

## Gurus and 15 Minutes of Fame

Every decade spawns market gurus who make a few correct calls, get massive media attention, then fizzle out. In the 1960s, we had Gerry Tsai, Fred Carr, and other mutual fund gunslingers. In the 1970s, we had Joe Granville and Henry Kaufmann. In the 1980s, it was Robert Prechter and Elaine Garzarelli. The 1990s brought us the high-flying internet stock managers. Today, Nouriel Roubini and Meredith Whitney are all the rage. But, eventually, they all return to earth.

Why do all the gurus eventually stumble? They stumble because it is very difficult to consistently pick winners and it is very difficult to accurately interpret market moving information. Let's look at these two issues in a little more detail.

**You can't consistently pick winners.** We all try and billions of dollars a year are spent on market research trying to uncover the next big winner. Is that rationale? Let me interject a little history here<sup>1</sup>. In 1900, a French mathematician named Louis Bachelier completed his doctoral dissertation titled *The Theory of Speculation*. This dissertation tried to explain why the stock market behaves as it does. Bachelier used complicated mathematical formulas to reach his conclusions, but they can be summarized as follows:

1. There are so many factors that influence stock prices (e.g., past events, present events, and discounted future events) that it is impossible to develop a mathematical model to predict stock prices.
2. There are so many diverging opinions on stocks that at any given point in time, there are buyers who believe in a price increase and sellers who believe in a price decrease. Since there's no reason to believe that the buyers are smarter than the sellers, or vice-versa, then, at any given instant, the expected change in a stock's price is zero. There are just as many buyers as sellers and neither one have better information.
3. If you agree with #2 above, then the mathematical expected return to a speculator is zero – a “fair game.”
4. If you agree with #2 and #3, then the market believes that the current stock price is the true price. If the market didn't believe that, then it would quote another price which is either higher or lower.

According to Bachelier, a stock's price will change only when there's a good reason for it to change such as new information. Unfortunately, nobody knows whether this new information will cause the price to go up or down, hence, we have a 50/50 chance of an up or down move. And, probability theory says under those conditions 1 out of

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<sup>1</sup> Peter Bernstein's book, *Capital Ideas*, pages 18-23

1,000 will make 10 accurate calls in a row; hence, a guru is born. But, the odds will eventually catch up with them, hence the fizzle.

**You can't consistently and accurately interpret market moving information.** Even if you knew one day in advance what the non-farm payroll numbers were going to be or whether the Fed was going to change interest rates, it would still be difficult to profitably trade with that information. The problem is we would have to know what "the market" was expecting, how "the market" interpreted the information, and how quickly "the market" assimilated it. That's impossible to do without surveying every market participant. Even if you did that survey, their minds could change before you could react.

In the end, we're back to the basics. Instead of trying to hit home runs, we look for singles and doubles. This strategy may not put us on the cover of *Money Magazine*, but it may help us methodically meet our clients' objectives.

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