the bottom of the bear market will be. Sure, there will be lots of people making guesses. It is even certain that one of those guesses will turn out to be right. A new guru will be born, who will have his or her time in the sun until their next major prediction fails miserably. It has always been so.

The second thing that I want you to take away from this article is that there is no need to make predictions at all. As investors, all we actually need is the skill to identify the condition of the market and the ability to work out a strategy for the situation. I have no confidence that I can predict when the bear market will end, but I think I will recognise it fairly soon after it has happened. More importantly, I believe it is not too difficult to devise a strategy for that situation.

I think this approach will work well. It has in the past. It will require enormous patience and discipline. It is not “fun”. If you want “fun”, take some of your money down to the casino. The stock market is not the place to gamble.

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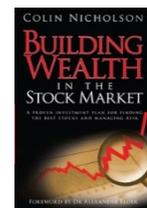
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