Why Forecasts Should Never Be Taken Too Seriously

Description

The last few years have thrown up a number of unexpected results for investors. Within the political sphere, Donald Trump's election victory and Brexit are two obvious examples of events which were incorrectly forecasted. Within the global economy, the growth rate of the Chinese economy has slowed to a lower level than the market anticipated, while share prices in 2017 have soared higher than expected following Trump's election victory.

Difficulties

Those examples show how difficult it can be to forecast the future. This does not only apply to near-term events, such as elections and GDP growth rates, it equally applies to the performance of a company.

Although equity analysts publish their forecasts for company results, they are subject to major change throughout the year. For example, they may start out estimating $1 earnings per share at the start of a financial year. By the end, this may have gradually been reduced to $0.90, which ends up being relatively close to the actual figure.

While it may appear as though the market consensus was exceptionally accurate, the reality is that those forecasts have been subject to change. Often, the original forecast bears little resemblance to the actual result. Therefore, it could be argued that the original forecasts should not be taken too seriously. After all, predicting a wide range of variables accurately and on a consistent basis is exceptionally difficult, if not impossible.

Opportunities

Of course, the fact that share prices are impacted by actual results being different than forecasts creates an opportunity for Foolish investors. Following surprises such as election results and GDP figures, it is sometimes possible to buy high-quality stocks at discounts to their intrinsic values.

Often, following surprise results, investors either become greedy or fearful. This can equate to larger margins of safety which may signal an opportune moment to buy. Or, it could mean inflated share prices, which may prompt investors to take profits.

Similarly, a company may be forecast to record rather lacklustre profit growth over the next few years, and its valuation may be marked down as a result of this. For long-term investors, this may present an opportunity to buy, since history shows that companies which are financially sound and that have a strong management team will often go on to adopt the right strategy through which to deliver high rates of growth.

Equally, stocks which are assumed to offer high, stable growth rates may be worth selling in order to avoid the disappointment which almost inevitably comes along as the economic cycle moves into a contraction phase.

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