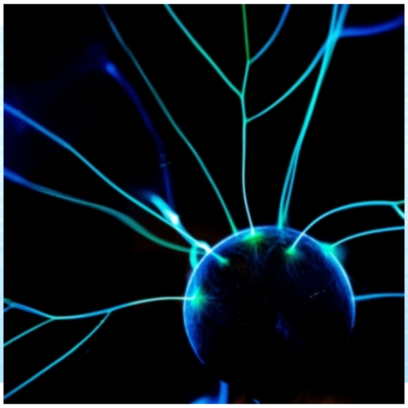

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The Uncertainty Principle

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Scientists are hopeful that someday Quantum Physics may stitch together a "Theory of Everything", which would essentially be one giant mathematical formula that includes the fundamental theories of physics. This would explain everything from the biggest forces, like gravity, all the way down to subatomic level forces and everything in between, like electromagnetism. Even if we possessed that incredible formula, I fear we would be no better at predicting what the markets will do next, or any time in the future.

The early work started with Quantum mechanics, pioneered by Neils Bohr and Werner Heisenberg, all the way back in the 1920's. They brought forth a new way to look at the world, that still does not sit well with many (including Einstein at first), called the "Uncertainty Principle". They postulated that there is no such thing as absolute reality, and there are no strict undeniable laws. It is impossible to know every aspect of a situation because they are too numerous and varying, and therefore chance and uncertainty will always play a role. Because there is no strict rule, the future cannot be predicted, and one can only guess with statistics. The thought is that there is no undeniable reality, only observations. So, if we cannot predict where an electron will be in a field, then I doubt we can accurately predict the economy or markets.

As participants in the market, strategists try to guess at the future given observations like earnings, economic statistics, and geopolitical events. They tend to arrive at a narrative that incorporates all the known inputs available, but still cannot predict what is going to happen six months from now with any accuracy because nobody knows all the factors, how they will relate to each other, how those relationships will change, and most importantly, what these factors mean for the market. Let's look at the world post-Covid outbreak:

- In March of 2020 the expectation was for the pandemic to shutter a large portion of the economy and the market to crater – *wrong, fastest "V" recovery and less than half the expected death rate*.
- Going in to 2021 everyone expected a long-term healing process for the economy with a dip back to recession – *wrong, the economy was red hot as economies re-opened*.

- Going in to 2022 everyone expected recession, and nobody was worried about inflation – *wrong, no recession and inflation surged as Russia invaded Ukraine*.
- Going into 2023 everyone again was expecting recession, unless they were instead worried about inflation – *wrong, as the economy surged, inflation fell, and markets rallied*.
- After Silicon Vally Bank collapsed everyone expected the Fed to cut rates to stabilize markets – *wrong, the Fed still raised rates and markets were fine*.
- Going in to 2024 everyone was convinced that inflation was tamed and a soft landing ahead for the economy, and market priced SIX rate cuts coming from the Fed – *wrong, inflation has been stubborn and we are looking at maybe 1 or 2 cuts (if any). The jury is still out on the economy, but things are weakening.*

When I say "everybody" in the examples above, you can basically include most major Wall Street Bank strategists, Fed governors, and talking heads on TV. The markets will move very quickly to spoil predictions almost all the time, and this leads to price discovery and long-term market efficiency, but also short-term volatility at times. Please remember that the person talking on the TV might sound intelligent and confident, but they don't *know* anything, nobody does, they just have a loud opinion.

When our investment team looks for shorter-term defensive tactical positioning, we never guess at the future trying to predict what will happen. Instead, we rely on market-based indicators that help us to measure and react to what is happening. We are never early, and in fact we will usually be a little bit late. We do not attempt to identify tops or bottoms. We just try to avoid trouble. Market signals, especially shifts in volatility, are signs that new information is being processed and could warrant a shift in portfolios. By ignoring grand market narratives and, instead, focusing on signals within the market, our tactical tools allow us to position portfolios for long-term success, while still having protection against short-term uncertainty.

(For the record, I did not use any form of AI to write this article and instead was inspired by the Albert Einstein biography by Walter Isaacson.)