The Financial Charlatans

By Eric C. Pritz, CFP®, CMFC

Why you should never listen to market pundits and prognosticators

Any of you who listen to sports radio have no doubt heard an endless parade of commercials for professional sports betting services where they claim unbelievable documented track records of success in picking against the spread. I'll tell you right now that those claims are absolutely 100% true: their "*lock of the week*" has in fact been spot-on for six weeks running!

Who could resist, right?

Like any trick, however, it's actually rather disappointing when you see how simply the "magic" is accomplished. Let's assume the firm starts with a pool of 10,000 prospective clients. In week one, they advise half of those clients to bet on Team A, and the other half to bet on their opponent Team B. The 5,000 winners from week one then get split again in week two, with half being advised to bet on Team C, while the other half are advised to bet on their opponent Team D. And this continues on in the same manner so that by week six the firm has 300+ clients who think the prediction guru walks on water because he or she has made EVERY pick correctly – clients who will now gladly provide glowing testimonials and fork over considerable money for next week's sure-fire pick.

Self-promoters not savants

Just as it's impossible to consistently beat the Vegas odds, so too is it a fool's errand to try to accurately predict the movement of markets. In the December 17, 2007 issue of Barron's, the overwhelmingly robust consensus estimate from market pundits was for 11% growth in the S&P during 2008. We all know how that prediction turned out (a 37% plummet in the Index). And market history is littered with a litany of similar misses. Sure, even a blind squirrel finds the occasional acorn, but more often than not, it's the result of someone sticking with the same prediction year in and year out until at some point that prediction comes to fruition and the individual can finally and loudly pronounce "*see, I told you so.*" It's sort of the financial equivalent of the boy who cried wolf.

So why do they even bother?

As an investor, you need to understand that most of the prognosticators you see on CNBC and other financial news outlets are there for one reason and one reason only – to promote themselves and their firms. They're not taking time out of their hectic schedules in an effort to be caring and magnanimous. Rather they want to attract more investors to their firm, or generate more subscriptions to their monthly or weekly investment newsletter.

Once you realize the motivation, the underlying biases quickly become apparent. Think about it. Who would you expect to attract more stock investors, the upbeat and bullish predictor of 10% market growth or the surly bear who is forecasting global recession? Conversely, the pundits who publish and sell newsletters quite often gravitate to the contrarian point of view, looking to exploit your fear of losing money by suggesting they can help you get to the sidelines before the bottom begins to fall out.

Stick to your plan
There's no question that accurate and timely information is critical to making sound financial decisions. But no amount of data is ever going to provide you with a crystal ball to predict the day-to-day movements of financial markets. Rather than trusting the predictions of those who have no more idea of where the market is headed than you do, trust instead in the core tenets of sound investing (i.e., diversification, risk management and asset allocation).

Most importantly, rely on your financial advisor. Work closely with him or her not only to establish a comprehensive plan that addresses both short-term needs and long-term goals. The best advisors don't distinguish themselves with hot tips or bold predictions, they do it by sticking to a disciplined approach and removing emotional mistakes to keep you on-track toward achieving your ultimate objectives.

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