JOIM
www.joim.com

JOURNAL OF INVESTMENT MANAGEMENT, Vol. 14, No. 1, (2016), p. 100

CASE STUDIES

"Case Studies" presents a case pertinent to contemporary issues and events in investment management. Insightful and provocative questions are posed at the end of each case to challenge the reader. Each case is an invitation to the critical thinking and pragmatic problem solving that are so fundamental to the practice of investment management.

Jack L. Treynor

"Case" Weatherman's Bias

Because the weather is constantly changing, we have to prepare for it. But failing to prepare for bad weather is more expensive than failing to prepare for good weather. Weathermen cause more pain with the former than the latter; we are more forgiving when they predict bad weather that doesn't happen than when they predict good weather that doesn't happen. Weathermen who value their job learn to bias their forecasts.

The task of central bankers is steering between too much restraint and too much ease. The ideal change is one for which the next change is equally likely to be more ease or more restraint. But central bankers have a problem: restraint is more painful for their constituents than more ease. Central bankers learn that we are more forgiving when they predict restraint that doesn't happen than when they predict ease that doesn't happen.

Questions

What is the proper role for forecasts of a change?

Does a forecast of a change have less impact than an actual change?

Are money markets unstable?

Can forecasts be used to cope with the instability?

Is the instability worse than it used to be?

Are they a useful tool to a Fed trying to cope with an oversensitive money market?

Would forecasts be less necessary if the money markets weren't so unstable?

If we explained the problem to weathermen, would they empathize?