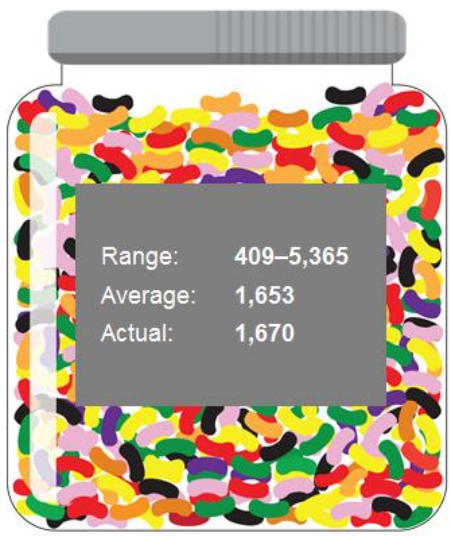
Passive Capital Management

The Wisdom of Crowds

Wisdom of Crowds: Why the Many Are Smarter Than the Few and How Collective Wisdom Shapes Business, Economies, Societies and Nations, is a book written by James Surowiecki, an American journalist, about the aggregation of decisions reached by individuals within a group that result in better decisions than could have been made by any single individual. The book presents numerous case studies to illustrate its argument that a diverse collection of independently deciding individuals is likely to make certain types of decisions and predictions better than individuals or even experts.

As an example, imagine you were in a room with 100 other people and you were all asked to guess how many jelly beans were in a jar.



You might guess 1,000 beans were in the jar. The other 99 people would likely guess different numbers but if an average was taken of all the guesses, that average would be very, very close to the actual number. Together, we know more than we do alone.

The wisdom of crowds is an amazing thing whether we are talking about jelly beans, politics or investing. No one person is smarter than the collected wisdom of many. Political polls may indicate one trend but all the voters in America determine the outcome. Market indicators may predict a trend but it is the many investors worldwide buying and selling who determine the outcome of stock prices each day.

Last week's presidential election is a good example of why we believe so strongly in our passive investment strategy. The polls, while indicating a tight race, all predicted Secretary of State Clinton would emerge the winner. The pollsters got it wrong. The day after the election, stock futures were down hundreds of points indicating a huge sell-off in the stock market. Instead, the Dow Jones Industrial Average closed up 257 points. The indicators got it wrong.

The core of our investment philosophy states that no one person can consistently and correctly predict how capital markets will act in the short-term. It is the actions of millions of investors buying and selling that determine what course markets will take, up or down, every day. So rather than trying to outsmart the market (i.e. outsmart the wisdom of the crowd), PCM's strategy is to own the market and capture the returns that each segment provides.

We can't predict or control what the crowd will do, but we can increase our odds of a successful outcome by controlling the aspects of investing that can be controlled; diversification, asset allocation, costs and discipline.

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