

Summer Blockbuster – Nobody Knows Anything

William Goldman, the Oscar-winning screenwriter of *Marathon Man*, *Butch Cassidy and the Sundance Kid* and *All the President's Men*, wrote a memoir, *Adventures in the Screen Trade*, in 1983. Goldman shocked readers with his conclusion that, despite adulatory interviews of movie stars and directors, despite the braggadocio of studio executives, despite the triumphal marketing of movies, nobody knows anything. Consider the legions of movies that come out each year, most of them disappointments. Every star, no matter how talented or honored, has acted in their share of clunkers; every legendary director has had fiascos; every major studio has released an embarrassing list of duds. If the directors, actors and executives are such experts and artists, why do they produce so many failures?

Goldman posits they are unable to recognize, in advance, a successful movie, star or director. He describes a casting director who dismissed a suggestion to hire the young Robert Redford, saying, "He's just another California blond – throw a stick at Malibu, you'll hit six of him." Despite his brilliance, Goldman had firsthand experience in humility, having turned down offers to write the screenplays for *The Graduate* and *The Godfather*, and having written other novels and screenplays that never saw the light of day.

It is not just the movie business. Consider venture capitalists, lionized in the media as philosopher kings, sitting atop the commanding heights, allocating capital. The classic return pattern for venture capital partnerships, however, is that for every ten investments, five go bankrupt, three or four live but do not thrive, and one (or, if they are lucky, two) succeed, make up for the rest and provide a decent return on capital. Venture capitalists are playing the odds; good venture capitalists will have the odds in their favor, but if they are so metaphysically wise, why invest in the eight or nine companies that fail? Because they do not know, in advance, which companies will

succeed. Goldman's rule also applies to investing, where the media persists in presenting successful investors as fortunetellers. The brokerage firm strategist tells us that China is growing rapidly, that the price of oil and food are rising, or that the baby boomers are aging, and then predicts which stocks will go up as a result. Talking heads present mundane, common knowledge and then proceed to the unlikely. What makes anyone think that the stock picks do not already reflect the common knowledge? Did Goldman Sachs (no relation to William) not get that flash about China's growth? Did Merrill, Lynch not get the memo about aging baby-boomers? Stock prices probably already reflect anything that sounds plausible.

In contrast, consider the fate of a market strategist two years ago who predicted: (1) gas above four dollars a gallon; and (2) the hot topic in July 2008 would be a possible conservatorship for Fannie Mae and Freddie Mac. Her employer would not have let her embarrass the firm on CNBC and probably would have informed her about the psychiatric coverage in the firm health plan. Imagine we predict the Dow Jones Industrial Average will hit 50,000. That is alluring, and is certainly attention grabbing, but it sounds implausible. Earnings growth, though, is a remarkably consistent 5.9 percent annually over time. At that rate, at current valuations, the Dow, about 11,300 as we write this, will hit 50,000 in 26 years – and that is actually below the average annual gain in the Dow over the past 60 years. The prediction sounds implausible, is likely to happen (some day), but nothing that tells you what to do tomorrow.

“Chance favors the prepared mind”

– Louis Pasteur

Despite its nihilistic tone, Goldman's rule should be liberating, not depressing. We should revel in our unshackling from the tyranny of having to try, and failing, to predict the future. Goldman knows some actors, directors, writers and studio executives are better than others are, but he also knows there is a huge and unavoidable element of luck in the movie business. He points out that we might strain to recognize the name Humphrey Bogart had not George Raft turned down the leads, offered to him before Bogart, in High Sierra, The Maltese Falcon and Casablanca. He relates that Montgomery Clift turned down the leads in Sunset Boulevard, East of Eden and On the Waterfront, so instead we got star-making roles for William Holden, James Dean and Marlon Brando. Goldman's point is that this element of chance or fate is inevitable. The thing to do is perfect your craft and persevere, rather than worry about if you will be lucky or unlucky.

Nobody knows anything in the sense of exact predictions of the future, but you can prepare for the certainty of uncertainty. Investors and their advisers should embrace fate and stop expending energy on predictions. The dismal record of market forecasters shows prognostication might be psychologically satisfying, effective in selling and entertaining, but not valuable. The superior investor or adviser realizes that the unexpected will happen constantly – the secret is to accept that truth and not panic when the unavoidable but unpredictable inevitably occurs. If you have a rational, disciplined, well-designed approach to investing, you and your portfolio likely will weather the sure-to-happen but often-ignored bear markets and economic recessions. You will be less inclined to make unwise, emotional decisions under stress because you fully recognize the potential impact of chance. If you like the sound of that approach, contact us at www.sigmainvestment.com or at (503) 419-3938. We cannot promise a summer blockbuster; we even guarantee that we will be wrong sometimes, but we will always attempt to follow a rational evidence-based process. In the movie biz, this is underselling. In the investing biz, it is the truth.