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WEALTH MANAGEMENT

February 2021

Monthly Insight

Checking the Crystal Ball: 2020 Predictions Scorecard

Who wouldn't like the ability to accurately predict the future? (By the way, notice the word "accurately" in the previous sentence. Anyone can make a prediction, but accurate predictions are an entirely different thing.) Throughout human history, people have fantasized about the ability to see what's coming before it gets here. Myths, fairy tales, and even classical music works have been composed around the benefits—and the surprising liabilities—that come with possession of a working crystal ball.

The financial industry is no exception, of course. Each year, many respected firms, individual analysts, and various gurus publish their predictions for the coming year in the markets. Their motivations for doing this primarily center around attracting the attention of investors, would-be investors, and opinion-makers. If there's one thing human nature can guarantee, it is the tendency to gravitate toward anything that seems to offer an inside tip or some other form of secret knowledge aimed at generating profits and reducing downside risks.

In fact, it is worth posing the question: If the various prognosticators and prediction peddlers really believe in the value of their predictions, why wouldn't they keep the information to themselves and simply invest accordingly? After all, if you've got the inside line on what the financial markets are going to do over the next twelve months, why not capitalize on it? Of course, that isn't really the point of these published predictions. As I've mentioned, their main value to those who put them out for public consumption is the potential for attracting the attention —and, often, the advertising or other revenue—from those who click, subscribe, or buy the expert's latest book.

In retrospect, it seems that the year we've just finished would have been a tough one for anybody in the financial prediction business. After all, no one predicted the onset of a worldwide pandemic and the economic mayhem following in its wake. COVID-19 has truly been a "black swan" event: something never before seen and certainly not anticipated. And yet, it is interesting to look back at some of the major predictions that were made at the beginning of 2020 to see how many of them proved correct, now that this momentous year is finally behind us.

Analyst and researcher Larry Swedroe publishes an annual scorecard for predictions by financial media and columnists, and he recently released his results for 2020. He gives each of the predictions a score of +1 if the prediction was right and -1 if the prediction was wrong. He tries to focus on predictions made with some sort of guarantee that the outcome is certain. Let's take a look at his scores for 2020.

- Forecasters predicted GDP growth of 1.8% in 2020. When the final numbers come in, it will be closer to -3.5%. **Score: -1.**
- Prognosticators said that profit growth would continue to be strong, reaching $178 per share on the S&P 500. The actual number is going to come in at around $136. **Score: -1.**
- Predictions called for US stocks to deliver high single-digit returns. The actual return more than doubled the forecast. **Score: -1.**
- The forecast was for inflation to remain tame, at around 1.8%. Actual: 1.24%. **Score: +1.**
- Market prophets said that the Fed Funds rate would be lower at the end of the year than at the beginning. Actually, the Fed lowered its rate effectively to zero. **Score: +1.**
- Forecasters believed the interest rate environment would favor real estate investment trusts (REITs) over stocks. With the S&P 500 returning 18.4% in 2020 vs. -14.68% for REITs (through 11/30/2020), it would seem that turned out completely wrong. **Score: -1.**
- The consensus among predictions was for large-cap stocks to continue to outperform small stocks. It was close: small cap indices returned 19.1% while large caps gained 21.0%. **Score: +1.**
- Published predictions indicated that gold would post another strong year. Gold was up almost 24%. **Score: +1.**
- Forecasters indicated that climate change would lead to another year of significant losses to reinsurers, so investors should avoid the asset class. The two publicly available reinsurance interval funds both posted positive returns. **Score: -1.**

Overall, Swedroe assigned five minuses and four pluses for a net prediction score of -1. So, if you had based your investments for 2020 on any one of these predictions, you would have had a 55% chance of being wrong—and, of course, a 45% chance of being right.

My takeaway from all this is, as I frequently remind my clients, that it is impossible for anyone to predict movements in the markets or the economy with reliable accuracy. For that reason, I do not advocate basing long-term investment decisions on predictions of the future, regardless of their source. On any given day, it is possible to find someone who is solemnly assuring the public that a major market selloff is looming and another observer stating with equal confidence that the market is poised to soar. Investors who use this type of information as the basis for their buying and selling decisions are apt to be confused and anxious, much of the time.

On the other hand, I continue to believe that investors who formulate a long-term plan suited to their goals and risk tolerance, who hold a well-diversified portfolio, and who systematically rebalance and reassess risk factors in light of observable market developments will generally do quite well over the long haul. Certainly, this type of approach is not as interesting as paying close attention to the sometimes-sensational headlines that appear in the financial media, but my experience is that my clients don't particularly want excitement where their important assets are concerned. When it comes to securing retirement, funding the education of the next generation, or leaving a financial legacy for the future, I believe my clients are best served by a strategy less oriented toward the headlines and more dependent on evidence-based, time- and market-tested principles.

There's an old stock market proverb: "It is very difficult to make predictions, especially about the future." Without a doubt, clarity can be hard to come by. That is why, as a fiduciary financial advisor, I work with my clients to provide the maximum clarity available from evidence-based, research-tested market principles. If you would value greater clarity in your financial plan, or to get a second opinion on how your investments are positioned for the coming years, please click here.

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"When it comes to serving our clients, our belief is that people come before profit and service is above self."