Hello Everyone,

Recently, Commerce Secretary, Wilbur Ross, was on Fox Business with Maria Bartiromo. He opined that the North American economy might benefit from the outbreak (of Coronavirus) as companies “reevaluate their supply chains” to factor in emergent outbreak risk.

In short, Secretary Ross is predicting Coronavirus could bring jobs back to America.

Please tell me we are not this callous.

Today’s missive looks at another aspect of the “Predictions Game”. You may find “the Wall Street game” a bit cynical…but hopefully not callous.

Signed, Your Eager-To-See-If-Impeachment-Is-A-Short-Term-TV-Special-Or-A-Drawn-Out-Mini-Series Financial Advisor,

Greg

KKOB 01.31.2020 How Wall Street Works Part 2

Bob: So, Greg, we are on the topic of ***How Wall Street Works*** --- with the goal being to make our listeners better investors. And, today’s report is entitled, **The Predictions Game**. So, is this where everyone predicts what the markets will do? ….even though we know no one can see the future.

Greg: Well, that’s pretty accurate assessment…but let’s look at how (and why) Wall Street issues forecasts anyway. And, Bob, I’ll tell you, if you’re in my business long enough you tend to roll your eyes once you understand the drill.

So, to set this up, remember ---first and foremost--- Wall Street is a sales organization and not an investment organization. Knowing that makes understanding the Predictions Game a lot easier.

So, Bob, let’s pretend you’re an analyst for Goldman Sachs ---and one of the stocks you follow is Apple.

Bob: Does that mean I get to wear fancy suits, drink exotic drinks, and live in an exclusive apartment in downtown Manhattan?

Greg: As an analyst…probably not. Still, you work for Goldman, so you're probably doing OK.

Anyway, here's how it works. First, you issue a price, or profit, target for your assigned stock. Oh, and the object is to do this very publicly. You might even go on CNBC or Fox Business and say something like this. "*Based on our research, expectations, and management interviews, we expect Apple to earn $15 per share."*

Then, the game goes like this. Over the course of the next several weeks, you gently lower that 15 dollar number to 14, then 13, then 11. But you do that part quietly. No TV. No big press releases.

Then, when Apple eventually announces its earnings and says, "We made profits of $13/share", you go back on TV and gush about how Apple beat earnings expectations.

Bob: But, wait. It started at $15, and was lowered to $11. And then when it comes in at $13, it's a success?

Greg: Right. That's why we roll our eyes.

Bob: So, why not just stick to original $15? Why the financial gymnastics?

Greg: Because the goal is to constantly generate interest. When you first announce $15 everyone says, "*Wow! $15 that great! I should buy."*

Then, after quietly lowering expectations, you can generate more interest by saying, "*Apple beat expectations!"*

That "beat" then allows the sales department to call clients and say things like *"Mr. or Ms. Client, did you hear? Apple beat their profit expectations for the tenth consecutive quarter. Let's buy!"*

Bob: Which is why you say Wall Street is a sales organization…they want you to be constantly buying.

Greg: Right. Which gives me a chance to address your first question about the Prediction Game and the overall market. Bob, in 1999, did Wall Street tell you to sell before the dot com crash? No.

In fact, in January 2000, the S & P 500 was at 1470. Knowing that, here were the year-end price targets given by the superstar analysts of the day.

- Abby Joseph Cohen from Goldman Sachs said we'd hit 1525.
- Al Goldman at AG Edwards said 1700.
- Christine Callies at Credit Suisse First Boston --1560.

A year later, we'd gone from 1470 to 1320. And, by October of 2002, we were at 768. Yikes! From 1470 to 768! And not once did the analysts get the price targets right ---or tell you to sell.

Bob: But along the way I'll bet everyone kept saying they were beating expectations---- because the game is to start high, go low then say you won…..even if you never got back to the original prediction.

Greg: You just summed up how analysts can say they are winning the Predictions Game in a declining market.

Anyway, I'm not saying companies or markets can't do better than expectations. Clearly, that happens a lot…otherwise the market wouldn't be near all-time highs.

What I'm saying is, as an investor, before you get super excited about how a company, or the overall market, exceeded expectations, make sure you know where they started.

Bob: Good advice.   I always learn something. How do people reach you?

Greg: My number is 250-3754. Or, go to my website at zanettifinancial.com.