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FINANCIAL STRATEGIES

The Wisdom of Crowds

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How many jelly beans are in this jar?

Like me, I'm sure many readers have had the opportunity to make such a guess at various fairs and fundraisers over the years. I've certainly never guessed the exact count, nor have I won a prize for guessing the closest count. But I wouldn't be surprised to learn that as a collective, the guessers honed in on the correct number each time.

In 1906, Sir Thomas Galton attended a farmers' fair and was intrigued by a weight guessing contest. Participants were asked to guess the weight of an ox on display, after it was subsequently butchered and dressed. There were 800 entries. The winner won a prize.

Galton, a cousin of Charles Darwin, was an English Victorian-era statistician, polymath, sociologist, psychologist, anthropologist, eugenicist, explorer, geographer, inventor, meteorologist, geneticist, and psychometrician.[1] (Is anyone else feeling like a "slacker?") After the contest, he took the tickets and ran a statistical analysis on them. He learned that the average guess was off by less than one pound…for an ox that weighed 1,198 pounds! This average guess was closer than the actual winner, and also better than the guesses of all the cattle experts at the fair. The concept of the Wisdom of Crowds was born.

In 2018, the Gallop Organization found that approximately 54% of the U.S. population, or about 175 million people, owned stocks, either directly or as part of a fund. That certainly constitutes a crowd. And every day, millions of informed investors "vote" on the value of thousands of investments. There is arguably a good deal of "wisdom" in this continuous process of setting investment values. In a nod to the Wisdom of Crowds, investors will often consider "What is the market telling us?" Undoubtedly, there have been countless times the market has been proven right as a company moves towards further success or to failure.

We generally believe in The Wisdom of the Crowd, with one significant caveat – that human beings are inherently emotional. Emotions can lead to distorted prices in the market, especially in the short run. We are always wary of the crowd at extremes.

It has been said that two emotions can take over the market – fear and greed. While all investors strive to buy low and sell high, emotions often cause investors to do the exact opposite. From September 27th to December 24, 2018, the S&P 500 fell by nearly 20%. More than the usual number of clients "checked in" with us that last week. Not one client called to say that he or she wanted to increase their allocation to stocks. Warren Buffett famously said to "Be fearful when others are greedy, and greedy when others are fearful." In practice, this is very difficult to do.

On December 26th, we sent a piece to all our clients titled The Scrooge's Bear Market. In that piece, John Burke listed the "10 reasons why we think this will be one of the mild bear markets, and why we are optimistic that it may not get much worse at all." December 24th turned out to be the bottom of that period of significant decline. The S&P 500 is up over 20% since then. Apparently, the crowd got very emotional in that last quarter of 2018, and presumably lacked some wisdom at that time. As Benjamin Graham, the so called "Father of Value Investing," once said, "In the short run, the market is a voting machine; in the long run, however, it becomes a weighing machine." We invest with a long-term perspective, and we do our best to avoid making emotional investment decisions along the way.

So how many jelly beans are in that jar? There are exactly 1,321 jelly beans. I bought the jar and counted them myself. Now I hope not to eat them all myself.

1 – Wikipedia

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