TFA Monthly Newsletter

March 2020

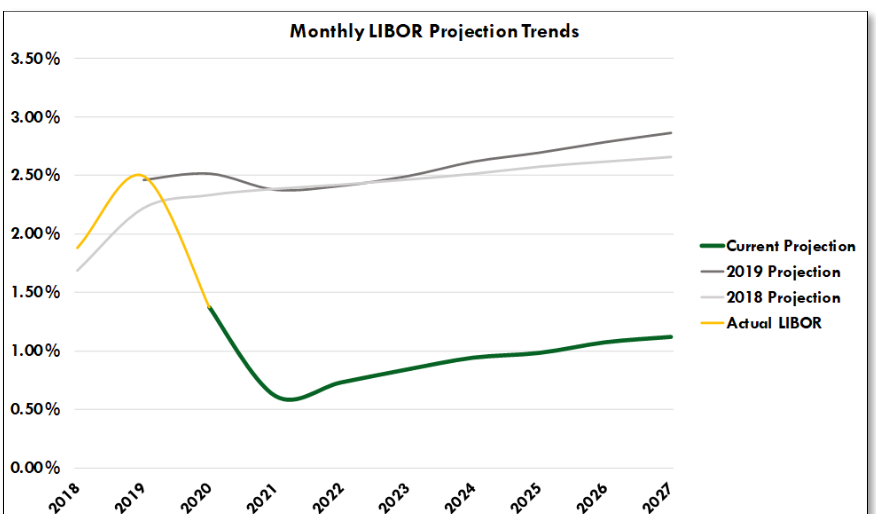
Taking Projections with a Grain of Salt

By David Howard

Businesses and governments often use detailed forecast models to make important decisions. These projections are formulated based on myriad assumptions. Even though assumptions are based on universally accepted benchmarks from trusted sources, reality often tends to deviate from forecasted expectations.

LIBOR

One of the best examples is predicting interest rate forecasts. LIBOR, the London Inter-Bank Offered Rate, is often used globally by banks and other financial institutions as a benchmark or base rate for interest payments on underlying debt. Below is a graph which shows 30-day LIBOR projections for the past couple of years.



Source: 1-Month LIBOR Projections prepared by Derivative Logic. Historical 1-Month LIBOR sourced from St. Louis Federal Reserve.

As you can see, interest rate prognosticators in 2018 thought rates would be significantly higher than today's projections forecast. There are just too many variables that ultimately impact interest rates, especially the further out into the future you are trying to predict. Notice the difference. In early 2018, projections estimated monthly LIBOR in the beginning

(continued on Page 2)

IN THE NEWS

Commercial Casino Ballot Initiative Could Be Coming To Oregon
2/3/20 – WorldCasinoDirectory.com

Oneida Indian Nation Acquires Hotel To Accommodate 'Increased Visitor Demand'
2/6/20 – NativeBusinessMag.com

Largest California Tribal Gaming Association Announces Support For Sports Betting Initiative At The 25th Western Indian Gaming Conference
2/11/20 – Pechanga.net

Virginia House, Senate Approve Casino Bills
2/12/20 – BristolHeraldCourier.com

Navajo Nation Seeks To Power Los Angeles With Clean Energy
2/20/20 – NativeBusinessMag.com

South Dakota Approves $100M Solar Energy Project On Pine Ridge Land
2/21/20 – NativeBusinessMag.com

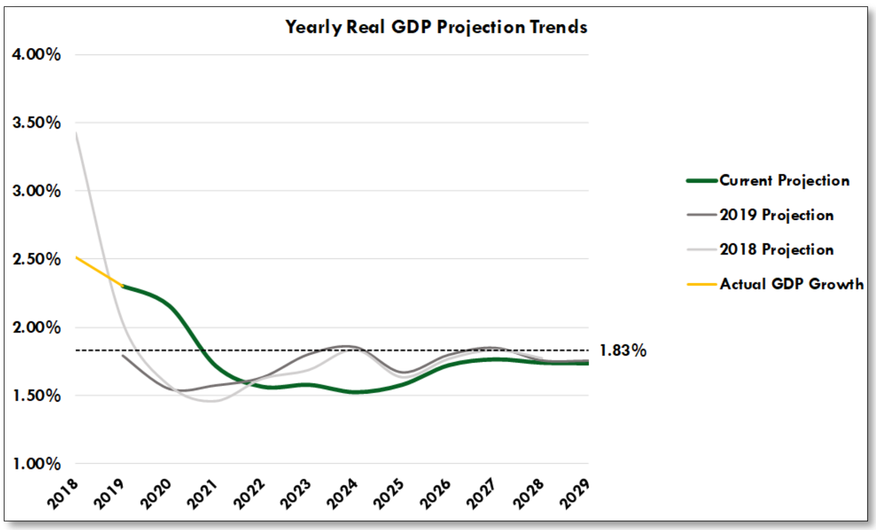
Sportsbetting Legislation Clears Initial Hurdle In Washington
2/25/20 – WorldCasinoDirectory.com

(continued from page 1)

of 2020 would be around 2.33%. However, the actual monthly LIBOR rate realized in early 2020 is approximately 1.61%, even though the outlook was only two years apart. Imagine the difference if the projection gap was larger. As you can see, short-term interest rate forecasts are much closer to the actual realized rates than long-term interest rate forecasts.

GDP

Let's look at GDP, or Gross Domestic Product, a widely used measure for overall growth in the economy. We often look at GDP growth projections for long-term analysis in gaming revenue forecasts. The graph below compares Real GDP projections over time versus actual measurements.



Source: Real GDP Projections sourced from the Congressional Budget Office's 10-Year Economic Projections. Historical Real GDP sourced from St. Louis Federal Reserve.

Similar to LIBOR forecasts, the future predictability of GDP growth has its limitations. However, GDP growth projections performed better than the interest rate projections. In 2018, growth for 2019 was estimated around 2.05%, whereas actual GDP growth for 2019 came in at 2.33%. Considering a gap of 2 years, the difference is off by about 28 basis points versus 72 basis points for LIBOR. Overall, the margin of error in GDP predictability is much lower than LIBOR forecasts, especially as GDP approaches the current long-term average growth projection of about 1.83%.

Although forecasts are predicted on a variety of sound economic inputs, the level of confidence begins to shrink and the probability of error grows larger the further out projections are estimated. Don't take this the wrong way – we are big believers in forecast models as a valuable analysis tool. We always recommend assumptions should be studied and vetted in consideration with a number of other economic variables when forecasting and updated often as new information comes in.

It's kind of like a 50-foot putt versus a 6-foot putt on the golf course. You aren't expecting to make the 50-foot putt, but the goal is to get close.

TFA
201 Continental Boulevard
Suite 110
El Segundo, CA 90245
tfacp.com

KRISTI JACKSON
CHAIRMAN
310.341.2335
kjackson@tfacp.com

DAVID HOWARD
CEO
310.341.2795
dhoward@tfacp.com

WILLIAM NEWBY
PRESIDENT
310.341.2796
wnewby@tfacp.com

WILLIAM CRADER, CFA
MANAGING DIRECTOR
310.341.2336
wcrader@tfacp.com

TFA CAPITAL PARTNERS

FOLLOW TFA ON: