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Visibility

Peter L. Bernstein

The long run is a great crutch, a favored bad-weather friend. When investors are growing wealthier, nobody wants to be reminded of regression to the mean or how bull markets diminish future returns. When the going is rough, however, the long run is a wonderful source of comfort. Reminders of the uptrend even through sharp market fluctuations salve our pains and wounds, encouraging us to hang in, no matter how low our asset values might fall in the interim.

The asymmetrical view of the long run is silly on two levels. First, such inconsistency is bad thinking. Either the long run matters or it doesn't; you cannot have it both ways. But the real problem is in how much reliance we can place on the long run to begin with. *Does the long run matter?*

When we extrapolate the long-run past to predict future equity returns, we are making the extraordinary assumption that the market will replay *every one* of those historical episodes in the years ahead. Leave out just one, and all the averages and standard deviations change. That is a bold assumption indeed.

The market will fluctuate, as J.P. Morgan asserted, but we can have no certainty about the amplitude of fluctuations, the timing of those fluctuations, and the trend or lack of trend around which prices will vary.

In a different vein, the notion of "visibility" is used with the same degree of inconsistency as the long run. Recent experience offers a vivid example of what I am driving at. Here are some complaints by a few big league CEOs from high tech, right out of the headlines of this past springtime.

> Bill Aylesworth of Texas Instruments: "We don't have any clarity as to when we'll get improvement." John Chambers of Cisco: "Visibility going forward is more difficult than we have ever seen." (Have you ever seen visibility going backward? Indeed, have you ever seen visibility?) Henry Nicholas of Broadcom: "We don't have the visibility." John Roth of Nortel: ". . . the poor visibility. . . ." Scott McNealy of Sun Microsystems, when asked about 2002: "Guidance is probably too strong a word anymore—wildass guess."[1]

Note how visibility vanishes the minute things get rough. While these statements reveal how terrible visibility was last spring, there is no mention of lack of visibility back when the world could not get enough of these products, and stockholders could not pay too much for the shares of these companies. Is it not odd how nobody gripes about lack of visibility when the going is good?

This asymmetry is precisely the opposite of the way we invoke, or ignore, regression to the mean over the long run, as convenience suits.

The future these guys thought was "visible" back when business was terrific never arrived *because it never existed*. If they had such great visibility back then, if their "guidance" and carefully contrived decisions had been something different from wild-ass guesses, how come their companies have been left with awful earnings (if any), woeful amounts of excess capacity, and customers with equally woeful stores of inventory?

Their very conviction about visibility and their unrealistic belief in certainty was the main reason the future they foresaw failed to arrive. They made no preparation for unexpected outcomes; they made no hedges against being wrong; they ignored the tails of the distribution. In fact, their decisions based on certainty of permanent growth and success in the years ahead were the primary source of the future that would do them in!

As Nobel Laureate Kenneth Arrow reminds us: "To me our knowledge of the way things work, in society or in nature, comes trailing clouds of vagueness. Vast ills have followed a belief in certainty."[2]

We can speculate, we can calculate, we can estimate—but we can never be certain.

[1]Frederick J. Sheehan, Jr., *Quarterly Market Review and Outlook*, July 2, 2001.

[2]Kenneth J. Arrow, "I Know a Hawk from a Handsaw." In M. Szenberg, ed., *Eminent Economists: Their Life and Philosophies*. Cambridge and New York: Cambridge University Press, 1992, pp. 42-50.

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