The Red House

FORECASTING THE FTSE 100

"I never make predictions, and I never will." Paul (Gazza) Gascoigne

The soothsayers in the money pages have been at it again with their predictions of a year end figure for the FTSE100 Index. In ancient Rome the practice was to sacrifice a chicken and examine its entrails. There is an apocryphal story from the USA of a chimp throwing darts at a stock list in the USA who outperformed all the highly paid stockbrokers, he was also cheaper as he was only paid bananas.

So, how are today's financial fortune tellers doing? We thought it would be interesting to look at the Financial Times, the most authoritative business newspaper and home of the FTSE100 Index, to see if their predictions could better chimps or chicken entrails.

2008 and 2009 have been two of the most remarkable years for equity returns since records began. It is in years such as these that those seeking guidance and reassurance from expert commentators needed the most help. So how did the FT do?

2008 forecasts

At the start of 2008 the Index stood at 6,486. Amongst the predictions in the FT Money section for the end of the year were:

Brewin Dolphin	7,200
Credit Suisse	7,200
Hargreaves Lansdowne	6,900
New Star	6,800
Justin Urquhart Stewart (Seven Investment)	6,413
Fidelity	6,000

The average of all the predictions in the FT for the end of the year was 6,400.

The index ended the year at 4,434. The average prediction was 30% off target with the top two shown above nearly 43% wrong.

The same edition of FT Money also had an article by the editor recommending three structured products that had "a 100% capital guarantee" provided certain indices or individual shares did not fall below a certain level. There was no mention of counterparty risk and the individual shares in question were UK bank shares!

2009 forecasts

At the start of 2009 the index stood at 4,434. Most of the industry experts from 2008 were not quoted (or had disappeared – New Star for example) but two were undaunted by their 2008 performance with these predictions:

Hargreaves Lansdowne	5,000
Justin Urquhart Stewart	4,600

The lack of industry forecasts were filled by the FT's own expert columnists and their forecasts ranged from 3,700 to 5,290.

The Index ended the year at 5,413. The two investment firms were 9.5% and 15% off target. The columnists' predictions varied from 37% off target to a pretty accurate 3% variation.

2010 forecasts

By now the picture is becoming clearer, certainly to us. Either these tipsters don't really know and are kidding us to get copy or they think they do know making them really dangerous either to rely on for their opinion or to manage money for investors.

So how do the 2010 forecasts look? This year started at 5,413 and the expert FT columnists vary from 3,980 to 6,000 for an end 2010 forecast. Hargreaves Lansdowne is the only industry tipster to have lasted 3 years. They are forecasting 5,750. Judging on recent past performances we could see variations from these forecasts of 30% to 40% above or below the final index value. What is the use of that information?

The Red House view

What do we think at TRH?

In summary, we don't believe in forecasts. The reality is no one really knows what the future holds for equity markets. We do however believe that the best way to get the returns an investor deserves from taking equity risk is by doing a few things exceptionally well:

- Don't try to beat the market, own the market
- Diversify to reduce risk
- Manage and reduce costs at all times
- Don't buy products or investments you don't understand
- Control your emotions, through the good and bad times
- And finally, make sure you are making the most of all of your tax allowances

As another great sportsman from the other side of the pond said –

"It's tough to make predictions, especially about the future" — Yogi Berra

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Sources

FT Money 29/12/2008, 03/01/2009, 02/01/2010

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