Contact us +44 (0)20 7399 0800 international@rathbones.com

Rathbones
Look forward

Rathbone Income Fund

Update April 2019

The fox knows many things – the hedgehog knows one big thing.

Archilochus of Paros, Greek poet, 7th century BC

The illusion that we understand the past fosters overconfidence in our ability to predict the future.

Daniel Kahneman, "Thinking, fast and slow", 2011

On In 1968, the famed Stanford biologist Paul Ehrlich predicted an inevitable and imminent apocalypse brought on by overpopulation in his seminal failure *The Population Bomb*. Maybe Mr Ehrlich's dramatic overreach was driven by a reaction to the optimism and virility of the Summer of Love just a year earlier. Whatever it was, Mr Ehrlich was convinced that we would all be doomed by the 1970s – 1980s latest. And he was dead wrong. An article in the Atlantic magazine (June 2019, if you'd like to dig it out) by David Epstein investigates how a leading expert in butterfly populations could be so wrong about a question of populations. And how Mr Ehrlich could remain so adamant of his predictions – albeit a bit off on the timing – considering what has transpired in the past 50 years.

The general point that Epstein makes in his article (based on his book, *Range: Why Generalists Triumph in a Specialized World*) is that experts are nearly always wrong in their predictions, despite the erudition of their work. This does by no means undermine or invalidate their scholarship, rather it highlights that their very specialisation narrows their world view, blinding them to other possible influences, futures and outcomes.

In 1980, 12 years after his work first hit the bookstands, Mr Ehrlich famously made a bet with US economist Julian Simon, a rival who argued vehemently against Mr Ehrlich's catastrophic view of the world (c.f. *The Ultimate Resource*, 1981). Mr Simon envisaged a future of boundless possibility, one in which scientific advancement would solve all the problems that overpopulation would create. The two men wagered on commodity prices. Mr Ehrlich that over 10 years, a selection of five commodities would have higher prices due to unavoidable supply and demand imbalance; Mr Simon that the reverse would happen. The world did not implode. Prices actually fell in the subsequent decade. Mr Simon won the bet.

However, evidence suggests that, over any 10-year period, commodity prices tend to rise more often than fall, so was Mr Simon just lucky? Mr Epstein writes that the outcome actually had very little to do with either man's theories; their arguments were just relevant but contradictory parts of a far more expansive and complex set of inputs that determine the price of commodities. He writes: "Yet both men dug in. Each declared his faith in science and the undisputed primacy of facts. And each continued to miss the value of the other's ideas… As each man amassed more information for his own view, each became more dogmatic, and the inadequacies in his model of the world grew ever more stark."

The character of this dispute reverberates through all aspects of everyday life, and is amplified in a world where social networks offer the opportunity for everyone to state an opinion and have it corroborated without question through the positive feedback loops that these networks depend on to thrive. It affects politics, culture and financial markets; any instance where ideas have a value, which is everywhere.

Expertise does not afford the ability to predict the future; rather it creates the environment whereby too much confidence is placed upon these same predictions. Maybe we have not had enough of experts, we should just recognise the overwhelming odds against anybody ever being right in the minutiae.

Daniel Kahneman, in *Thinking, Fast and Slow* writes of the "illusion of valid prediction", the cognitive bias indulged by experts to justify trusting that their knowledge of the patterns and behaviours of the past implies greater insight into the future. Yet this indulgence ignores the obvious truth that the world is an unpredictable environment, and that just because an opinion is stated with the confidence born of erudition does not mean that it will be right. Importantly, the illusion is stoked by confirmation bias, the willingness to place great emphasis on information that backs up a view, or crucially, supports a prediction.

Of course, doom-monger Mr Ehrlich's premonition of environmental collapse resonates with greater significance today, half a century on. Should he be disregarded as a crank now that we have hindsight? No, we do not think so. The point is: the world is an extraordinarily complex system and our work methodologies need to accept this.

So what about foxes and hedgehogs? Philip Tetlock is professor of organisational behaviour at the Haas School of Business, UC Berkeley. In the 1980s, he watched how political observers prognosticated upon the Cold War relationship between the US and the USSR and consistently failed to come close to envisaging the break-up of the Soviet Union. This observation encouraged him to build up a database over many years, tens of thousands of predictions from hundreds of analysts in the fields of politics and geopolitics. Guess what? Analysts relied upon their narrow fields of expertise, while behavioural traits encouraged them to accept corroborating evidence and dismiss contradictory data. The results were very poor indeed.

He labelled this large majority of these forecasters 'hedgehogs'; individuals with one great theory that overrides all else, a weight of argument that affords no contradiction or dispute. These were people who become so specialised in one field that they were too easily blind-sided by events beyond that area.

On the other hand, there was a smaller subset of individuals who were far more successful in their analysis: the foxes. They were willing to gather information with a far bigger net, hungry for whatever information might be of relevance. And not only did they look further afield, they were far more willing to recognise when the information they were receiving contradicted their view. They had a far better facility to re-calibrate. (John Maynard Keynes once said: "When the facts change, I change my mind. What do you do, sir?" Classic fox.)

This argument can progress to a fascinating conclusion, especially in a modern world accorded such astonishing connectivity. While technology can magnify false confidence, through the positive feedback loops on social media, for example, it also has a massive positive effect. The internet connects human beings like never before and there is absolutely no need for anyone to operate in an intellectual silo. Although this does not endow us with the ability to predict the future with any certainty, it does exponentially improve our chances of solving problems in the present, thereby influencing future outcomes. The global ubiquity of the internet, and the speed by which data can be communicated and processed, facilitates the most rapid exchange of ideas in human history. Exchange is the key word here. If every exchange is a lesson rather than a polarised affirmative or negative, then the capacity for growth is huge.

On a much smaller scale, our approach to investment management benefits from the same dynamic. We work as a team with a very flat structure. Our arguments around the merits of a stock have the trinity of risk as a core framework, so we are using the same language of business, financial and price risk. But thereafter, the philosophy is most definitely one of challenge and debate. There is a clear constructive dynamic that evolves from this encouragement to disagree and explore. One of us may be able to construct a portfolio in their own vision, but, over time, biases are bound to build up. On the other hand, a willingness to open up your work to criticism and debate is very powerful, if a little painful at times.

Recent trading has reflected a rebalancing of risk in the portfolio, tilting further towards value. For example, we have reduced **Legal & General**, but added to **Aviva**, trimmed **Greene King** and **Berkeley Group**, but increased **Restaurant Group** and **Bellway**. Importantly, we have more aggressively reduced **AstraZeneca** on valuation grounds, and have also cut our position in **BAE Systems**. Finally, we have raised **Anheuser-Busch Inbev** up to a more meaningful weighting in the Fund.

Companies seen this month: Aviva, **Lockheed Martin** and **Whirlpool.**

Carl Stick
Fund Manager

Alan Dobbie
Fund Manager

This is a financial promotion relating to the Rathbone Income Fund. Any views and opinions are those of the investment manager, and coverage of any assets held must be taken in the context of the constitution of the fund and in no way reflects an investment recommendation. The information contained in this note is for use by investment advisers and journalists and must not be circulated to private clients or to the general public. Price performance based upon bid to bid prior to 21st January 2019 and single price (mid) thereafter.

Rathbone Unit Trust Management Limited
8 Finsbury Circus, London EC2M 7AZ

International information line
+44 (0)20 7399 0800
international@rathbones.com
rathbonefunds.com