Absolute Zero

What will be the price of a barrel of oil by the end of this year? And will the stock market be lower or higher then than it is now? What about interest rates—is this the year they will finally start to go back up again?

If you don't have a good guess at the answers to questions like these, you might be tempted to see what the experts think about them. The world seems to have no shortage of economic experts who are willing to prognosticate on data points such as these, and you can find them at some rather august institutions: the International Monetary Fund (IMF), the World Bank, the Federal Reserve Bank, OECD, Goldman Sachs, IHS, Kiplinger's, and on and on and on.

A Batting Average of 0.000

That may not be such a good idea, though. There is an economist at the IMF who occasionally evaluates the predictive abilities of his fellow economists, and what he has found is fairly startling.

This man, Prakash Loungani, recently looked at the consensus forecasts for 77 different countries around the world just before the most recent Global Financial Crisis. As late in the game as September 2008, not one of those 77 countries was predicted to go into an economic recession before the end of 2009.

September 2008! This was after Bear Stearns collapsed, just as Lehmann Brothers was about to go down, and mortgage delinquencies were both high and rising. In short, the hand-writing was on the wall.

With the benefit of hindsight we can all laugh at the absurd fact that no country was predicted to have a recession, because we know that indeed 49 of those 77 countries not only entered into a recession very soon thereafter, but some *really* entered into it. U.S. GDP, which had been cruising along nicely, slipped more than 3% in 2008 and 2009, with domestic stock market averages dropping around 35% or 40%.

Is It Really Possible to Give 110%?

But as bad as the economists did in predicting the extent of the global recession of 2008/09, consider this: one year later, the consensus called for 54 of the 77 countries to be in recession. From the prior paragraph you can see that only 49 countries were actually in recession, which means that the economists went from a 0% success rate in September 2008 to a more than 100% success rate by September 2009!

That reminds one of us of our great uncle Walter, who has predicted 17 of the 3 most recent Super Bowl appearances by the Cowboys.

Pick an Economist, Any Economist

With aggregate results like this, perhaps you are thinking that the problem lies not with *all* economic forecasting, but with the fact that the economic forecasts are being taken together as a group. After all, if you take a large enough sample of random humans, the total result of the group shouldn't be much different from the overall average of humanity. In statistics, this is known as the law of large numbers.

So, the theory would go, perhaps there are a handful of really insightful economists out there, and they are especially good at making forecasts. It's just that, when you group them together with all the rest of their colleagues, the results seem uninspiring.

And Mr. Loungani actually tested for this. Unfortunately, what he found was that economic forecasts were pretty much the same no matter who made them. That is, the IMF's forecast was virtually indistinguishable from the OECD's, and the World Bank's forecast was nearly the same as one from the private sector. In other words, economic forecasters tend to run in a pretty tight herd, not unlike a group of bison roaming the financial plains.

So it won't do you any good to try to hunt for that one really good economic forecaster, on whose opinions you can make your investment decisions, launching your IRA's annual returns into the stratosphere and bringing forward your eventual retirement age by decades. It's just not going to happen, so you should save yourself the trouble of trying.

A Virtually Unblemished Record of Failure

In the recent Global Financial Crisis, many dozens of countries' economies went into recession nearly simultaneously. In more normal circumstances, that doesn't happen. While France is growing nicely, Brazil may suffer a setback, for instance.

So Mr. Loungani also studied the records of economic forecasters over many geographies and over many years, to see if he could find pockets of foresight here and there. He looked at 63 countries over the course of the final 10 or 12 years of the 20th century, and he discovered that there were 60 unique recessions that took place during that time frame.

For example, Poland experienced one recession, which was in 1991. Venezuela had two, in 1996 and 1998. And the monetary bulwark of Switzerland actually had four years of recession: 1991, 1992, 1993, and 1996.

And how well did the economic forecasters of those days predict those 60 recessions? To quote directly from the source:

> The simple answer is: "Not very well." Only two of the 60 recessions that occurred over the sample were predicted a year in advance, two-thirds remained undetected by the April of the year in which the recession occurred, and in about a

> quarter of the cases the forecast in October was still for positive growth… In 80% of the cases, the forecast made in October of the year of the recession under-estimated its extent.

As Financial Times columnist Tim Harford recorded last year in recounting Mr. Loungani's work, the economists' "record of failure … is virtually unblemished."

Conclusion

Of course, all of this should be nothing new to either us or our clients. As we wrote about in our most recent quarterly client commentary, economists have always been notorious for being bad predictors. About a year ago, most predicted a significant rise in interest rates in 2014, but they actually fell. Most predicted the price of oil to remain stable, but it plummeted by more than 50%.

So how much attention should investors pay to economic forecasts? Our answer is about the same as their success rate: absolutely zero.

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