

The Crystal Ball Challenge

Let's suppose that an investment genie floated out of a bottle and offered to show you the headlines of the Wall Street Journal a day in advance, giving you a huge edge over the rest of the investing public. You could use this advance information to buy and sell stocks and bonds, knowing what the Federal Reserve Board was about to do with interest rates, which companies were about to publish earnings disappointments or surprises, what new macroeconomic data was about to be disseminated to the public—and so on.

You'd soon be rich, right?

A team of researchers actually conducted this experiment, not with a genie, but with actual Wall Street Journal headlines over various time periods, giving finance students a 36-hour advance look at past headlines, allowing them to make trades based on their advance knowledge, and then revealing the subsequent market moves in stocks and bonds. That also revealed whether the trades were profitable or not. Each player started with a hypothetical \$1 million and were given 15 days of front pages.

The result might surprise you. Roughly half of the 118 finance students who participated in The Crystal Ball Challenge lost money, and one in six lost everything. The average gain was 3.2% over the 15-day experiment.

This was actually better than the general public's results. The researchers opened the game up to any and all who wanted to play (you can join in the fun here: <https://elmwealth.com/crystal-ball-challenge/>), and the median outcome for individual investors was a loss of 30% of their capital. Only 40% made a (hypothetical) profit, and 36% lost everything.

Any lay investor who thinks he or she can beat professional traders in the market should look at what happened when the head of trading at a large bank, a macro hedge fund trader, some senior government bond traders and a former senior trader at a private brokerage firm decided to accept the challenge. All of them finished with gains, with a median gain of 60%. One might compare day trading by a retail investor to swimming in a school of hungry sharks.

What does this prove? That even with advance knowledge, it's hard to know what the markets will do, and even if you guess right most of the time (the students were

a little more than 50% accurate in their predictions), you can still lose money. The professionals, who read the tea leaves for a living, made better use of their unfair advantage because, according to the researchers, they knew which trades to pass over due to uncertainty, and which ones to bet big on.

The bigger lesson: don't try this at home, even if the genie offers you a chance to peek into a crystal ball.

Source:

<https://www.advisorperspectives.com/articles/2024/10/07/crystal-ball-isnt-enough-make-you-rich>