Forecasting during a Crisis

by

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Georgia State Economic Forecasting Conference
“Managing Risk and Uncertainty During Crisis”
November 15, 2001
Atlanta, Georgia
Outline of Presentation

• Some lessons from 13 crisis forecasts.
• The Good News: Returns to risk taking will rise (But only for the Brave)
• Wall Street crash awakens sleeping tiger.
• The Taliban = warm-up for the real war.
• The next phase of the war will also be quick; are you ready of $86/barrel oil?
• The long-term danger? Opportunistic terrorists, will spread biological and cyber viruses just to panic us.
Prolegamena: My Favorite Crisis Forecasts

The Fiascos:
- 1987 stock market crash would hurt the economy in early 1988
- Rodney King riots would hurt real estate values in Watts
- Prop. 13: media-ocracy comes early to California
- Carter's CETA madness: turn dirt in 90 days
- I told Mexicans in 1982 that oil prices were going to $86/barrel -- soon.
- From Brazilian experience, foot and mouth disease would never threaten US

Some Successes:
- Northridge earthquake: a success because I cut the estimate TEN-FOLD.
- Titanic remedies made ocean shipping MORE dangerous
- . Com mania will destroy Silicon Valley
- Volcker-Reagan would stop inflation without long term unemployment
- Kimbell-Shulman: office space investments would be hurt by (temporary) tax advantages
- Stock market returns will be low in the decade 2000-2010
- The royal Saudi fear: 2,500 Ibn Saud grandsons --some are bound to be terrorists.
Lesson 1. Don’t stick your head in the sand

- Some anthrax victims have waited to the last minute to be checked even though they were obviously “… at risk.”
Lesson 2. Don’t exaggerate risks

• During WWII American statisticians estimated German tank production monthly fairly accurately, but the estimates used for planning were 10 times too large.

• The statistician (later my Professor at Yale) passed the estimate to his superior, who being a prudent man, doubled it and passed to to his superior, who...
Therefore, face danger fearfully but realistically

• An in-depth psychological study of the attitudes of surgery patients before and after surgery found:
  – Best results when attitude prior to surgery was fearful but realistic.
  – Next best when patients were hysterical—since fears were neurotic & not based on real threats.
  – Worst results when patients had no fear. Later felt angry at surgeons for “victimizing” them. Couldn’t manage the pain.

• Realism requires empirical evidence.
## Ibbotson Real Wealth Data

**Wealths from 75 years of investing in:**

<table>
<thead>
<tr>
<th>Year</th>
<th>Small Company Stocks</th>
<th>Large Company Stocks</th>
<th>Long-Term Corporate Bonds</th>
<th>Long-Term Government Bonds</th>
<th>U. S. Treasury Bills</th>
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<tbody>
<tr>
<td>1925</td>
<td>1.00</td>
<td>1.00</td>
<td>1.00</td>
<td>1.00</td>
<td>1.00</td>
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<td>1940</td>
<td>1.15</td>
<td>2.31</td>
<td>2.94</td>
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<td>1.55</td>
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<td>12.40</td>
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<td>28.17</td>
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<td>1.45</td>
<td>1.08</td>
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<td>1985</td>
<td>203.10</td>
<td>45.80</td>
<td>2.53</td>
<td>1.68</td>
<td>1.23</td>
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<tr>
<td>2000</td>
<td>658.03</td>
<td>266.55</td>
<td>6.15</td>
<td>4.66</td>
<td>1.71</td>
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</table>
Ibbotson Nominal Wealth from Investing in Large Company Common Stocks 1925-2000
Ibbotson evidence shows good returns on large company investments: Kimbell thinks otherwise

Total Returns to Large (Safe) Company Common Stocks
Ibbotson Data over History:
Kimbell's Forecast--you can't play it safe

For Decade Beginning

<table>
<thead>
<tr>
<th>Year</th>
<th>Annual % Return</th>
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<tbody>
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<td>1930</td>
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<tr>
<td>1940</td>
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</tr>
<tr>
<td>2000</td>
<td>0.0</td>
</tr>
<tr>
<td>2010</td>
<td>10.0</td>
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</tbody>
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Ibbotson evidence show high returns on small company investments

**Total Returns to Small Company Common Stocks**

Ibbotson Data over History: Kimbell's Forecast (including reasonably priced dot-com related firms)

For Decade Beginning

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</thead>
<tbody>
<tr>
<td>Annual % Return</td>
<td>2.0</td>
<td>25.0</td>
<td>12.0</td>
<td>16.0</td>
<td>18.0</td>
<td>14.0</td>
<td>21.0</td>
<td>16.0</td>
<td>12.0</td>
</tr>
</tbody>
</table>
Low tech weapons hid under our radar
This fight is for the media’s attention using weapons of mass disruption
wall.street is no longer a place, now it is a .com

- Almost 1/3 downtown Manhattan office space taken down in a few hours.
- Vacancies rose, but rents will adjust.
A “Where were you” story: My friend, David Shulman, at Lehman Bros. got out on the street when the 1st plane hit...was looking up at this when the 2nd plane crashed.
These were just the opening shots
The locus of conflict: that locust of Baghdad
Meet the next Ambassador to Saudi Arabia
Post-Soviet Union Bedfellows

• In the next phase of the war, 1 million Russian troops will move southwest of the Caspian Sea under U.S. command
In defiance we stand...