



Does It Work?

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It was one of those innocent inquiries of youth that was so endearing that the illogic was irrelevant. My youngest daughter Hillary, who was about eight at the time, was in a Sedona, Arizona tourist shop when she became interested in a display of dream catchers and wanted to know what they were. Her aunt Brenda told her if she put one over her bed, the netting would catch the nightmares but the holes were big enough to let the good dreams through. Upon hearing this, Hillary had only one question, "Does it work?" Of course not, but since when has logic had anything to do with how we handle our fears?

If you don't believe me, consider the words of *The Economist* in its review of *Expert Political Judgment*, by Phillip Tetlock, "There is a remarkable tendency to trust experts, even when there is little evidence of their forecasting powers." For financial experts, the evidence is so remote that Eugene Fama, renowned as the father of modern finance, sarcastically declared, "I'd compare stock pickers to astrologers, but I don't want to bad-mouth astrologers." So why, contrary to reason, do we trust experts with such terrible track records? Because, Tetlock explains, "...no matter how unequivocal the evidence that experts cannot out-predict chimps... we...are enthralled by experts for the same reasons that our ancestors submitted to shamans and oracles: our uncontrollable need to believe in a controllable world, and our flawed understanding of the laws of chance."

In other words, we want answers. But the Heisenberg Uncertainty Principle in physics informs us that certain things are fundamentally unknowable. As Tetlock puts it, "Just because we want an answer, even *desperately* want one, does not mean we have an answerable question." And what appears to be an answer is often chance. It's what the mathematician John Allen Paulos referred to as the "Jean Dixon effect;" the tendency to attribute skill to a few correct predictions while ignoring the far more numerous incorrect ones. Although deep down we may know that financial markets are random and unknowable, Tetlock explains, "...we lack the willpower and good sense to resist the snake oil... Who wants to believe, on the big questions, we could do as well tossing a coin as by consulting accredited experts?"

The experts definitely don't want to believe their advice is useless so they "...talk themselves into believing they can do things that they manifestly cannot," says Tetlock. They congratulate themselves for their shrewdness when they get things right and they attribute failures to unusual circumstances or bad luck. Combine this delusion of experts with client fears and you get, warns Tetlock, "... a symbiotic embrace between self-confident suppliers of dubious products and their cling-on customers."

The products investors are embracing are dubious because the underlying strategies are based on chance which, according to the "Jean Dixon effect," means there is no way of knowing in advance which ones will work. Instead of relying on chance, which is uncontrollable, Tetlock and *The Economist* recommend focusing on what is controllable. That's why they suggest buying low cost index funds and only paying for advice that steers you away from "fraudulent funds" and makes you "aware of the benefits of diversification and of the effect on your portfolio of taxes rules and regulations."

While trusting dream catchers may be endearingly innocent, trusting forecasts of financial experts is irrationally ignorant. That's why any rational discussion of forecast-based financial products and strategies would logically lead to a negative response to the question, "Does it work?"

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