

EPIC ADVISORS, LLC

Weekly Market Commentary

January 21, 2009

Sean Hannon, CFA, CFP

Technology is a wonderful thing. As the cost of technology declines and its capabilities increase, we unlock a potential never imagined. Because of this dynamic, I have started a business, managed investments, and communicated ideas in a manner that was not possible as recently as ten years ago. Back then, anyone looking to comment on the market was on their own—there were no blogs or online news sites to carry their stories. Any effort to market your investment results was costly and limited. Today, the barriers to entering the investment field are minimal. If you want to become an investment advisor, you can register with your state, pass the needed exams, begin building a track record, and market yourself to clients without ever leaving your home. Thanks to technology, all these steps are a mouse click away.

One of the first books about investing I ever read was Peter Lynch's *One Up on Wall Street*. While there are many interesting lessons in the book, the fact that sticks with me years later is that during Lynch's investing career, information was difficult to obtain. If you wanted an annual report, you had to call the company and ask for one to be sent to you. Now we can go to the company's website and print the information in seconds. If you wanted to see financial ratios, you trekked to the library reference desk. Now we go to Yahoo! Finance and get the answers immediately. If you wanted to track down a rumor, you had to get on the phone with broker after broker. Now we head to online message boards for a quick analysis.

Although I'm thankful for these advances, as they are key to running my business, technology has a downside. As more information has become available, investors have begun to expect certainty in the markets. There is so much information at our fingertips that some investors believe that by harnessing massive computing power and readily available data, they can answer any question that arises and develop a precise answer that leaves no room for doubt.

A perfect example lies at the heart of our current economic crisis. Quantitative analysts felt the massive amounts of data at their fingertips would allow them to create securities that offered predictable behavior in an uncertain world. By combining high math with reams of data, Wall Street firms created mortgage-backed securities they believed would never default. With so much data mined and so many scenarios explored, most investors thought losses would be contained and we had entered a new period of increased prosperity.

Looking back, those investors were wrong. As the practice spread and demand for complex derivatives increased, marginal loans were originated. Although many scenarios were explored, no one asked what would occur if housing prices fell. Investors had fooled themselves into thinking that

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increased amounts of information would lead to precise answers. Instead, all the extra data created an environment in which the proper questions were not asked, leading to a false sense of security. The results have been disastrous.

The credit meltdown is an extreme example, but these lessons clearly apply to individual investors. Even though we can now acquire information in seconds that once took weeks to obtain, investing remains a strange mix of both art and science. The science part now takes less time. However, we must apply the hard facts in a disciplined, consistent manner. Technology might calculate a P/E ratio quicker than I do by hand, but it cannot tell me if the ratio is appropriate for the risks being taken. In today's volatile market where prices swing indiscriminately, applying judgment and reason will deliver far greater gains than any purely quantitative process.