Why Bold Market Predictions Rarely Pan Out

22 years ago, James Glassman and Kevin Hassett published a book titled, *Dow 36,000: The New Strategy for Profiting from the Coming Rise in the Stock Market*. In the book, the two authors claimed the Dow Jones Industrial Average should hit 36,000 almost "immediately," even though at the time the Dow was trading just above 10,000. It was 1999, however, when euphoric sentiment about stocks was quite common, and many investors thought the market could only go up.[1]

Everyone knows what happened just a year later. The bold, bullish prediction of Dow 36,000 was followed by the tech bubble bursting in 2000. The Dow would not reach the authors' forecast level until November 2021. The prediction was 20+ years early, and dead wrong.

Glassman and Hassett were not necessarily unqualified to make stock market predictions. Mr. Glassman is a former undersecretary of state and the founding executive director of the George W. Bush Institute, and Mr. Hassett is a former Fed economist who served as Chair of the Trump Administration's Council of Economic Advisors. Both are well-versed in economic and market matters, but they made an emotionally-charged error forecasting short-term, 100+% gains in a market that was already notably detached from fundamentals.[2]

There are numerous other examples of bold forecasts from credible market and economic experts gone wrong. One is from 1929, when one of the U.S.'s top economists, Irving Fisher, declared that stocks had hit a "permanently high plateau," implying that the only direction from there was up. Similar to Glassman and Hassett, Mr. Fisher made his prediction at the tail end of the Roaring '20s, when positive sentiment was very high. The market began its crash two weeks later, which would eventually give way to the Great Depression.

In 1981, there was a well-known technical analyst named Joe Granville that penned a popular newsletter about stocks and trading. At the beginning of the year, he urged his readers to sell everything, and he remained bearish – incorrectly – throughout the memorable 1980s bull market run. He continued to wrongly refer to the bull market as a "sucker's rally," and was never proven right.

Finally, a more recent example took place in the summer of 2012, when the famed bond manager Bill Gross wrote that "the cult of equity is dying," and that "investors' impressions of 'stocks for the long run' or any run have mellowed." This declaration of the death of equities came in the early stages of what might be considered the longest bull market run of history, which is arguably still underway today. Since that forecast was made, the S&P 500 is up well over +200%.

The point of recalling these forecasts is not to admonish the economist or investor who made the prediction. The point is to remind investors that bold market forecasts should be taken with a grain of salt, *especially* those with set price targets, specific dates, or predictions of massive gains or losses over a short period.

These bold, flashy forecasts often garner the most attention because they are just that – bold and flashy. But believing them can lead to rash and risky decision-making. In 1929, Mr. Fisher borrowed thousands of dollars to make his bullish wager, which ultimately bankrupted him a decade later.

Bottom Line for Investors

Investors do not need bold forecasts in order to do well in the stock market and ultimately reach long-term financial goals.

From 1928 to 2020, the average annual geometric return on the S&P 500 was 9.8%. Over the same period, the average geometric return of risk-free 3-month Treasury bills was 3.3%.[3] Comparing the two shows investors the "risk premium," which tends to hold across different periods of time and across different countries. Throughout history, it has been reasonable to expect those stocks – over long stretches of time – can generate a 6-7% annualized premium above Treasuries. The effect of this excess return, when compounded, is what leads to wealth generation.

Unfortunately, investors have difficulty staying the course. We know equity markets experience average intra-year corrections of -14.3%,[4] a bear market every few years, and once a decade, investors can expect unbridled white-knuckle panic in the equity markets. Many of these events spook people out of stocks, which compromises the ability to effectively capture the risk premium over time.

Recent history is a great example of the challenges investors face in committing to stocks long-term. In the past 15 years, we've experienced the Global Financial Crisis of '08 and a steep, pandemic-induced bear market. But what is important to realize – which can only really be seen in retrospect – is that the best course of action in a crisis is to buy stocks. It is effectively the Baron Rothschild quote, "Buy when there's blood in the street, even if the blood is your own."[4]

For many investors, this mantra is easier said than done, but the takeaway is the same: the history of the United States is the triumph of the optimists, and for investors trying to generate true wealth in the market, the key is to invest and stay invested over long-periods of time, regardless of market fluctuations. The past fifteen years of market returns is a clear vindication of such a strategy.

ABOUT MITCH ZACKS

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[1] Wall Street Journal. November 1, 2021. https://www.wsj.com/articles/dow-jones-36000-stock-market-predictions-glassman-hassett-11634823650

[2] Ramsey Solutions. September 27, 2021. https://www.ramseysolutions.com/retirement/the-12-reality

[3] JP Morgan, https://am.jpmorgan.com/us/en/asset-management/adv/insights/market-insights/guide-to-the-markets/

[4] Investopedia, March 9, 2020. https://www.investopedia.com/articles/financial-theory/08/contrarian-investing.asp

Weekly Market Update

Important Market News We Think Worth Considering

IN FOCUS THIS WEEK

- **Rising inflation**
- **Higher producer prices**
- **A soft patch in the U.K.**

Inflation Keeps Going Up

The biggest news to hit the tape this week was the sizable increase in U.S. inflation. According to the Labor Department, the consumer price index – which roughly measures what consumers spend on a basket of goods and services – soared by 6.2% in October from the previous year. This level of price increase marks a 30-year high and follows five straight months where inflation has topped 5%. The question of inflation in 2021 has never been about *whether* prices would go up – it's been about *how much* and for *how long.* So far, the answers to the latter seem to be that inflation is going up more than expected and for longer than expected, though the Federal Reserve continues to lean into the notion that inflation is 'transitory,' largely a product of temporary supply chain issues being met with record consumer demand. Inflation is not uniquely a U.S. problem – nations around the world are seeing increased consumer demand as the pandemic risk fades, and supply chains simply have not been able to keep up. In theory, once supply chains 'catch up' to meet demand and inventory needs, the price pressures should fade. The question is, what is the actual timeline for supply chains being fixed? If the answer is a few months, it would ultimately make the current spike in inflation less worrisome. If it's longer, the Federal Reserve may need to step in sooner – and more aggressively than originally planned – to raise interest rates, which could potentially start the clock at the end of this profit cycle.[1]

Producer Prices Also Jumped, in the U.S. and China

An equally important, but far less acknowledged, gauge of inflation is producer prices, as measured by the producer-price index (PPI). A good way to understand the PPI is in relation to the consumer price index, or the CPI. The CPI measures the change in prices from the consumer's point of view, while the PPI measures the change in prices from the business's point of view. In a sign inflation is currently broad-based, the U.S. PPI also soared in October, recording its biggest increase on record at 8.6%. It's not a forgone conclusion that higher business prices translate into higher consumer prices, as in some cases the businesses will absorb higher costs (which tends to squeeze profit margins). Understanding the full effect of increases in the PPI is best observed in analyzing corporate earnings, and corporate earnings calls and estimates. China is also experiencing higher producer prices, with factory gate prices soaring by 13.5% from a year earlier, following a 10.7% rise in September. That's the fastest pace of increase in 26 years, which could trickle as a factor driving global inflation.[2]

The U.K. also Experiences a Soft Patch

Figures released this week released by the U.K. Office for National Statistics showed the U.K. also hitting a soft patch this summer, no doubt driven by surging Delta cases and slowdowns in Europe and the U.S. The U.K. reported a Q3 GDP increase of 1.3% compared to 2020, which

was a notable deceleration from the 5.5% GDP growth pace set in Q2. Supply chain bottlenecks and a somewhat messy transition out of the European Union have contributed to headwinds, but the U.K. also has an issue the U.S. doesn't -- the prospect of weaker consumer spending.[3]

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[1] Wall Street Journal. November 10, 2021. https://www.wsj.com/articles/us-inflation-consumer-price-index-october-2021-11636491959?mod=djemRTE_h

[2] Wall Street Journal. November 7, 2021. https://www.wsj.com/articles/economy-week-ahead-inflation-employment-gdp-11636315203

[3] CNBC. November 11, 2021. https://www.cnbc.com/2021/11/11/uk-economy-grows-0point6percent-in-sept-after-weak-summer.html

DISCLOSURE

Past performance is no guarantee of future results. Inherent in any investment is the potential for loss.

*This information is supplemental to GIPS and is based off the composite
**The standard deviation shown here is calculated since inception

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