Traders, Investors and Economists

Traders are different than investors. Traders use capital to finance short-term trading strategies. Investors use capital to finance long-term ownership stakes in good businesses.

Most traders don’t care if the market goes up or down. They can make money either way. And while many investors can roll with the market's punches, most investors hope to buy low, sell high, collect dividends, and own good companies that go up.

Both traders and investors think, and talk, about the economy, and react to it, but successful traders and investors often know little about economics.

Traders follow technical indicators – Fibonacci numbers, 200-day moving averages, or trading volume – and become adept at understanding market psychology. Investors think about cash flow, return on investment, p-e ratios, Graham and Dodd, management, and profit margins.

Economists think about money, entrepreneurship, trade, productivity growth, capacity, potential GDP, tax rates, Keynes, Smith, and Friedman. The interesting thing is that none of this happens in isolation.

Traders are watching the market fall apart. Some are selling short and making a profit, but others are seeing their entire leveraged trading strategy blow up in their face. At the same time, long-term investors are watching hard-won profits evaporate. As a result, it’s easy to translate all of this into a view on the economy.

But, just because traders and investors believe a recession might be right around the corner does not mean economists think so, too.

In fact, the “average” economist surveyed by USA Today in late January expects real GDP to grow 1.8% in 2008, while early February surveys by Bloomberg and the Wall Street Journal (taken after the weak January jobs number), show growth of roughly 1.6% this year. In the Bloomberg survey, just 12 out of 62 economists forecast two consecutive quarters of contracting real GDP in 2008.

Despite this, TradeSports.com, which allows bettors to take a position on current issues of the day, places the odds of two consecutive negative quarters of real GDP at 66%.

These odds are well above those of the average economist. This could be because of the prevalence of the pessimistic market view by traders and investors. Traders and investors outnumber economists in reality and on business TV and in the press.

There are many economist jokes – one says, economists were put on earth to make weathermen look good. However, there is no evidence that traders and investors make better economic forecasts than economists themselves.

Market-based prognosticators are watching stock prices fall and leverage in credit markets come unwound. These are serious issues, but neither has led to a recession at any time in history unless the Federal Reserve was following a tight monetary policy or tax rates were being raised.

Because the Fed has never been tight in this business cycle, and after recent rate cuts real interest rates are below zero, there is no risk to the economy from tight monetary policy. At the same time, tax rates remain low and productivity is still strong.

At this point, traders and investors have become much more pessimistic than economists as a whole. But if economists are right (including those here at First Trust), opportunity abounds. The market is cheap.