Forecasting Is Hard

Yogi Berra is rightly credited with coining some of the best quips of the 20th century…

> "I knew the record would stand until it was broken."

> "If you ask me a question I don't know, I'm not going to answer."

And one of our personal favorites:

> "Always go to other people's funerals; otherwise they won't go to yours."

Yogi's sayings have a sort of timeless appeal that can be applied to a myriad of situations. But for those among us who are a little more, shall we say, *nerdy*, we have always appreciated the witticisms of the great physicist Niels Bohr.

Dr. Bohr was a simply fascinating person, winning the Nobel Prize in physics at the tender age of 37, assisting Nazi-era refugees who fled to his home land of Denmark, and even having various interesting things named after him (including a chemical element, a crater on the moon, and an asteroid). But he was also a keen wit:

> "Your theory is crazy, but it's not crazy enough to be true."

> "Some subjects are so serious that one can only joke about them."

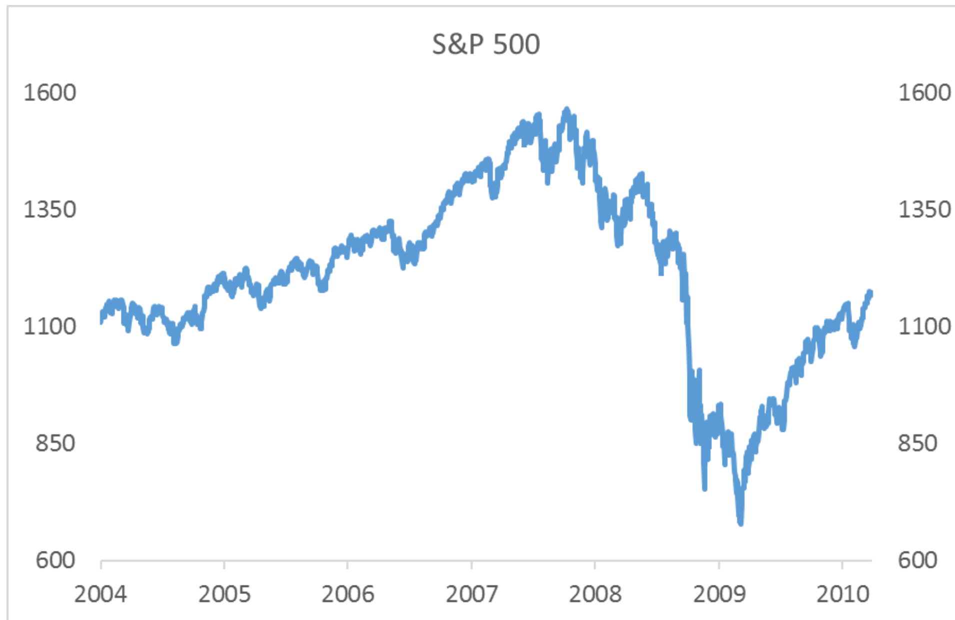
And the one which speaks directly to the topic of this article:

> "Prediction is very difficult, especially about the future."

Sure Niels Bohr Won a Nobel, But How Would He Fare in the Stock Market?

Consider the prediction made by some rather intelligent stock market pundits in early 2010: "This is not the onset of a new secular bull market [like in] August 1982."

To refresh your memory, in early 2010 the S&P 500 index stood at about 1,100, which was about the same level it had been five or six years earlier. It was also at about the same level it was a little over a year earlier, as that index briefly passed by 1,100 on its precipitous tumble down to a bottom of below 700 in early 2009:



source: Yahoo! Finance

So, depending on how you measure it, the index had either produced a total return of more than 60% since hitting bottom in 2009, or it had produced a paltry annualized 2% or so (just the dividends, basically) over the prior six years.

These particular pundits were of the mindset that the stock market was over-heated after posting that 60% return in such a short time frame. To prove their point, they took some snapshots of where things stood in late 2009 and compared them to the way they looked in late 1982:

Data Point	**1982**	**2009**
Fed Funds Rate	18% and only one way to go (down)	0% and only one way to go (up)
10-Year Bond Yield	15% and falling	3.8% and rising
Budget Deficit-to-GDP Ratio	~3% and moving toward surplus	~10% and steady or falling from here
Inflation Rate	10% and falling	0% and rising
Unemployment Rate	10.8% and falling	10% and rising
Global Trade Barriers	high and falling	low and rising

Investor Sentiment	10% bullish	88% bullish
S&P 500 Dividend Yield	6.0%	2.0%
P/E Ratio (10-year normalized in real terms)	7.0x	23.0x
Baby Boomer Population	median age 25, spending/investing years ahead (capital gains)	median age 52, retirement focus ahead (capital preservation)

source: Haver Analytics, Gluskin Sheff

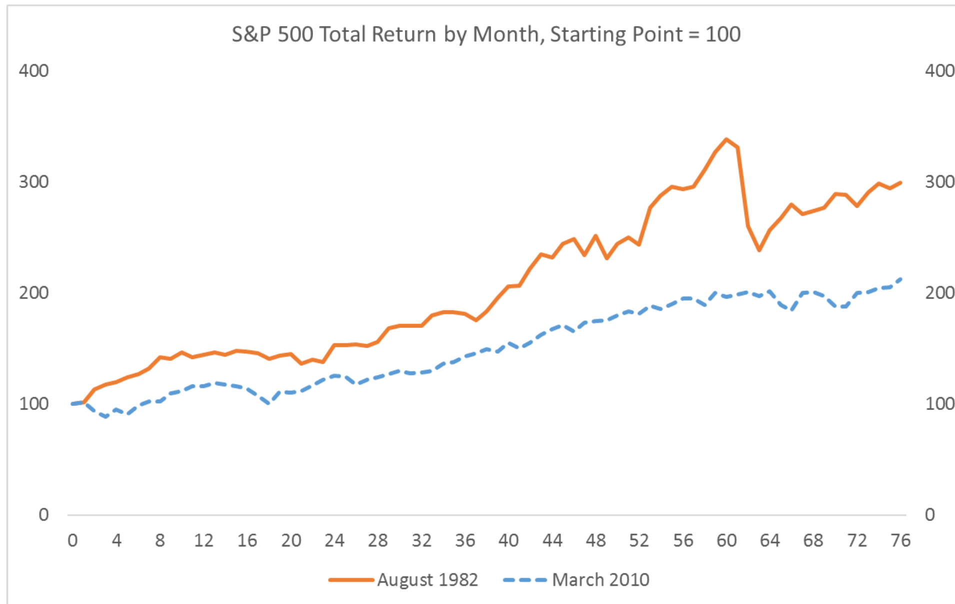
We don't know about you, but after digesting the data points in that table, we're starting to think that selling or maybe even shorting stocks might be a good idea in early 2010. This seems like pretty convincing stuff!

But as we now know with the benefit of hindsight, "up" was not necessarily the only direction in which interest rates could move in 2010 and beyond. The Fed funds rate is still stubbornly close to zero, and both the 10-year bond yield and the average rate on a 30-year mortgage are now significantly *lower* than they were six and a half years ago.

And as we discussed in our two-part article from last year *Is The Stock Market Over-Valued?*, the 10-year normalized P/E ratio popularized by Robert Shiller may not be the helpful indicator it once was.

We're certainly not trying to pick on the specific group of smart people who created this table. Since then, several other very smart and very wealthy investors have made similar arguments about why the stock market was due for a correction any day now. And yet, the market has continued to rise, sometimes at a dizzying pace like when it returned over 32% in 2013.

To be sure, it has not advanced as quickly as it did coming off the generational buying opportunity of 1982. We are now a little more than six years removed from the time the table above was published: 76 months, to be exact. Here is a comparison of the returns generated by the S&P 500 index over the course of those 76 months with the returns the same index earned in the 76 months following August 1982:



source: Standard & Poor's, Marketwatch, Inkwell analysis

From August 1982 through the end of 1988, investors who held the S&P 500 index with dividends being re-invested basically tripled their initial stake. Those in a similar situation from early 2010 through the end of July 2016 have roughly doubled theirs. Doubling one's money over 76 months, while surely not as good as tripling, is still nothing to sniff at.

Where Do We Go From Here?

All that is well and good, but the important question for investors is, "What's next? If I invest in stocks right now, can I double my money again in 76 months?"

And of course, the answer is that nobody knows. If we took the time, we could find some smart people predicting a very rosy future for stocks over the next five years. We could also find other smart people predicting an apocalyptic collapse. And we're quite sure that other smart people say that we will probably just tread water for a while.

When we do arrive at our destination in the future, try to remember that the people who ended up being correct in their predictions from today were not necessarily the smartest forecasters. Probably they will just end up being the luckiest.

Based on these results posted by the intelligent pundits whose data we have been examining in this article, we are certainly not going to stick out our necks and make a market call one way or the other. Crazy things can happen in the stock market over 1-, 2-, or even 5-year time frames.

The important thing to remember is that, over the long haul, stocks are the place you want to be. As we wrote in another article earlier this year (*Que Sera, Sera*), investors in the S&P 500 have never experienced a 15-year period in which they have earned less than 4% per year on average. In some 15-year periods their annualized return could be as high as 15% or 20%, in some 15-

year periods it could be as low as 5% or 10%. But it has never been lower than 4%, and it has averaged out to about 11%. Through the miracle of compounding, 11% per year on average over your investing lifetime should produce a satisfactory return. After all, there is no shame in growing rich slowly.

Conclusion

So yes, trying to predict the future is a very difficult business. If even a Nobel Prize-winning physicist thinks it's hard, what hope do the rest of us mere mortals have? Which is why we believe any money that will be needed for living expenses over the next five years should not be committed to the vagaries of the stock market. For longer time frames, though, we believe investors' patience and fortitude will eventually be rewarded.

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