Our natural human addiction to prediction.mp4

Speaker1: What's going to happen with house prices? How about oil and the stock market? Is a Canadian team ever going to win the Stanley Cup again? Hi, I'm Stan Clark and I'd like to talk about our natural human addiction to prediction. Human beings are driven to try to predict the future. The drive is so strong that researchers have called it a prediction addiction. Brain research has actually identified a region of the brain and a specific chemical dopamine that practically forces us to forecast. Over the course of history, people have used dozens of predicting methods such as tarot cards, tea leaves and crystal balls. Since the beginning of time, people have searched for fortune tellers, psychics and seers. Truth is, although we're strongly attracted to forecasting, we're just not very good at it. As the eminent philosopher and baseball player Yogi Berra once said, it's tough to make predictions, especially about the future. Some bold forecasts from the past bear this out like this one. A severe depression like that of nineteen twenty to nineteen twenty one is outside the range of probability. That's what the Harvard Economics Society wrote on November 16th. Nineteen twenty nine just before the start of the Great Depression. How about it will be years, not in my time, before women becomes Prime Minister, Margaret Thatcher said that on October twenty six, nineteen sixty nine or this more recent one, there's no chance that the iPhone is going to get any significant market share.

Speaker1: That was Steve Ballmer in USA Today April 30 at the two thousand seven forecasting company earnings is just as bad. Earnings are the key bottom line numbers that investment analysts try to predict. In a huge study covering more than two hundred thousand estimates over thirty eight years, earnings estimates were off on average by an amazing 40 percent. That's a huge error for something so important. But even though their ability to forecast is so poor, they still fool themselves and others into thinking they're good. Perhaps their real skill is getting us to remember the rights and forget the dead wrongs. We're attracted to forecasting because we're wired to do it and because our brains fool us into thinking we're better at it than we really are. Behavioral finance has uncovered many biases that keep us trying to define the future, including hindsight, bias, optimism, filtering and the confirmation bias. Economic forecast is especially hard for three reasons. First, there are thousands of factors involved, and the human mind is not wired to take that many factors into account.

Speaker1: Studies show we can maybe hold six or seven facts in our mind at any one time. Second, many of the factors such as human creativity and the emotional reaction of crowds are simply unpredictable. You know, things are going to change, but it's super hard to figure out the details. Third, there's an element of circularity involved. People adjust their actions based on the forecasts themselves. An example of this was the Y2K hype in nineteen ninety nine. Predictions of planes falling from the skies and computer systems crashing turned into a non-event because people took actions which prevented the predictions from coming true. I keep a copy of the book The Complete Y2K Home Preparation Guide, right beside my crystal ball to remind me of this. The problem with predicting is that we bet too heavily and what we think are the likely outcomes and we overpay for things based on highly suspect forecasts. Besides, forecasting takes time, and this diverts us from focusing on things that are truly productive. Summing up, looking for economic or stock market profits is not the right way to make stock market profits.