Forget the gurus – toss a coin

Philip Coggan reads an enjoyable work debunking forecasters – and makes his own prediction.

THE FORTUNE SELLER: THE BIG BUSINESS OF BUYING AND SELLING PREDICTIONS
by William A. Sherden, John Wiley

Light showers, bright intervals and moderate winds. That was the official Meteorological Office forecast for October 15, 1987, the day of the worst storm to hit England since 1703.

We all complain about the weather forecasters but they are far from the worst offenders in the $200bn a year prediction business. At least weather forecasts are pretty accurate for the next 48 hours. In this entertaining and well-written book, the author debunks those who make a living predicting trends in economics, the stock markets, demographics, science, social change and corporate organisation.

All too often, such predictions fail to improve on the record of a toss of a coin, or on the "naive forecast" – that existing conditions will prevail. For example, the Old Farmer's Almanac in the US claims a long term success rate of 80 per cent for predicting daily temperatures; the author points out that, just using the seasonal average temperature as a naive forecast, is right 90 per cent of the time

The problem for all such forecasters is our old friend, chaos theory. Old style science assumed that the universe obeyed set laws and that, provided one could know the initial conditions of a system, one could predict the outcome.

This works to a degree in a purely physical field, such as the weather, where natural laws do apply - hence the accuracy of most short term forecasts. The problem is twofold: an accurate picture of the initial conditions is impossible to assemble, because the earth is so vast; and the laws that govern weather are so complex that only a small discrepancy in the initial conditions causes vast forecasting errors over the longer term.

In the social sciences, where the behaviour of humans comes into play, there are not even any natural laws to apply. Economics and the stock market, to take two examples, are complex systems in which the players are constantly adapting their strategies to cope with changing conditions. Those who predict the stock market, and this includes financial journalists are thus doomed to fail. Even the existence of apparent investment gurus, such as Warren Buffett, does not disprove the thesis.

The best diagram in the book shows the percentage of mutual fund managers in the US who performed in the top half of the industry. Over one year, obviously, the number of managers in the top half was 50 per cent. But how many maintained that performance over two years? 27 per cent. Over three, four and five years, the numbers dwindle to 14, 4 and 3 per cent respectively. This is almost exactly the same percentages (50, 25,13, 6,3) as one would predict by flipping a coin. In other words, the performance of fund managers is almost entirely random: no skill is involved.

When it comes to pundits of social change no such rigid criteria can be applied. Such forecasts, like those of astrologers, are often so vague that success can be claimed, whatever the outcome. Alternatively, the pundit will predict so many things that the law of averages will ensure that a few of them will come true; the lucky guesses can then be cited in retrospect as evidence of the sage's foresight, while the failed forecasts are conveniently forgotten.

The author duly applies his blowtorch to the reputations of futurologists such as Alvin Toffler, author of *The Third Wave*, and John Naisbitt, who wrote *Megatrends* 2000 in 1982."Looking back, it is clear that three of Naisbitt's megatrends were long-term trends that were already well established before he wrote his book and that the other seven trends never materialised."

Only in the chapter on business forecasting does the author (a consultant) falter, by Introducing bin own views, rather than concentrating an assessing the record of the industry. But by that stage the reader should have absorbed the healthy cynicism required to weigh up such opinions.

In the end, however, despite the dismal record of most forecasters, the business will keep on growing, simply because people have a psychological need for some vision of the future, however unsoundly-based. And that is my confident prediction.