<u>The Outlook: March 1, 2024</u>

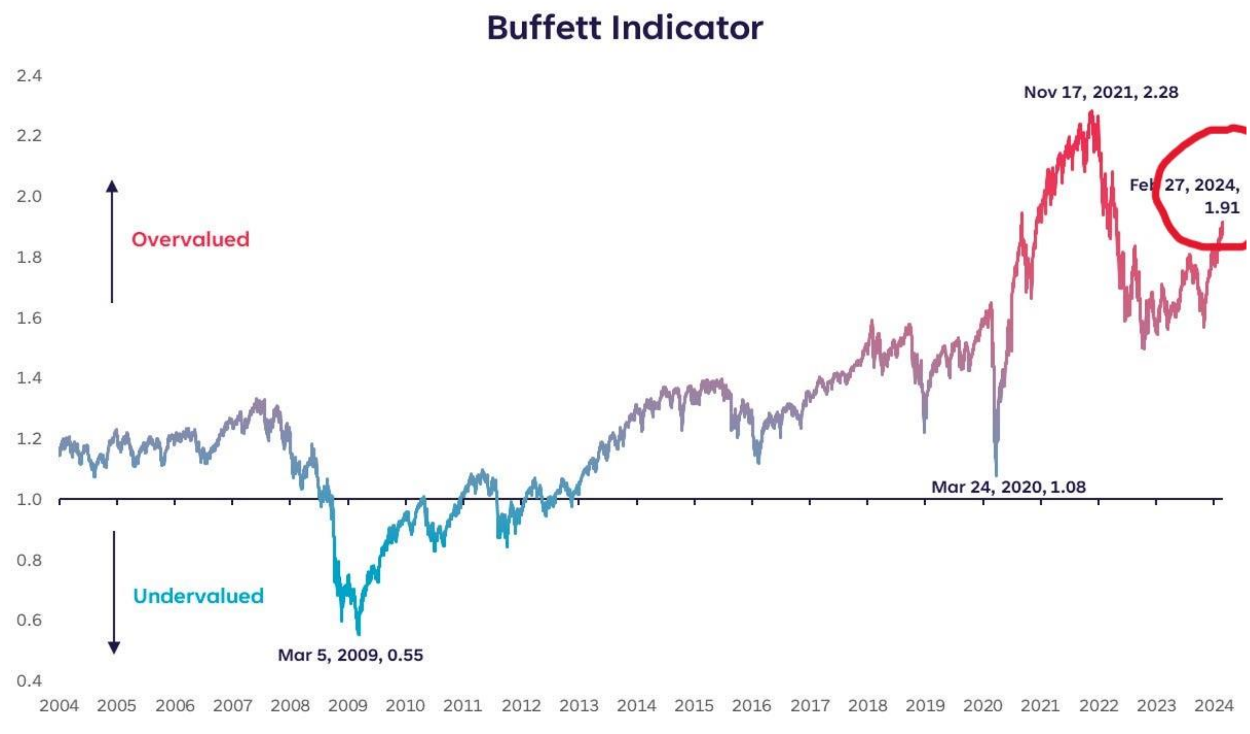
Model Train Wrecks.

Let's talk just briefly, today, about "models." Models are formulas used to predict things: the future of inflation, the stock market, interest rates, climate, earthquakes, and so on. They are "really complicated formulas," thunk up by "experts."

Now, putting words like "experts" in quote marks means, of course, that we're being sarcastic. It's not much fun to read or listen to sarcasm . . . but forgive us, this time. Our point is so important that it might be worth a touch of sarcasm, for emphasis. Here's our point:

> ***In the investment world (and every other world) we're pretty much surrounded by "experts" and their "models." Rather than being inclined to believe them (because they always sound "expert" and because we lack the time to dig into them and really understand them), we'll be a lot safer, 99% of the time, if we decide to automatically <u>disbelieve</u> them.***

Purely as a random example, here's a model for predicting where the market is going.



Source: SoFi, Bloomberg. The Buffett Indicator is the ratio of total US stock market capitalization, proxied as the Wilshire 5000, relative to nominal GDP.

This is a fun model to make an example of. First, it's named "Buffett," so everyone in the investment world's first impression is, "Oh! The Oracle of Omaha! He must know something!" Then, it's nicely colored for us: blue/green means "good" and red means "bad," meaning if we own stocks in the red zone we'd best dump them from the back of the sleigh and whip up the horses, aiming for the hills, with the wolves howling behind us. With the red circle—which is today—the model tells us that the market is the most expensively valued in the last two years, which sounds dangerous.

Finally, in fine print at the bottom we are handed down the formula. It is "the whole value of 5000 American companies divided by the whole value of goods and services produced by America in the last 12 months."

If we blinked at that, thinking "Ah, come again?" it's OK. At Outlook we've been pondering such models for 47 years now, heaven help us . . . and we blinked. Now, if we were still in college or grad school, this would be the exact moment to think, "Hmm. I didn't understand a word the Professor just said. Should I raise my hand and ask a question, or will that just let him know how dumb I am?"

We all handled that decision in our own ways, didn't we! (Of course the smart—and cowardly—thing was always to keep our hands down, and hope someone else would ask.) But anyway, if after forcing ourselves to think, we only wondered why comparing a "stock" (the market) to a "flow" (GDP) made for a sure-fire predictive formula . . . we'd be right: right enough, at least, to say <u>"Maybe that formula's helpful somehow, but I won't bet the ranch on it."</u>

That last line has been the right label for oh, two or three thousand "models" Outlook has been shown over the decades, covering everything under the sun in the investment world. And one of the best things about being able to use words like "decades" is that it lets us notice how many clever models become train wrecks, eventually. When that happens, we <u>never</u> hear from the expert model builders, saying "Ah! Pardon us! We got that one wrong, wrong, wrong!" We musn't blame them: they are, of course, trying to make a living being expert model builders. No . . . they just move on to their next model; or they tell us how cleverly they've tweaked the old model, so now its crystal ball is even more perfectly clear.

Just over the last few years, an almost countless volume of models has been wrong, wrong, wrong about: inflation (in both directions); US economic growth; the stock market; interest rates; the outcome of a war; global consumption of oil . . . we get the idea. Have any been right? Certainly. Were the right ones lucky, or smart?

That last question brings us right to the heart of Outlook's approach to investing, namely: "If it's not simple enough to be clear; and if its foundation is anything <u>other than cold, undeniable facts</u> (about cash and financial strength, especially) than let's skip it." In other words, if someone tells us we need a "model" to understand it, we'd best put our hands over our wallets and run in the opposite direction. In other, other words, good investing is about insisting we understand what we own, and being patient; not about how clever we might be.

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