That Was Then, This Is Now...What Can Be Learned?

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History is a great teacher, but the weakness of using distant history to inform on decisions in the present is that many people fall prey to the recency effect and the trappings of "this time it is different."

I will not include charts and statistics in this commentary; I will express some observations from the last twelve months, which will be informative and hopefully present valuable lessons that can be applied in the future. I will keep this month's commentary very short and to the point.

Below are passages (in italics) from several of our proprietary commentaries written over the last twelve months:

July 2022:

Should the economy begin to slow down without being accompanied by significant layoffs and sharp rises in the unemployment rate, this would presumably take the aggressive path for interest rates off the table. The markets would, at that point, begin to make a "soft landing" for economic growth and inflation its base case. I see very early signs that this scenario is becoming more likely.

We expect the unexpected in the near term, with conventional wisdom and consensus opinion continuing to be more unreliable than usual.

Lesson learned

Wall Street consensus forecasts are almost always wrong. Furthermore, many times they are wrong to a significant degree. At the end of 2021, the consensus Wall Street market forecasts for 2022 were, as reported by Reuters on December 1, 2021, "the benchmark S&P 500 will gain 7.5% from Tuesday's close of 4,567 to end the year at 4,910, according to the median forecast of 45 strategists polled by Reuters over the last two weeks."

Market and economic forecasters usually fall prey to becoming trend followers, not rigorous analysts and strategists. When markets turn down, and pessimism is running high, the consensus opinions and forecasts will routinely be significantly shaded by the prevailing negativity of the time. In most cases, such negativity (FDR quote: "The only thing we have to fear is fear itself.") will be very wrong. On July 19th, 2022, Politico, in an article titled Wall Street Braces for an Economic "Hurricaine," wrote, "Wall Street indicators, including the direction of stock prices and the dollar, now predict a recession will hit by early next year, according to research from George Saravelos, global head of foreign exchange research at Deutsche Bank."

As we know, 2022 became a significant Bear Market while the U.S. economy's strength confounded most economists and market strategists. Our leaning toward an economic "soft landing" in mid-2022 and a more confident "soft-landing" outlook later in the year did not stop the markets from pricing in the opposite for most of the second half of 2023. In our business, you can be right but look wrong until the markets finally agree.

November 2022:

One concept that holds true more than not with equity markets is that periods characterized by more frequent down-month periods or substantial down-year periods than average are typically followed by a more extended period of months that are characterized by the opposite.

Lesson Learned:

At any given moment, markets price in scenarios colored by the most recent trends and emotional sentiment. Last year's Bear Market was long and painful, with scary headlines and dire predictions. This is what always happens during Bear Markets. The selling and pessimism get exhausted, and dire forecasts fade, ushering in another Bull Market. Fear resulting from the recent chorus of "doomsayers" paralyzes many investors, so they do not recognize the positive turn in the markets until long after the bottom of the market.

In retrospect, the absolute low point of the S&P 500 for the 2022 Bear Market occurred in early October. As the St. Louis Federal Reserve Bank reported, from January through October 2022, the S&P 500 was down seven out of ten months. From the time that we wrote our November 2022 commentary, the S&P 500 has risen seven out of nine months.

January 2023:

With the December CPI release, our expectation for the widely watched headline year-over-year CPI is to be under 2.5% by mid-summer. (Per a Reuters report published on February 10, 2023 titled Revisions show U.S. consumer prices a bit firmer than previously reported, annual CPI revision announced with the release of the January CPI in early February revised up prior monthly CPI by 0.4 in aggregate. The impacted prior readings occurred in October, November, and December. Had this been known in January when our commentary was written, our mid-summer 2023 CPI expectation would have been 2.90% or under.)

Now that 2023 has arrived, the market is finally catching up with many realities we identified months ago. Given how much pessimism has been priced into equities over the last fourteen months, we are confident that prices can better approximate fair values as we progress through the year.

Lesson Learned:

Understanding how important economic statistics are calculated and tuning out the noise of financial media pundits whose forecasts and analysis are significantly impacted by how their investments are positioned can allow you to parse out biased opinions from objective analysis. Also, understanding the objectives of the Federal Reserve and the tools at its disposal can assist an investor in interpreting central bank messaging, which is often very carefully crafted to attempt to manipulate investor and consumer behavior to achieve specific policy objectives.

In July 2023, when the June CPI was released, it measured 2.90%. We were unsurprised and pleased with the CPI's path in the first half of 2023 and the strong advance in the broad equity markets from January through July.

Final Thoughts:

The takeaway from this month's commentary is that one does not need to be a Nobel Laureate economist to be able to distill objective public information down to meaningful data points. Such data points can be used to arrive at realistic base case forecasts and assumptions. Even with good objective data points, the most essential quality an investor must possess is to control one's own biases and emotional tendencies.

Of course, there are many nuances involved in the subject matter that I highlighted in this commentary. The takeaway that I hope readers get from this commentary is that, as fiduciary advisors, and asset managers, we work very hard to provide our unvarnished objective opinions on forward-looking matters that are meaningful to our work. We try hard not to be overly swayed by the emotions the markets and media engender. Although we pay close attention to experts who follow the markets, the economy, and relevant government policy matters, we always strive to think independently.

Disclosure:

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- The Standard & Poor's 500, or simply the S&P 500, is a stock market index tracking the performance of 500 large companies listed on stock exchanges in the United States. It represents the stock market's performance by reporting the risks and returns of the biggest companies. Investors use it as the benchmark of the overall market, to which all other investments are compared.
- The NASDAQ Composite Index is a large market-cap-weighted index of more than 2,500 stocks, American depositary receipts (ADRs), and real estate investment trusts (REITs), among others. Along with the Dow Jones Average and S&P 500, it is one of the three most-followed indices in US stock markets. The composition of the NASDAQ Composite is heavily weighted towards information technology companies.
- The Dow Jones Industrial Average (DJIA), also known as the Dow 30, is a stock market index that tracks 30 large, publicly-owned blue-chip companies trading on the New York Stock Exchange (NYSE) and the Nasdaq.
- The Russell 2000 index is an index measuring the performance approximately 2,000 small-cap companies in the Russell 3000 Index, which is made up of 3,000 of the biggest US stocks. The Russell 2000 serves as a benchmark for small-cap stocks in the United States.