23rd Annual Hyman P. Minsky Conference on the State of the US and World Economies

Stabilizing Financial Systems for Growth and Full Employment

The National Press Club

Washington, D.C.

Frank Veneroso

April 9-10, 2014

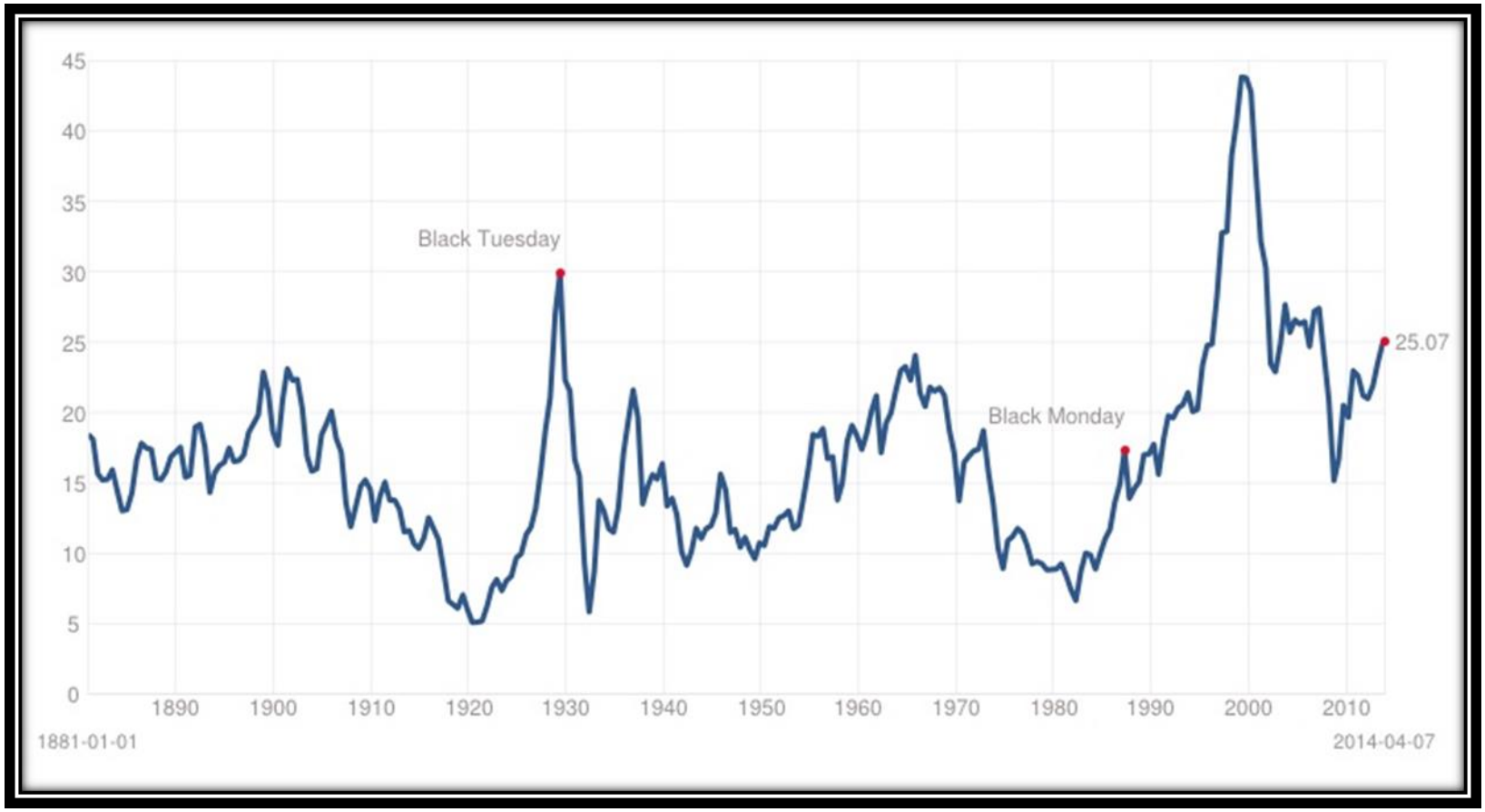
Organized by the Levy Economics Institute with support from the Ford Foundation

Bubble Valuations?
Do We Have A Stock Market Bubble Again?

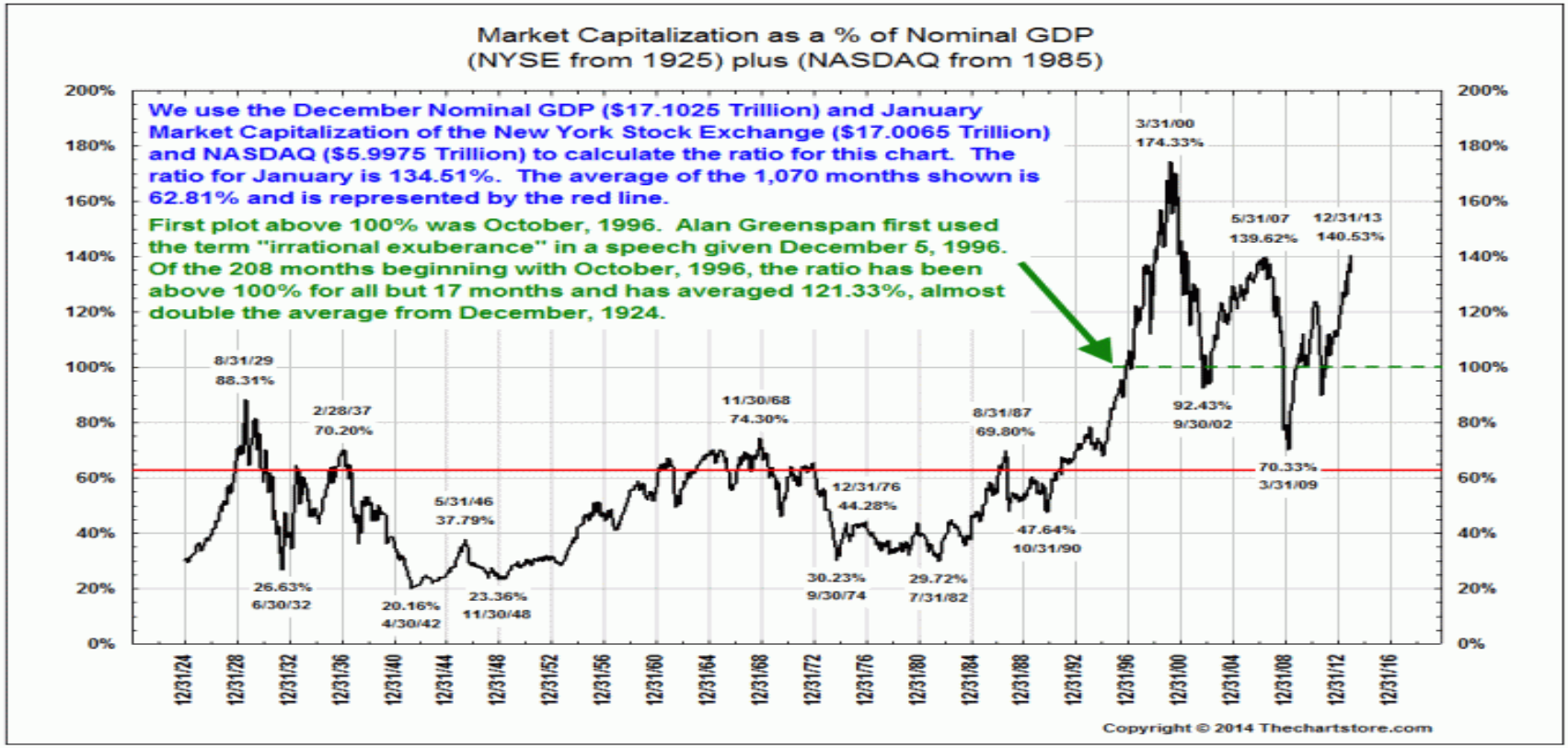
Tobin's Q

Above 2007 Peak

Shiller PE Ratio Based On Current Reported GAAP Earnings



Market Cap To GDP



Above 2007 Peak

Bubble Signature:
The Parabolic Price Path

Bull Markets Are Appalachians
Bubbles Are Matterhorns

Japanese Stock Market Bubble

Acceleration

Gold Bubble

Acceleration

1929 Stock Market Bubble

ACCELERATION

NASDAQ

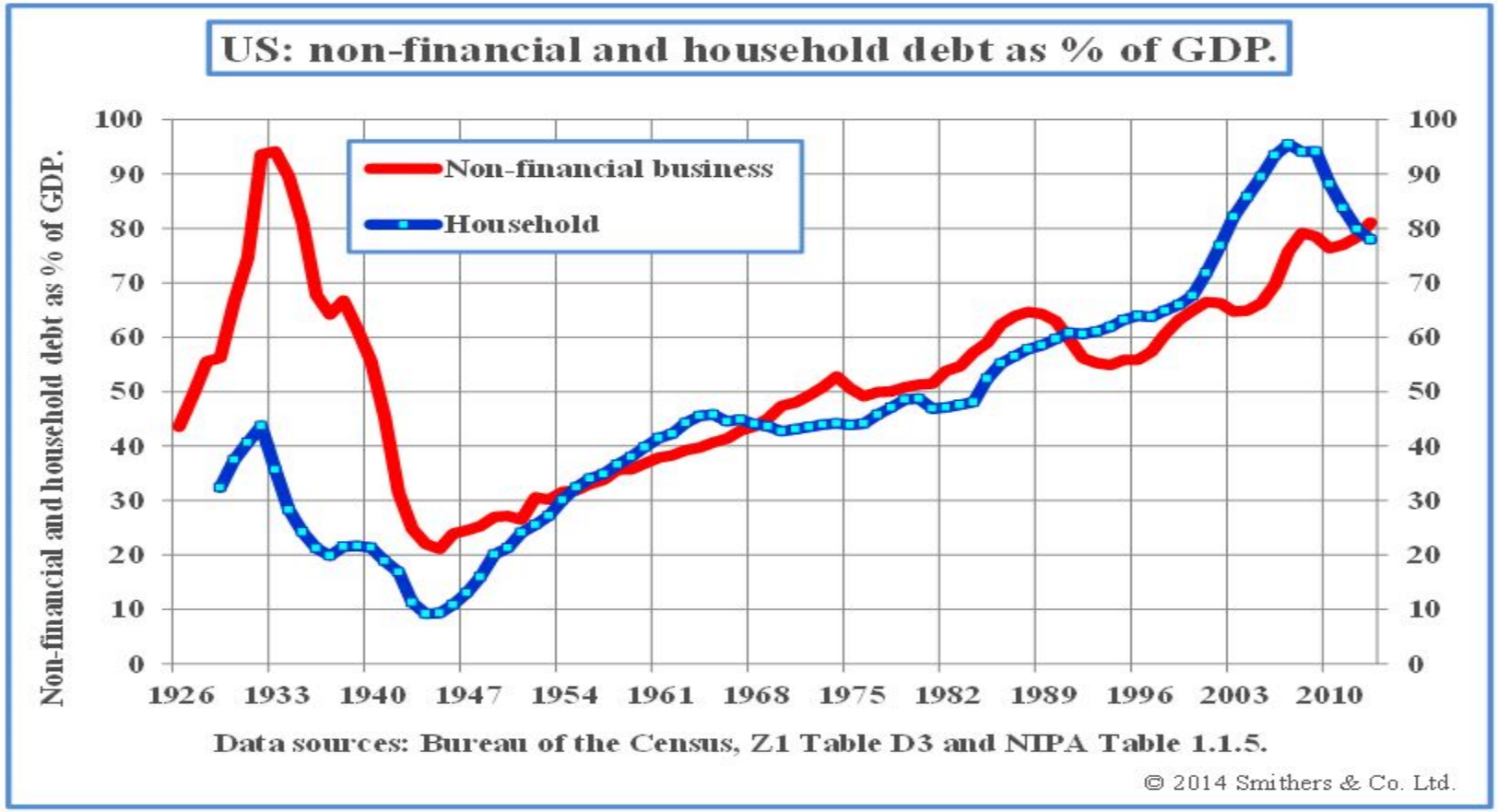
ACCELERATION ONCE AGAIN

Nasdaq Biotech Index

ACCELERATION BIG TIME

Do We Have A Credit Bubble Again?

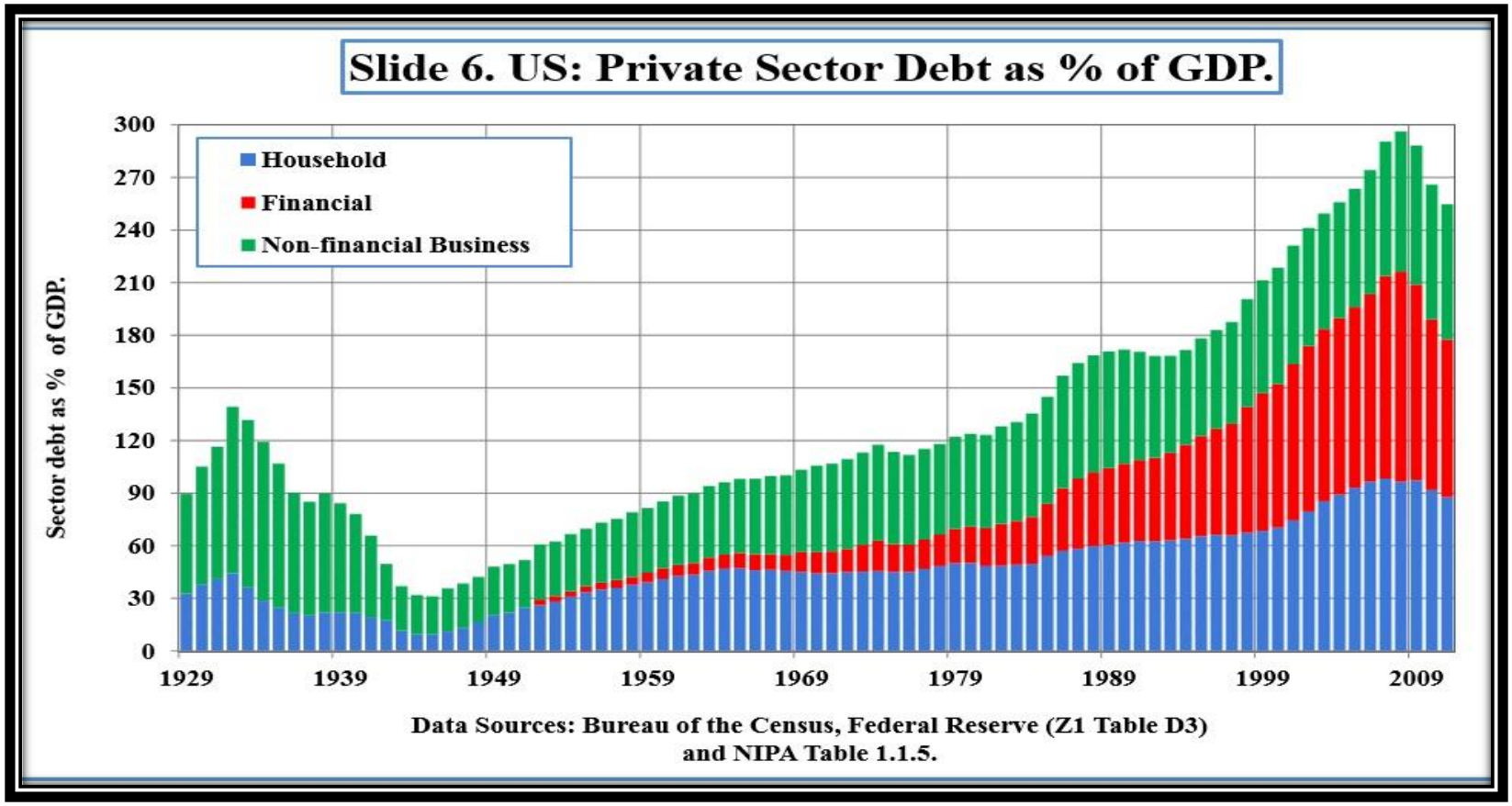
High Household Debt, No Bubble Dynamics



Andrew Smithers, Smithers & Co. Ltd.

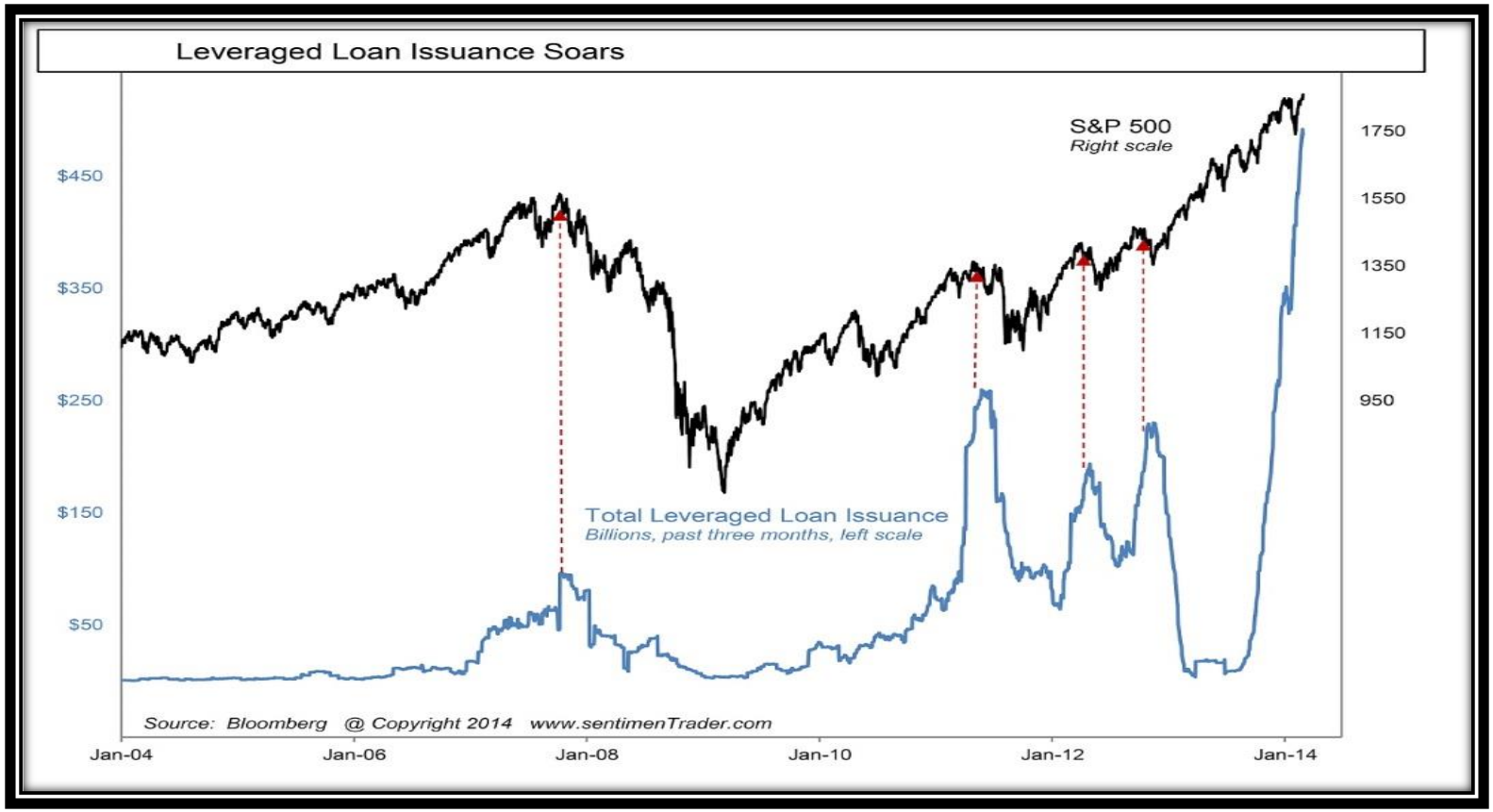
High Corporate Debt, Maybe Nascent Bubble Dynamics

Financial Sector Debt, Some Of Which Is Corporate (SIVs, Leases, etc.)



So Corporate Debt May Be Very, Very High

Low Quality Corporate Debt Is Exploding. Leveraged Loans



A New Corporate Credit Bubble

Are Current Record U.S. Profits For Real?

Overrating Earnings: The Most Inflated Measure

S&P: “Inflated” Operating Earnings vs. “GAAP” Reported Earnings

QUARTER END	OPERATING EARNINGS PER SHR	AS REPORTED EARNINGS PER SHR
12/31/1993	$7.16	$5.08
09/30/1993	$6.92	$5.81
06/30/1993	$6.57	$4.89
03/31/1993	$6.25	$6.11
12/31/1992	$5.61	$3.60
09/30/1992	$5.12	$4.73
06/30/1992	$5.21	$5.40
03/31/1992	$4.93	$5.36
12/31/1991	$4.63	$2.55
09/30/1991	$5.11	$3.74
06/30/1991	$4.79	$4.54
03/31/1991	$4.77	$5.14
12/31/1990	$5.01	$4.40
09/30/1990	$5.97	$5.33
06/30/1990	$6.06	$6.07
03/31/1990	$5.61	$5.54
12/31/1989	$5.84	$4.80
09/30/1989	$5.54	$4.85
06/30/1989	$6.53	$6.48
03/31/1989	$6.41	$6.74
12/31/1988	$6.37	$5.62
09/30/1988	$6.22	$6.38
06/30/1988	$6.05	$6.22
03/31/1988	$5.48	$5.53

QUARTER END	OPERATING EARNINGS PER SHR	AS REPORTED EARNINGS PER SHR
12/31/1999	$13.77	$12.77
09/30/1999	$12.97	$11.93
06/30/1999	$13.21	$12.51
03/31/1999	$11.73	$10.96
12/31/1998	$11.47	$8.56
09/30/1998	$10.45	$8.99
06/30/1998	$11.43	$9.87
03/31/1998	$10.92	$10.29
12/31/1997	$11.29	$8.94
09/30/1997	$11.03	$9.87
06/30/1997	$11.13	$10.44
03/31/1997	$10.56	$10.47
12/31/1996	$11.01	$9.86
09/30/1996	$9.92	$9.78
06/30/1996	$10.31	$10.13
03/31/1996	$9.39	$8.96
12/31/1995	$9.78	$7.13
09/30/1995	$9.78	$8.69
06/30/1995	$9.50	$9.26
03/31/1995	$8.64	$8.88
12/31/1994	$8.80	$8.35
09/30/1994	$8.03	$7.94
06/30/1994	$7.75	$7.38
03/31/1994	$7.17	$6.93

Twenty-five Years Ago The Discrepancy Was Often Minimal

Operating Earnings: The Most Inflated Measure

S&P: “Inflated” Operating Earnings vs. “GAAP” Reported Earnings

QUARTER END	OPERATING EARNINGS PER SHR	AS REPORTED EARNINGS PER SHR
12/31/2005	$20.19	$17.30
09/30/2005	$18.84	$17.39
06/30/2005	$19.42	$18.29
03/31/2005	$18.00	$16.85
12/31/2004	$17.95	$13.94
09/30/2004	$16.88	$14.18
06/30/2004	$16.98	$15.25
03/31/2004	$15.87	$15.18
12/31/2003	$14.88	$13.16
09/30/2003	$14.41	$12.56
06/30/2003	$12.92	$11.10
03/31/2003	$12.48	$11.92
12/31/2002	$11.94	$3.00
09/30/2002	$11.61	$8.53
06/30/2002	$11.64	$6.87
03/31/2002	$10.85	$9.19
12/31/2001	$9.94	$5.45
09/30/2001	$9.16	$5.23
06/30/2001	$9.02	$4.83
03/31/2001	$10.73	$9.18
12/31/2000	$13.11	$9.07
09/30/2000	$14.17	$13.71
06/30/2000	$14.88	$13.48
03/31/2000	$13.97	$13.74

QUARTER END	OPERATING EARNINGS PER SHR	AS REPORTED EARNINGS PER SHR
12/30/2011	$23.73	$20.64
09/30/2011	$25.29	$22.63
06/30/2011	$24.86	$22.24
03/31/2011	$22.56	$21.44
12/31/2010	$21.93	$20.67
09/30/2010	$21.56	$19.52
06/30/2010	$20.90	$19.68
03/31/2010	$19.38	$17.48
12/31/2009	$17.16	$15.18
09/30/2009	$15.78	$14.76
06/30/2009	$13.81	$13.51
03/30/2009	$10.11	$7.52
12/31/2008	-$0.09	-$23.25
09/30/2008	$15.96	$9.73
06/30/2008	$17.02	$12.86
03/31/2008	$16.62	$15.54
12/31/2007	$15.22	$7.82
09/30/2007	$20.87	$15.15
06/30/2007	$24.06	$21.88
03/31/2007	$22.39	$21.33
12/31/2006	$21.99	$20.24
09/30/2006	$23.03	$21.47
06/30/2006	$21.95	$20.11
03/31/2006	$20.75	$19.69

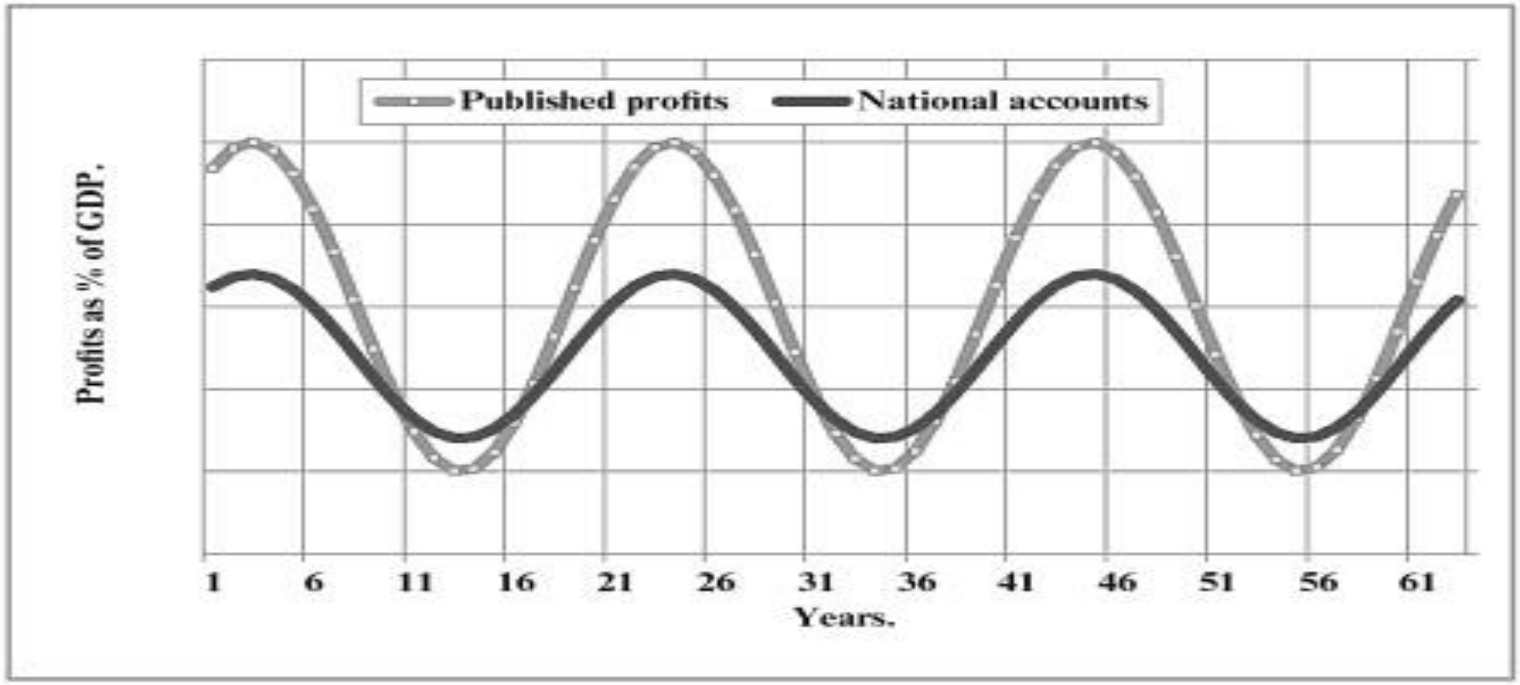
Fifteen Years Ago The Discrepancy Was Not So Great

Operating Earnings: The Most Inflated Measure

	OPERATING	AS REPORTED
QUARTER	EARNINGS	EARNINGS
END	PER SHR	PER SHR
12/31/2013		
9/30/2013	$26.92	$24.63
6/28/2013	$26.36	$24.87
3/28/2013	$25.77	$24.22
12/31/2012	$23.15	$20.65
9/28/2012	$24.00	$21.21
6/29/2012	$25.43	$21.62
3/30/2012	$24.24	$23.03

Recently Operating Earnings Considerably Exceed Reported Earnings, Are Then Written Down Drastically In Recessions. Check 2008.

Reported GAAP Earnings: The Next Most But Still Inflated Measure



ANDREW SMITHERS: THE STYLIZED PROFIT CYCLE

COMPANIES PUBLISH INFLATED GAAP PROFITS IN BOOMS, AND FESS UP WITH WRITE DOWNS IN BUSTS.

The Volatility Of Reported GAAP Earnings

- *You think you know where profits are. I don't think you really do.*
- *Consider the following changes in various measures of profits in the last deep recession.*
  - *S&P core earnings fell peak to trough by 92%.*
  - *MSCI defined earnings fell by 55%.*
  - *I/B/E/S pro-forma earnings fell by 36%.*
  - *NIPA profits fell by about 25%.*
- *My point is very simple. These various measures of profits are all supposed to be measures of more or less the same thing. Yet their changes in little more than a year are totally disparate. How can you know which measure is the right measure? I don't think you can.*

The Fantasy Of Corporate Earnings Forecasts

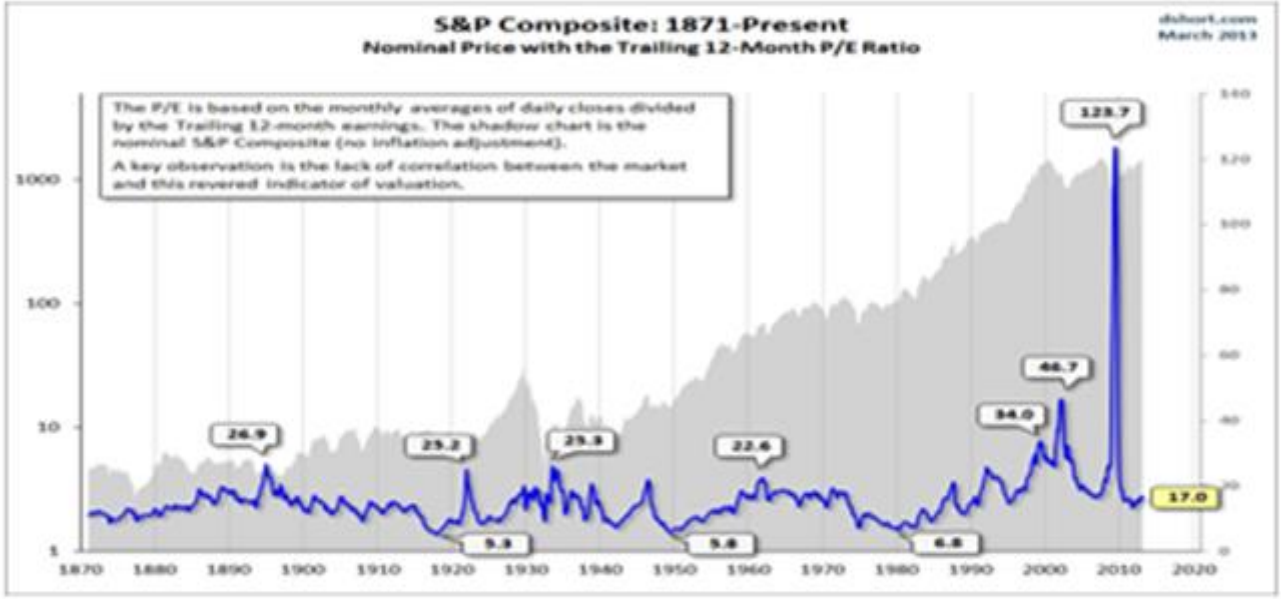
		12 Month Earnings Per Share		
QUARTER		OPERATING	REPORTED	OPERATING
END		EARNINGS	EARNINGS	EARNINGS
		(ests are	(ests are	(ests are
		bottom up)	top down)	top down)
ESTIMATES				
12/31/2014		$121.45	$119.70	$123.63
09/30/2014		$117.44	$114.60	$119.63
06/30/2014		$113.49	$108.93	$114.40
03/31/2014		$109.90	$104.60	$111.62
12/31/2013 (4%)		$107.19	$99.42	$107.74

The Profit To GDP Ratio Is At A Record High.

Yet Every Year Earnings Growth Is Forecast At 2x or 3x Nominal GDP Growth.

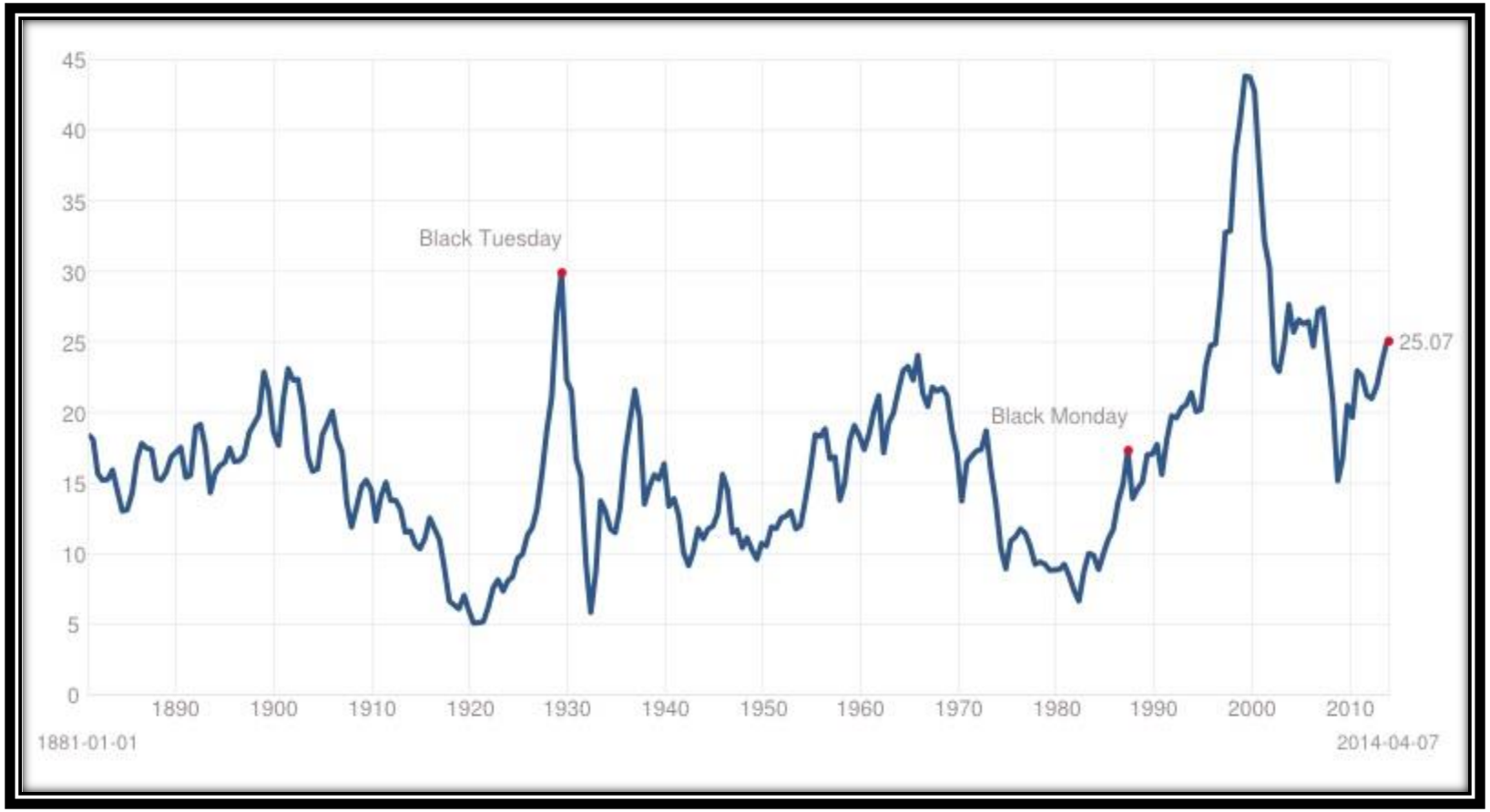
The Volatility Of Current P/E Ratios

Earnings Inflation Is Written Off In Recessions. So Current PE Ratios Are Hyper Volatile



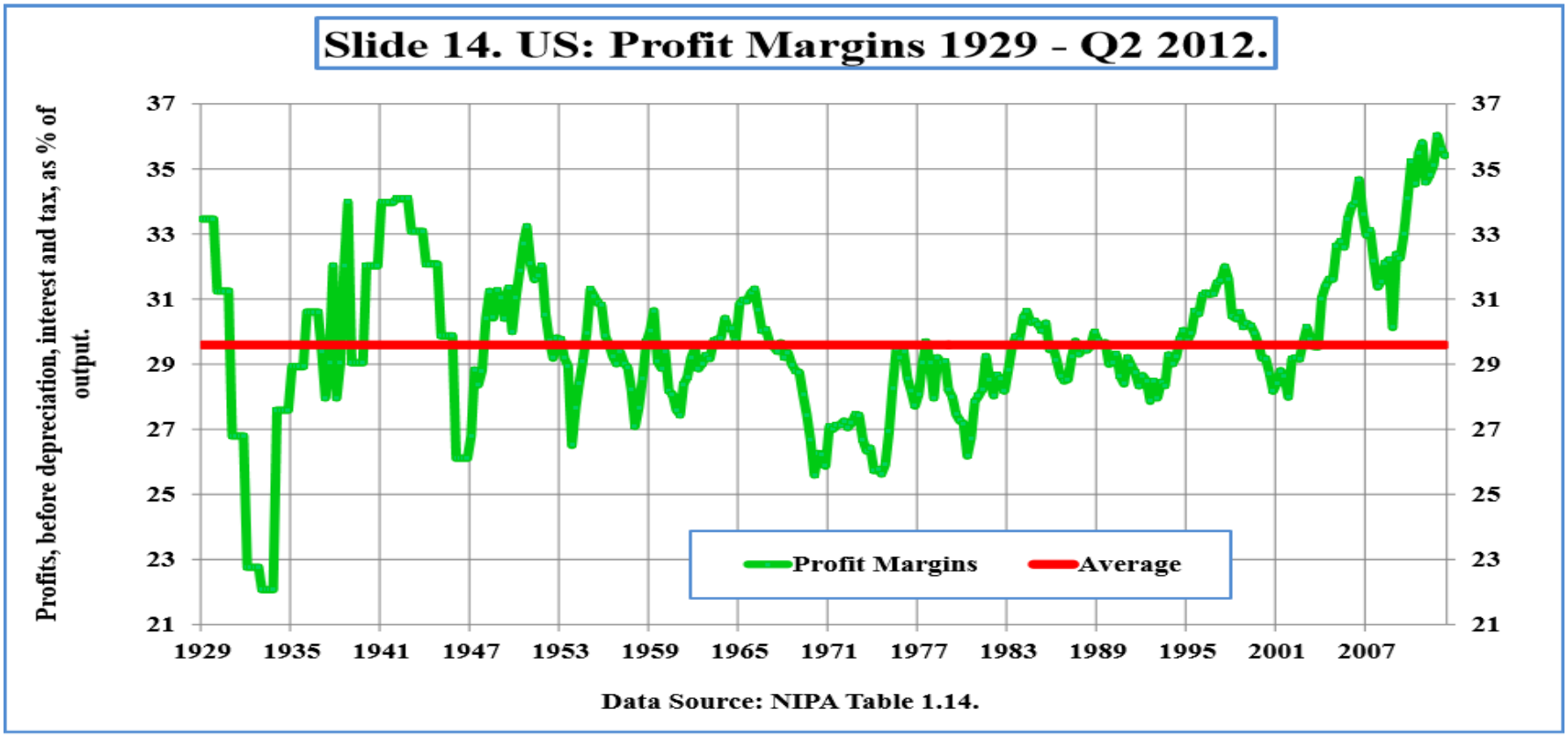
Which Means Current PE Ratios Are Next To Worthless

The Shiller P/E



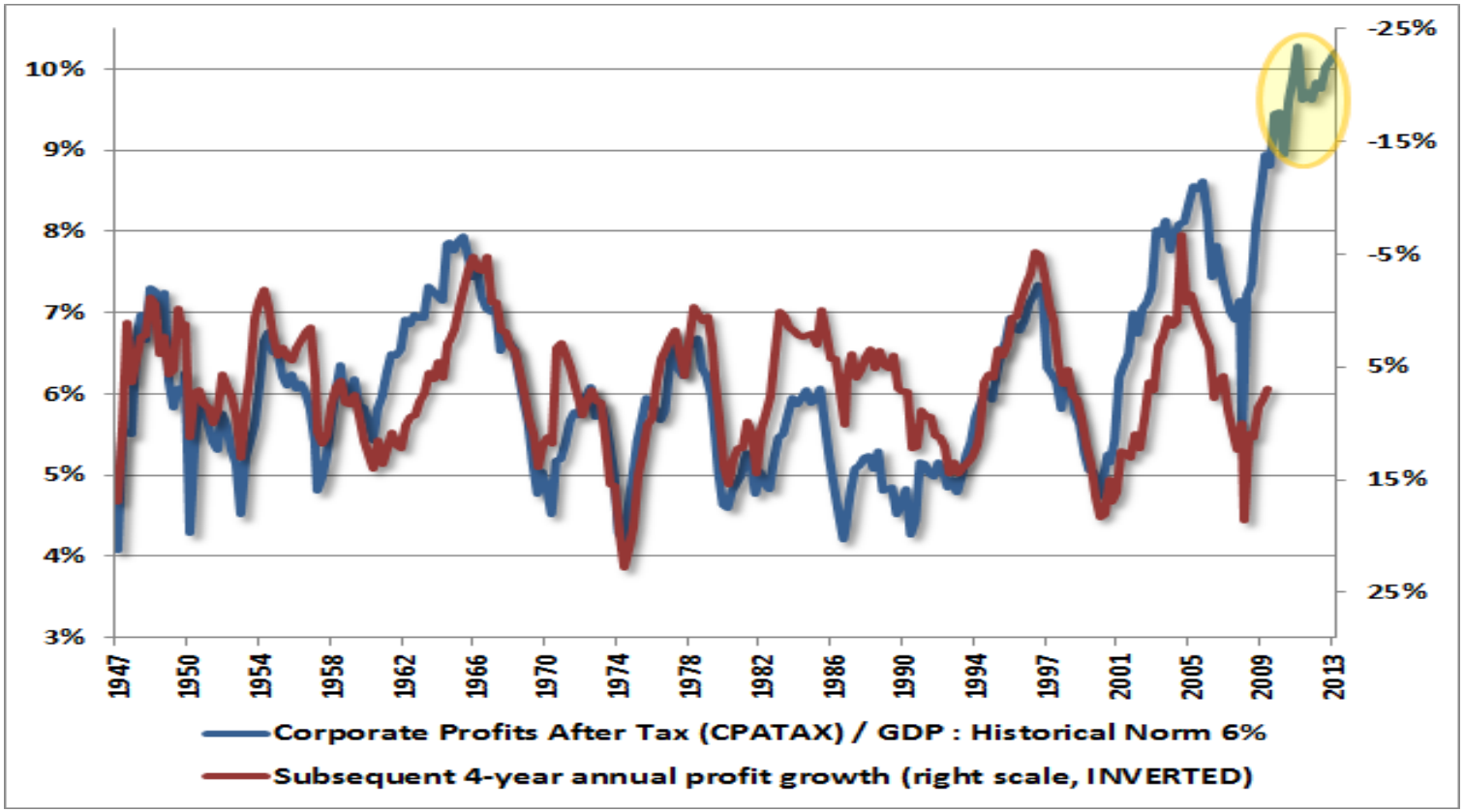
Shiller Smooths The GAAP P/E for Business Cycle And Accounting Cycle Volatility

Are NIPA Profits Correct?
Record Gross Corporate Profit Margins



Amidst A Weak Global Economy?

Are NIPA Profits Correct?
Net Corporate Profit Margins



John Hussman, www.hussmanfunds.com

Amidst A Weak Global Economy?

Why NIPA Profits May Be Overstated; The Sectoral Financial Balances Argument

The financial balances of government, corporations, households and the rest of the world must sum to zero. Therefore when the government's fiscal deficit contracts, profits tend to contract.

The Government Fiscal Deficit Has Fallen From 10% Of GDP To 3% Of GDP

Summary Table 1.

CBO's Baseline Budget Projections

	Actual, 2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	Total 2014-2018	Total 2014-2023
							In Billions of Dollars							
Revenues	2,449	2,708	3,003	3,373	3,591	3,765	3,937	4,101	4,279	4,496	4,734	4,961	17,669	40,241
Outlays	3,538	3,553	3,618	3,803	4,067	4,300	4,542	4,811	5,078	5,350	5,691	5,939	20,330	47,199
Deficit (-) or Surplus	**-1,089**	**-845**	**-616**	**-430**	**-476**	**-535**	**-605**	**-710**	**-798**	**-854**	**-957**	**-978**	**-2,661**	**-6,958**
On-budget	-1,151	-872	-630	-433	-476	-533	-598	-693	-763	-799	-878	-872	-2,670	-6,675
Off-budget[a]	62	27	14	3	*	-2	-6	-17	-35	-55	-79	-106	9	-283
Debt Held by the Public at the End of the Year	11,280	12,229	12,937	13,462	14,025	14,642	15,316	16,092	16,957	17,876	18,902	19,944	n.a.	n.a.
							As a Percentage of Gross Domestic Product							
Revenues	15.8	16.9	18.0	19.1	19.1	18.9	18.8	18.7	18.7	18.9	19.0	19.1	18.8	18.9
Outlays	22.8	22.2	21.7	21.6	21.6	21.5	21.7	22.0	22.2	22.4	22.9	22.9	21.6	22.1
Deficit	**-7.0**	**-5.3**	**-3.7**	**-2.4**	**-2.5**	**-2.7**	**-2.9**	**-3.2**	**-3.5**	**-3.6**	**-3.8**	**-3.8**	**-2.8**	**-3.3**
Debt Held by the Public at the End of the Year	72.5	76.3	77.7	76.3	74.6	73.4	73.1	73.5	74.2	75.0	76.0	77.0	n.a.	n.a.

Source: Congressional Budget Office.

Note: * = between -$500 million and zero; n.a. = not applicable.

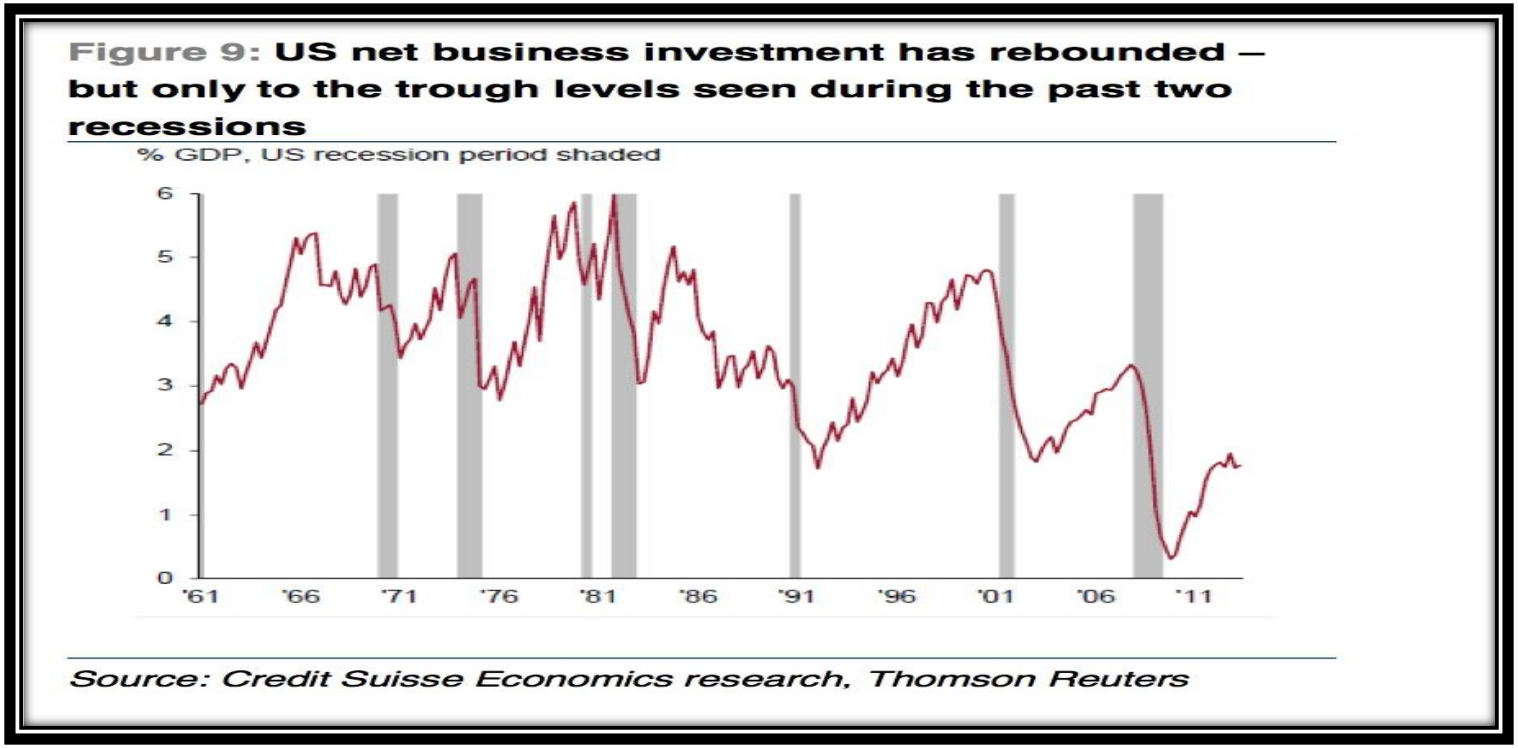
a. Off-budget surpluses or deficits comprise surpluses or deficits in the Social Security trust funds and the net cash flow of the Postal Service.

WHEN THE GOVERNMENT DEFICIT FALLS BY 7% OF GDP, THE SURPLUSES OF THE THREE OTHER SECTORS MUST FALL BY AS MUCH. BOTH COMPANY REPORTED AND NIPA PROFIT MARGINS SHOULD HAVE FALLEN. THEY HAVE NOT.

Why NIPA Profits May Be Overstated

When Investment Is Low, Profits Tend To Be Low

Business Fixed Investment To GDP



Not This Time

Why NIPA Profits May Be Overstated

There Are Two Measures Of The Savings Rate: NIPA and Flow Of Funds. They Once Were The Same. FOF Is Now Much Higher

	2009	2010	2011	2012	2012	2012	2012	2012	2013	2013	2013	2013
					Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
NIPA (FOF) DATA	7.9	10.8	12.0	8.6	6.6	12.0	6.0	9.9	13.6	6.8	0.9	7.8
NIPA (NIPA) DATA	6.1	5.6	5.7	5.6	5.4	5.5	4.9	6.6	4.1	4.7	5.0	4.5
DIFFERENCE	1.8	5.2	6.3	3.0	1.1	6.6	1.1	3.3	9.5	2.1	-4.1	3.4

Substitute FOF Savings Into The Income Accounts Implies NIPA Profit Rate Is 2% -3% Of GDP Lower.

Why NIPA Profits May Be Overstated; The Sources And Uses Argument

Uses: Net Corporate Issuance Of Equity

Data Source: BEA.gov and FederalReserve.gov

	2005	2006	2007	2008	2009	2010	2011	2012	2013
Net New Equity Issues	-341.8	-565.7	-786.8	-336.0	-62.1	-277.4	-472.2	-399.5	-383.7

Uses: Business Investment (1.5% of GDP) And Net Equity Purchases (2.4% of GDP)

Why NIPA Profits May Be Overstated; The Sources And Uses Argument

Sources: NIPA Retained Earnings (5% Of GDP) And Corporate Borrowings (7% Of GDP)

Household Net Worth and Growth of Domestic Nonfinancial Debt

Year		Household net worth[1]	Growth of domestic nonfinancial debt[2]				
			Total	Households	Business	State and local govts.	Federal
2003		49,426	8.0	11.8	2.2	8.3	10.9
2004		56,515	9.3	11.1	2.2	11.4	9.0
2005		62,538	9.3	11.2	9.0	5.8	7.0
2006		67,331	8.7	10.0	10.9	3.9	3.9
2007		67,753	8.6	6.8	13.6	5.5	4.9
2008		57,180	6.0	0.1	6.3	0.6	24.2
2009		58,920	3.1	-1.7	2.2	4.0	22.7
2010		63,354	4.1	-2.6	1.5	2.3	20.2
2011		64,763	3.7	-1.4	6.0	-1.7	11.4
2012		70,863	4.9	0.2	7.2	-0.2	10.9
2013		80,664	4.3	0.9	7.2	-1.3	6.5
2012:	Q1	67,220	4.7	-1.1	4.4	0.4	13.5
	Q2	67,266	5.3	1.4	5.0	2.9	11.0
	Q3	69,525	3.0	-1.5	5.0	-0.2	7.1
	Q4	70,863	6.2	2.1	9.2	-3.8	10.4
2013:	Q1	74,088	4.4	-0.6	4.9	2.4	10.1
	Q2	75,434	3.5	0.8	7.7	1.1	2.5
	Q3	77,710	3.8	3.0	8.4	-3.9	1.5
	Q4	80,664	5.4	0.4	7.1	-4.9	11.6

1. Shown on table B.100, which includes nonprofit organizations. Billions of dollars; amounts outstanding end of period, not seasonally adjusted
2. Percentage changes shown on an end-of-period basis; quarterly data are seasonally adjusted annual rates

Uses: Business Investment (1.5% of GDP) And Net Equity Purchases (2.4% of GDP)

Sources And Uses Imply NIPA Profits Are Overstated.

Kenneth Arrow
Bye-Bye, EMH, REH

General Equilibrium

The balancing of supply and demand under these conditions may be referred to as equilibrium in accordance with the usual use of that term in science and mathematics. The adjective, "general", refers to the argument that we cannot legitimately speak of equilibrium with respect to any one commodity; since supply and demand on any one market depends on the prices of other commodities, the overall equilibrium of the economy cannot be decomposed into separate equilibria for individual commodities.

General Economic Equilibrium: Purpose, Analytic Techniques, Collective Choice,
Nobel Memorial Lecture, Kenneth J. Arrow, December 12, 1972

General Equilibrium, Intertemporal Optimization And The Definition Of Uncertainty

We take from the theory of probability the concept of a state of the world, which is a description of the world so precise that it completely defines all initial holdings of goods and all technological possibilities. Uncertainty is not knowing which state will in fact hold.

General Economic Equilibrium: Purpose, Analytic Techniques, Collective Choice,
Nobel Memorial Lecture, Kenneth J. Arrow, December 12, 1972

The Impossibly High Bar To Intertemporal Optimization

The full competitive model of general equilibrium includes markets for all future goods and, to take care of uncertainty, for all future contingencies. Not all of these markets exist.

Rationality Of Self And Others In An economic System,
Kenneth J. Arrow

The Impossibly High Bar To Intertemporal Optimization

Such a system could not exist. First, the number of prices would be so great that search would become an insuperable obstacle; that is, the value of knowing prices of less consequence, those on events remote in time or of low probability, would be less than the cost so that these markets could not come into being.

Rationality Of Self And Others In An economic System,
Kenneth J. Arrow

The Impossibly High Bar To Intertemporal Optimization

When a market does not exist, there is a gap in the information relevant to an individual's decision, and it must be filled by some kind of conjecture.

Rationality Of Self And Others In An economic System,
Kenneth J. Arrow

The Impossibly High Bar To Intertemporal Optimization

Each agent has to have a model of the entire economy to preserve rationality. The cost of knowledge, so emphasized by the defenders of the price system as against centralized planning, has disappeared; each agent is engaged in very extensive information gathering and data processing.

Rationality Of Self And Others In An economic System,
Kenneth J. Arrow

The Impossibly High Bar To Intertemporal Optimization

The main implication of this extensive examination of the use of the rationality concept in economic analysis is the extremely severe strain on information-gathering and computing abilities. Behavior of this kind is incompatible with the limits of the human being, even augmented with artificial aids

Rationality Of Self And Others In An economic System,
Kenneth J. Arrow

The Great Keynes Goes Kenneth Arrow One Better

"Thus the fact that our knowledge of the future is fluctuating, vague ad uncertain, renders wealth a peculiarly unsuitable subject for the methods of classical economic theory . . . . By 'uncertain knowledge' . . . I do not mean merely to distinguish what is known for certain from what is only probably . . . . The sense in which I am using the term is that in which the prospect of a European war is uncertain, or the price of copper and the rate of interest twenty years hence, or the obsolescence of a new invention, or the position of private wealth holders in the social system in 1970. About these matters there is no scientific basis on which to form any calculable probability whatever."

Pg. 616-617
Robert Skidelsky, "*John Maynard Keynes, The Economist as Savior 1920-1937* "
Penguin Books, 1992

You Cannot Imagine Some Relevant Future States Of The World.

Keynes: The Real World Of Inefficient Markets

Keynes: Anti EMH, Anti REH

Over a little less than 20 years Keynes was an aggressive leveraged speculator in all markets, including stocks, and he was amazingly successful. Keynes' account of risk asset market behavior is today's overwhelming market reality. For Keynes, today's academically dominant body of efficient market theory and modern portfolio theory has NOTHING to do with reality.

Keynes: The Flimsy Basis Of Market-Priced Asset Valuations In Financial Markets

During the war, the English were in dire need of Spanish pesetas for purchasing war-related imports from Spain. With great difficulty, Keynes managed to obtain a small sum of pesetas and duly reported this to a relieved Secretary of the Treasury who "remarked that at any rate for a short time we had a supply of pesetas. 'On no!' said Keynes. 'What!' said his horrified chief. 'I've sold them again: I'm going to break the market'. And he [Keynes] did".

Roy Harrod, 1951, p. 203

So, Fama And Malkiel, You Think The Market Is So Efficient One Can't Beat it? Speak For Yourselves Skidelsky On Keynes The Speculator

"In 1919 he created what was in effect a hedge fund with his friend the stockbroker Oswald 'Foxy' Falk, to take advantage of the floating currencies which followed the war."

"The European currencies rallied against sterling, and, though the rally was short, it lasted long enough to wipe out Keynes' highly leveraged fund. He had lost the whole of his group's capital."

"In the 1920s, Keynes had been speculating with mixed success in the commodity markets. By the end of 1927 his net assets totaled £44,000 (or about £2.1 million today; $3.4 million; € 2.5 million). But in 1928 he was long on rubber, wheat, cotton and tin when their prices started to fall. His losses on commodities forced him to sell American securities to cover his position, so he was not invested on Wall Street when the crash came in 1929. The stock market collapses left him with a security portfolio dominated by 10,000 shares in the Austin Motor Company, whose value fell from £1.10 per share in January 1928 to 25p by the end of 1929. By that date, his net worth had slumped from £44,000 to £7,815 (in today's value from £2.1 million to £380,000; $3.4 million to $620,000, €2.5 million to €445,000) – a fall of more than 80% -- and it fell even more in 1930. He was so strapped for cash that he tried to sell his best pictures, but withdrew because bids were so pitiful.

"He acted on his principles, despite frequent attacks of 'nerves'. In 1932 he started buying preferred shares of the big American public utility holding companies, which his analysis showed to be depressed far below their intrinsic worth. He also took advantage of depressed prices to buy pictures, manuscripts and rare books."

"By 1936 he was worth over L500,000 or L27 million in today's value ($44 million, E32 million). His net worth had appreciated 23 times, when the U.S. stock market tripled and the London market did very little."

"Once, in 1936, he even had to take delivery of a month's supply of wheat from Argentina on a falling market. He planned to store it in the crypt of King's College Chapel, but found this was too small. Eventually, he worked out a scheme to object to its quality knowing that cleaning would take a month. Fortunately, by then the price had recovered and cornered the market."

Robert Skidelsky, *"Keynes The Return of the Master"*

Public Affairs, 2009

Keynes: Extreme Uncertainty Blinds Us To The Future

The outstanding fact is the extreme precariousness of the basis of knowledge on which our estimates of prospective yield have to be made. Our knowledge of the factors which will govern the yield of an investment some years hence is usually very slight and often negligible. If we speak frankly, we have to admit that our basis of knowledge for estimating the yield ten years hence of a railway, a copper mine, a textile factory, the goodwill of a patent medicine, an Atlantic liner, a building in the City of London amounts to little and sometimes to nothing; or even five years hence.

The State Of Long Term Expectation
The General Theory of Employment, Interest and Money,
John Maynard Keynes

So We Extrapolate The Present And The Past

It would be foolish, in forming our expectations, to attach great weight to matters which are very uncertain. It is reasonable, therefore, to be guided to a considerable degree by the facts about which we feel somewhat confident, even though they may be less decisively relevant to the issue than other facts about which our knowledge is vague and scanty. For this reason the facts of the existing situation enter, in a sense disproportionately, into the formation of our long-term expectations; our usual practice being to take the existing situation and to project it into the future, modified only to the extent that we have more or less definite reasons for expecting a change.

John Maynard Keynes, “Chapter 12: The State Of Long Term Expectation”
The General Theory of Employment, Interest and Money

And All The More So In Liquid Stock Markets

As a result of the gradual increase in the proportion of the equity in the community's aggregate capital investment which is owned by persons who do not manage and have no special knowledge of the circumstances, either actual or prospective, of the business in question, the element of real knowledge in the valuation of investments by whose who own them or contemplate purchasing them has seriously declined.

The State Of Long Term Expectation
The General Theory of Employment, Interest and Money,
John Maynard Keynes

Adaptive Expectations: The Convention

In practice we have tacitly agreed, as a rule, to fall back on what is, in truth a convention. The essence of this convention – though it does not, of course, work out quite so simply – lies in assuming that the existing state of affairs will continue indefinitely except in so far as we have specific reasons to expect change.

The State Of Long Term Expectation
The General Theory of Employment, Interest and Money,
John Maynard Keynes

The Convention Is A Social Construct

For if there exist organized investment markets and if we can rely on the maintenance of the convention, an investor can legitimately encourage himself with the idea that the only risk he runs is that of a genuine change in the news over the near future, as to the likelihood of which he can attempt to form his own judgment, and which is unlikely to be very large. For, assuming that the convention holds good, it is only these changes which can affect the value of his investment, and he need not lose his sleep merely because he has not any notion what his investment will be worth ten years hence. Thus investment becomes reasonably 'safe' for the individual investor over short periods, and hence over a succession of short periods however many, if he can fairly rely on there being no breakdown in the convention and on his therefore having an opportunity to revise his judgment and change his investment, before there has been time for much to happen.

The State Of Long Term Expectation
The General Theory of Employment, Interest and Money,
John Maynard Keynes

The Investor Need Not Lose Sleep Because He Knows The Mind of Mr. Market. For Keynes, Herding Is The Very Warp And Woof Of Financial Markets

Not Only Are Expectations Adaptive, They Are Very Weakly Anchored.

A conventional valuation which is established as the outcome of the mass psychology of a large number of ignorant individuals is liable to change violently as the result of a sudden fluctuation of opinion due to factors which do not really make much difference to the prospective yield; since there will be no strong roots of conviction to hold it steady. In abnormal times in particular, when the hypothesis of an indefinite continuance of the existing state of affairs is less plausible than usual even though there are no express grounds to anticipate a definite change, the market will be subject to waves of optimistic and pessimistic sentiment, which are unreasoning and yet in a sense legitimate where no solid basis exists for a reasonable calculation ….

Keynes: Professional Investors Game Those Loosely Anchored Expectations

It might have been supposed that competition between expert professionals, possessing judgment and knowledge beyond that of the average private investor, would correct the vagaries of the ignorant individual left to himself. It happens, however, that the energies and skill of the professional investor and speculator are mainly occupied otherwise. For most of these persons are, in fact, largely concerned, not with making superior long-term forecasts of the probable yield of an investment over its whole life, but with foreseeing changes in the conventional basis of valuation a short time ahead of the general public. They are concerned, not with what an investment is really worth to a man who buys it 'for keeps', but with what the market will value it at, under the influence of mass psychology, three months or a year hence.

At This Point The Behavior Of Market Participants Detaches From "The Fundamental" Defined As The Prospective Future Stream Of Cash Flows

And The Professional Investor Knows It Is All About Gaming The Other Guy

This battle of wits to anticipate the basis of conventional valuation a few months hence, rather than the prospective yield of an investment over a long term of years, does not even require gulls amongst the public to feed the maws of the professional; -- it can be played by professionals amongst themselves. Nor is it necessary that anyone should keep his simple faith in the conventional basis of valuation having any genuine long-term validity. For it is, so to speak, a game of Snap, of Old Maid, of Musical Chairs – a pastime in which he is victor who says Snap neither too soon nor too late, who passed the Old Maid to his neighbor before the game is over, who secures a chair for himself when the music stops. These games can be played with zest and enjoyment, though all the players know that it is the Old Maid which is circulating, or that when the music stops some of the players will find themselves unseated….

The actual, private object of the most skilled investment today is 'to beat the gun', as the Americans so well express it, to outwit the crowd, and to pass the bad, or depreciating, half-crown to the other fellow. …

John Maynard Keynes, "Chapter 12: The State Of Long Term Expectation",
The General Theory of Employment, Interest and Money

In Fact, To Remain A “Rational” Investor Is Far Too Dangerous

Investment based on genuine long-term expectation is so difficult today as to be scarcely practicable. He who attempts it must surely lead much more laborious days and run greater risks than he who tries to guess better than the crowd how the crowd will behave; and, given equal intelligence, he may make more disastrous mistakes. There is no clear evidence from experience that the investment policy which is socially advantageous coincides with that which is most profitable. It needs *more* intelligence to defeat the forces of time and our ignorance of the future than to beat the gun.

John Maynard Keynes, “Chapter 12: The State Of Long Term Expectation”
The General Theory of Employment, Interest and Money

In Fact, To Remain A “Rational” Investor Is Far Too Dangerous

Finally it is the long-term investor, he who most promotes the public interest, who will in practice come in for most criticism, wherever investment funds are managed by committees or boards or banks. For it is in the essence of his behaviour that he should be eccentric, unconventional and rash in the eyes of average opinion. If he is successful, that will only confirm the general belief in his rashness; and if in the short run he is unsuccessful, which is very likely, he will not receive much mercy. Worldly wisdom teaches that it is better for reputation to fail conventionally than to succeed unconventionally.

John Maynard Keynes, “Chapter 12: The State Of Long Term Expectation”
The General Theory of Employment, Interest and Money

In Reality, Our Animal Spirits Eclipse Our Rationality

Moreover, life is not long enough; – human nature desires quick results, there is a peculiar zest in making money quickly, and remoter gains are discounted by the average man at a very high rate. The game of professional investment is intolerably boring and over exacting to anyone who is entirely exempt from the gambling instinct; whilst he who has it must pay to this propensity the appropriate toll. Furthermore, an investor who proposes to ignore near-term market fluctuations needs greater resources for safety and must not operate on so large a scale, if at all, with borrowed money – a further reason for the higher return from the pastime to a given stock of intelligence and resources.

John Maynard Keynes, "Chapter 12: The State Of Long Term Expectation"
The General Theory of Employment, Interest and Money