

Gyrostat doctrine: Can markets really be understood and predicted?

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Much of modern portfolio construction rests on an assumption that is rarely examined: that markets can be understood, forecast, and navigated through increasingly sophisticated analysis.

Data has expanded, models have become more complex, and narratives more refined. Yet the central problem remains unchanged.

Investors do not observe the market as it is. They observe only its surface expression—prices, volatility, and the cost of protection. The underlying reality that drives future outcomes remains fundamentally unknowable.

This is not a limitation of skill. It is a limitation of knowledge itself. This raises a more fundamental question: what can actually be known in markets?

The limits of knowledge

The philosopher David Hume demonstrated that causation cannot be proven through experience. We observe sequences of events, but never the causal force itself.

Markets reflect this uncertainty. Relationships that appear stable—between rates and equities, diversification and protection, volatility and risk—can break down precisely when they are most relied upon.

Much of investment practice therefore rests on assumed stability rather than demonstrable truth.

If knowledge is derived from experience, and experience itself is limited, then the ability to know future outcomes remains inherently constrained.

The Kantian reframing

Immanuel Kant provides a useful distinction. He separates the world into two domains:

- the **noumenal** — reality as it is
- the **phenomenal** — reality as we observe it

The former is inaccessible. The latter is structured through observation.

In investment terms, the future path of markets, the true distribution of risk, and the nature of shocks belong to the unknowable domain.

What we can observe is how that uncertainty is priced—through volatility levels, option markets, and the cost of protection.

This distinction is critical. It shifts the focus from prediction to interpretation. In practice, it defines the boundary between what can be known and what must be managed.

From prediction to pricing of risk

Most investment processes attempt to operate in the unknowable domain. Forecasts, macro narratives, and valuation assumptions implicitly claim insight into future outcomes.

These approaches can appear robust in stable conditions but often fail when underlying assumptions are challenged.

A more durable approach is to operate within the observable domain.

The pricing of risk provides a continuous, market-based signal of how uncertainty is being valued at any point in time.

Periods of calm often coincide with low demand for protection, not low exposure to risk. Conversely, periods of stress reprice risk rapidly, often after the opportunity to act has diminished.

The implication is clear: the objective is not to predict the future, but to act within the limits of what can be observed through how risk is currently priced.

A structured response to uncertainty

Accepting the limits of knowledge does not lead to inaction. It requires structure.

A disciplined investment framework imposes consistency on inherently uncertain conditions. Portfolio construction, protection overlays, and implementation rules become mechanisms for responding to observable pricing rather than expressions of directional views.

This approach does not seek to eliminate uncertainty. It recognises that uncertainty is permanent and instead focuses on managing its consequences.

Implications for portfolio construction

If markets cannot be known with certainty, then portfolios cannot rely on being right.

They must instead be designed to remain robust when assumptions prove unreliable.

This has practical consequences, particularly in the retirement phase.

Drawdowns are not simply temporary deviations. When combined with withdrawals, they alter the path of capital in a way that cannot be recovered through time alone. This is the essence of sequencing risk.

A portfolio built on stable assumptions may appear resilient in calm conditions, but its true behaviour is revealed when those assumptions are challenged. At that point, diversification may fail, correlations may rise, and the cost of protection may reprice rapidly.

The issue is not that these outcomes are unpredictable. It is that they are often not incorporated into portfolio design.

This reframes the role of the investor:

- not to predict when market conditions will change
- but to recognise how portfolios behave when they do

It also shifts how risk is approached:

- from forecasting outcomes
- to managing the impact of drawdowns
- to understanding how sequencing affects capital over time
- to responding to how risk is priced in the present

In retirement portfolios, this is not a question of timing, but of structure.

The consequence of not addressing this is not theoretical. It is experienced directly in client portfolios when periods of stability give way to loss, and the opportunity to adjust has already passed.

Conclusion

The belief that markets can be known, forecast, and controlled is deeply embedded in investment practice. Yet the philosophical foundations suggest otherwise.

We do not see the market as it is. We see only how risk is priced.

This distinction is not academic. It defines the difference between building portfolios that rely on being correct and those designed to remain resilient when certainty proves illusory.

In this context, the role of the investor is not to predict the future, but to act with discipline within the limits of what can be known. This is not a different view of markets. It is a different starting point.

Gyrostat perspective

We do not attempt to predict the market as it is.

We act on how risk is priced—consistently and without reliance on prediction.

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