ALLAN GRAY

GRAY ISSUE
17 November 2020 Issue 237

Predicting the unpredictable

"It ain't what you don't know that gets you into trouble. It's what you know for sure that just ain't so." Mark Twain

The recent US election

Joe Biden became the president-elect of the United States of America after most of the news media called the election in his favour. The US election started on Tuesday, 3 November, and only on the fifth day of vote counting were they able to predict with certainty that Biden would be the next US president. Biden edged ahead of Donald Trump in Pennsylvania by slightly more than 0.5% (37 000 votes) and this eventually tipped the scales in his favour. This election saw the highest voter turnout percentage since 1900.

At the time of writing, Biden had received 77.9 million votes compared to Trump's 72.6 million votes. This outcome, of course, is dependent on the court challenges that Trump's team has launched – although they are yet to produce any evidence of voter fraud.

What did the polls predict?

Before the election, most of the polls predicted a comfortable victory for Biden, not unlike what they predicted in 2016 for Hillary Clinton. But instead, the race came down to one or two percentage points in a handful of states.

Looking at Wisconsin, pre-election polls showed Biden up almost seven points. The Post-ABC News poll projected a comfortable 17-point victory for Biden, while the Times predicted an 11-point victory. In the end, Trump lost the state narrowly by approximately 20 000 votes or 0.3%. It would seem most of the pollsters underestimated Trump and struggled to poll his supporters accurately.

One extreme example was the senate race for the district of Maine. At one stage, 14 polls predicted that Sara Gideon would overcome Republican incumbent Susan Collins and flip the seat for the Democrats. This proved to be wrong as Collins won by a comfortable margin.

In 2016, pollsters were left flabbergasted after they predicted a landslide victory for Clinton that never materialised. They tried to correct for this in 2020 by updating their polling methods but, despite their best efforts, the polls left much to be desired. The credibility of the polling industry is being questioned and the public trust in their predictions has been eroded. Pollsters will be unpacking the result to determine what they failed to consider in their models, but this will all be after the fact. They will be scratching their heads about how to fix this problem before the next election comes around.

How could following predictions impact my investments?

When predictions are wrong, it can have real-world consequences. Public polls influence public discourse; they can influence how much money a candidate attracts for their campaign, and even how people vote.

Similarly, trying to make personal investment decisions based on market predictions can be fraught with danger. Buying whichever share the general consensus predicts will do well could mean that you are paying a premium for the share, which decreases your chances of outperformance in the future.

Another example would be making investment decisions based on predictions of what the exchange rate will be in a month or in a year's time. History has proven this a dangerous game to play; there is simply too much uncertainty.

Who did we predict would win the US election?

We don't believe we have any edge in forecasting political outcomes, like the US election, or macroeconomic events, so we guard against being pulled into predictions. While we are acutely aware that the businesses we analyse operate in, and are subject to, the ups and downs of macroeconomic cycles and political shenanigans, we believe our time is better spent focusing on the individual factors that drive their long-term intrinsic values – which we believe can be analysed with a greater degree of certainty. We apply our minds to try and determine what each business is truly worth, considering a range of possible outcomes.

This 'bottom-up' approach to investing involves detailed analysis of the business, its income, expenses, outlook, and positioning within its industry. It is our experience that understanding companies and investing in them when they are trading below our assessment of their intrinsic value is far more rewarding than trying to predict economic, political and market trends.

Lastly, our investment horizon allows us to look past the short-term noise created by events like the US election or the Budget Speech and to focus on the intrinsic value of each business. Buying and selling based on everyday events and market movements may cause you to lock in losses that may have otherwise been avoided. If you are focused on a long-term goal, the short-term noise is just that – noise.

As we have said many times, the best determination of future returns is the price you pay for a stock, never mind what Trump decides to tweet at 3am.

Commentary contributed by Braam Visser, business analyst, Allan Gray