
The Not Knowing Plan

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Predicting where economies and markets are headed is a popular pastime around the beginning of a new financial year. Newspapers tend to call up economists and ask them for their 'outlooks', which inevitably have a short shelf life. Take 2020/21 for instance.

At the end of each July-June financial year in Australia, the website *The Conversation* polls economists from around the country for their view of a host of indicators, including GDP growth, unemployment, investment, and market variables like bond yields, currencies and shares.

The [2020/21 edition](#), published in late June 2020, featured the views of "22 leading economists from 16 universities in seven states". While individual forecasts often varied widely, the consensus estimate for the economy and markets was not particularly hopeful.¹

For unemployment, for instance, the panel picked it would continue rising. The economy, after all, had suffered a major shock and gone into recession. The most pessimistic view was the jobless rate would hit 11% by December; the most optimistic at a little under 7%. As it turned out, however, unemployment, fell to 6.6% and kept falling to just above 5% by mid-2021.²

House prices in Sydney and Melbourne were seen likely to go into reverse and end the year slightly lower. Some forecasters picked a fall of as large as 10%. By the end of 2020, however, house prices were 3-4% higher. And they kept rising. By the end of the March quarter, they had risen another 5-6%, according to the Australian Bureau of Statistics.³

For the Australian economy overall, the panel expected historically weaker economic growth. The average prediction for through-the-year GDP growth was a contraction of 4.6%. By the end of 2020, GDP was down just 1.1%. A quarter later, it was up 1.1% through the year.⁴

On currencies, there wasn't much luck either. The consensus was that the Australian dollar, having plunged during the COVID-19 shock to 18-year lows near 55 US cents, would struggle back up to 69c. The currency ended the year around 77c.

The economists didn't hold out much hope for Australian shares either. The average forecast for the S&P/ASX 200 index was a decline of 8% in the calendar year and a marginal rise of 2.3% in 2021. As it turned out, the market ended 2020 modestly higher and rose more than 28% for the full financial year, its best performance in 14 years!

Now keep in mind this was a heavyweight economic panel, including macroeconomists, economic modellers, former Treasury, IMF, OECD, Reserve Bank and financial market economists, and even a former member of the Reserve Bank board.

None of these observations is intended as a reflection on the skills of the panel, who are all undoubtedly highly credentialed experts. But it does show that when it comes to forecasting, no-one really has any idea about the future. There are just too many unknowns.

It also suggests that if even the professionals can't accurately forecast the fortunes of the economy and the markets, what hope have the rest of us? In this case, the Australian economy turned out stronger and more resilient and the share market more buoyant than most expected.

The lessons for the rest of we ordinary investors are familiar. If you can't forecast the future, you should really focus on all those things you *can* control - starting with a financial plan that takes account of your circumstances, goals and what you can stomach in terms of volatility.

What else? To control risk and increase the reliability of outcomes, you should diversify both across and within asset classes, and keep sufficient cash on hand to deal with emergencies. You should only take risks you understand, stay focused on the premiums your portfolio is targeting, and be mindful of costs and taxes. Lastly, you should regularly rebalance to ensure your mix of investment assets is appropriate for your risk tolerance and your goals.

The great US economist John Kenneth Galbraith once said: "There are two classes of forecasters – those who don't know and those who don't know that they don't know."

For the rest of us who don't have to earn a dollar making financial and economic forecasts, living with not knowing is a whole lot easier with the right plan.

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1. '2020-21 Economic Survey: No Big Bounce', *The Conversation*, 28 June, 2020.
 2. 'Labour Force Survey', *Australian Bureau of Statistics*, May 2021.
 3. 'Residential Property Price Indexes', *Australian Bureau of Statistics*, June 2021.
 4. 'National Accounts, March Quarter', *Australian Bureau of Statistics*, June 2021.

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