

Expectations vs. Forecasts

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I expect there to be one or two recessions per decade. I don't know when they'll come.

I expect that some investments I make won't do well. I don't know which ones.

I expect the stock market to drop 30% or more once or twice a decade. But I don't know when.

I expect interest rates will rise. Maybe this year, maybe not.

I expect another financial crisis. But who knows when it will come.

These are not contradictions or cop outs. There's a big difference between an expectation and a forecast, even if they seem similar.

An expectation is an acknowledgement of how things worked in the past and will likely work in the future. A forecast is strapping that idea to a specific point in time.

In an ideal world we could forecast investment details with pinpoint accuracy. But we usually can't, because there are too many moving parts and unknowns to identify exactly when and how billions of strangers will act.

This often leads to two responses:

Forecast anyway, giving yourself a false sense of precision and confidence.

Extrapolate, assuming no changes from today.

Both can be dangerous. It can be way more useful to have expectations without specific forecasts.

When you expect something to happen over time, you're not surprised when it comes. It forces you to invest with room for error, and psychologically prepares you for inevitable disappointments. This extends beyond investing: Business planning, career planning, raising kids, and relationships fall into that bucket.

The difference between, "I expect one or two recessions per decade," and "I expect a recession in the second half of 2018" is ten miles wide.

The difference is what each does to behavior. If I expect recessions, I'm not surprised when they come. But since I don't know when they'll come, I won't take any action in my portfolio that tries to navigate around the next recession. And those actions tend to be the root of most bad investment decisions for amateurs and professionals alike.

There is no reason to forecast unless you're going to take specific actions tied to that forecast. If you want to take fewer actions without being willfully blind to the future, just have expectations.

It's intellectual humility in an industry that doesn't have enough.