Wall Street Market Forecast Failures (Our Outlook, Too)

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Caves & Associates

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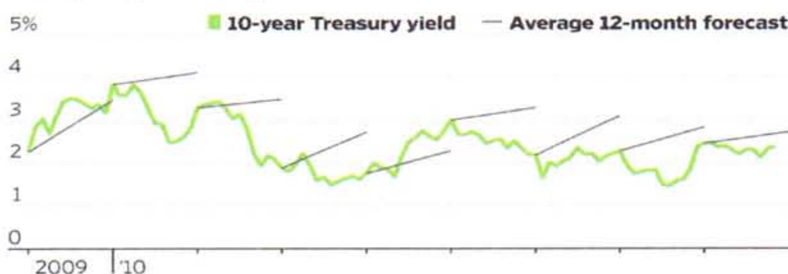
As we bid farewell to 2017, a year of very pleasant surprises, Caves & Associates, like many other advisors and Wall Street forecasters, is reviewing our early-2017 outlook for stocks, bonds, and the U.S. dollar to see how close the forecasts of various economists, managers, and our own outlook were to actual outcomes for the year. We have noted for many years 1) the fallibility of our forecasts, whether or not they agree with the consensus forecast at the time, and 2) the ensuing reality is typically significantly different from the consensus because the consensus is already factored into prices as of the start of the forecast year. It is only **new** information not accurately forecast and/or not presently knowable which will move markets in the future.

A recent Wall Street Journal article, *Those 2017 Predictions: So Wrong* (11/24/17, page B1-2), arrives at the same conclusion. At the beginning of the year, almost everyone was bullish about the prospects for the "reflation trade" of higher bond yields, modestly rising stock prices, and a stronger U.S. dollar, all driven by predicted Federal Reserve moves and President Trump's tax-cut plans. Almost a year later, inflation has not materialized, the benchmark 10-year Treasury yield is down, the S&P 500 Index has delivered **double** the gains **of the most bullish** Wall Street prognosticators, and the U.S. dollar is down.

Bond yield predictions and stock market forecasts have a dismal track record. Treasury yields have been forecast to rise every year for the past decade according to forecasts collected by Consensus Economics, yet they have gone down more often than up. Stock market forecasts are not much better. More than half the time since 2000, forecasts have been off dramatically: the S&P's long-run annual gain has been 9%, and forecasts have been off the mark, high or low, by even more than that amount. In the graphics below, the solid line projection should end at the actual result shown by the squiggly line for forecasts to have been accurate. For example, the interest rate forecast was only accurate in 2009. Respecting U.S. stocks, forecasters did well in 2003-2007 and 2010 but otherwise were generally way off the mark.



The accuracy of forecasts for 2017 has indeed been dismal, ours included. The key to what went wrong for forecasters last year was the lack of inflation, something retiring Federal Reserve Chairwoman Janet Yellen has described as a "mystery." Over the course of the year, investors became increasingly convinced they had overestimated inflation and came to believe that inflation would stay dormant, bringing down long-term bond yields and the U.S. dollar, even as solid economic growth boosted profits and stock prices.

The long-term trend showing the inability of economists and other experts to reliably predict future market trends convinces us that tactical moves based on market forecasts and outlooks will not reliably lead to higher portfolio returns and greater wealth accumulation. As a matter of maintaining our humility and discipline, we have not let our own outlooks impact our allocations of client portfolios. Therefore, although we will certainly remain aware of forecasts by economists and fund managers, **we will no longer be providing market outlooks in our future yearend and quarterly communications**. As noted at the end of the Wall Street Journal article, the value of Wall Street's yearend publications comes from the analysis they contain, not the prices they predict. The same is also true of our Outlook contained in the Caves & Associates yearend presentations.

We continue to believe that only a balanced, broadly diversified portfolio provides a rational approach to investment management. As always, we shun market-timing and significant tactical shifts. We will nonetheless continue some underweighting of tangibles and alternative strategies. Otherwise, we will remain steadfastly committed to 1) broad diversification, 2) being fully invested except for carefully-evaluated cash reserves, and 3) avoidance of making any significant bets that could introduce undue risk to client portfolios.

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