

Are most annual Investment Outlooks worthless?

Dominic McCormick | Select Investment Partners | 04 March 2016

Despite being close to the end of the first quarter, various 2016 investment outlooks from fund managers and newsletter providers are still landing in my inbox or on my desk, promising to tell us what the year ahead is likely to bring economically and in investment markets – and where to put your money.

Of course, I can understand the desire for these annual outlooks and the pressure on industry participants, including ourselves, to provide them. However, I am increasingly coming to the conclusion that the vast majority of these outlook pieces are frequently useless to the average investor or adviser. Worse, I think they can be destructive because they sometimes encourage a perception of clarity about the near term future path of asset returns that simply doesn't exist.

The biggest problem I see with these pieces is they are inherently forcing the writer to put forward strong views on the economy, markets and investment opportunities:

1. on a particular date, irrespective of whether the author actually holds strong investment views at that time; and,
2. for a particular time frame i.e. 1 year, a period that may have little to do with either the time frame one thinks an investment idea will play out, or the investment time horizon of the reader.

This issue was highlighted by some comments by Guy Stern, manager of Standard Life's GARS strategies (as quoted in the *Australian Financial Review* 7–8 November 2015). He highlights that his fund's "edge" over (macro) hedge fund is "patience". "Where a market or currency will be at the end of the year is very random. Our success is extending that time frame just a little. Over three years, your ability to be right about your forecasts gets much better."

This is the key problem with annual investment outlooks. The investment time horizon is being determined by the marketing imperative, not what one truly believes from an investment perspective.

Perhaps such outlooks should focus more on long-term valuations of asset classes, accepting that while valuations do provide some useful guidance to long-term returns, they are not a good short- or even medium-term timing indicator. Therefore, the author can't rationally project promise that the higher returns of more undervalued assets (or lower returns of overvalued ones) will come through over the near term / next year. One year is

not "long term". To be considered "long term" probably requires at least a five-year and probably seven- or 10-year horizon.

Perhaps such outlooks could also focus on one or two higher conviction asset allocation/sector ideas for the short- or medium-term (assuming the author has some), rather than succumbing to the pressure to have a view across the board on everything from economics to the full range of asset classes and sectors.

I don't think anyone can reliably predict how a wide range of economic and financial variables are likely to play out over the next year. A good investor develops a few true high conviction ideas after considerable reading, thinking and analysis. The notion that they can time it so that a multitude of these good ideas all appear to them in late December or early January in time to do a year's outlook is ludicrous.

In addition, it could make sense to couch much of the outlook discussion in terms of risks and probabilities and the impact of different scenarios. Certainly, this comes across as far from precise, but this is not a science. Too many of these newsletters/outlooks promise much more than they can possibly deliver.

I would have more respect for some of them if they occasionally came out with something like "We don't really have much of a clue as to what will happen in financial markets or the economy in the next few months to a year. We do think X asset class/investment looks expensive and Y looks cheap, but we have no idea when this valuation will reflect in returns. We are more confident it will over five years and beyond."

Perhaps the ideal investment outlook piece might highlight some investments representing long-term value, expensive areas to avoid, and have a solid story for why one or two assets/sectors/investments could do well over short- to medium-term. When they come up with five to 10 or more investment ideas, be sceptical - good ideas are hard to come by for even the best investors, at least most of the time. (Perhaps when markets are very depressed after an extended bear market such ideas should be plentiful but such periods are rare, perhaps one in every 10 years).

So, how should investors approach the multitude of investment outlooks that arrive this year and next? One approach is simply to ignore them. However, there is some value in them.

Firstly, as a group, they can give you guidance as to what the overall consensus thinking is on economies and markets i.e. what is actually priced into markets? This way, if you can actually come across information or develop high conviction views that are different from consensus, you may well have come across a potentially rewarding investment idea.

Secondly, if everyone is thinking very much alike, you should become increasingly concerned that the particular view almost certainly will not pan out as expected. Too much similar thinking and complacency about a view creates a highly unstable situation where the opposite path becomes more likely because the bulk of investors have already placed their

bet on the same outlook. If everyone is already on one side of the boat, a swing back in the other direction usually becomes inevitable.

In [my last article](#), I mentioned the 29 December piece published in AFR on the outlook for Australian stocks in 2016. Of the 73 Australian stocks covered, there was not one gold stock included, despite that sector being the best performer so far in 2016. Short-term yes. But, if you are looking for the true contrarian opportunities that can really make big money, most 2016 investment outlook pieces aren't the best place to start. (Except perhaps to do the opposite of the extremely popular ideas).

US strategist Jim Bianco recently had some interesting thoughts on whether the sharp drop in equity prices early this year was justified or whether it was an emotional overreaction?

"There is an old line in the market, first coined by the economist Paul Samuelson. It says that the stock market has predicted nine of the last five recessions. There is some truth to that phrase. But I would also point out that predicting nine of the last five recessions is a much better track record than the consensus of economists. We wish they were that accurate, but they're far worse. "

I suppose the point is while everyone is trying to predict the economy and markets, perhaps we should spend more time listening to what the market is telling us. Its behaviour (not just price but volume, breadth, reaction to news, etc) can often flag key issues and developments in the economy and fundamentals well before economists and financial commentators do.

Another problem with economists' predictions was highlighted at the recent PortfolioConstriction Forum Markets Summit. Chris Watling and Dr Bob Gay put up exactly the same chart on the US bank lending survey and yet came to completely the opposite conclusions. Chris sees a looming recession while Bob thinks everything is fine for now [but not in the long term – Ed]. If economists can't agree on what today's economic statistics mean, what credence can we put in more distant forecasts?

In a similar way that some investors and advisers overly rely on annual investment outlooks, I am amazed that some seem to go to investment conferences with a blank sheet of paper (and blank mind) and expect to be handed, on a platter, an array of implementable investment ideas for the next year or until the next conference. This is clearly lazy and dangerous.

The better way to approach such conferences is to come with a realistic picture of your own investment views and the areas where you lack conviction and use the presentations as a stress test to challenge your ideas (or lack of them). If you get only one or two new ideas, this is probably a good result. Any more and you are likely someone who has trouble holding strong views and is simply being swayed by a good presentation.

What does all this mean for investors?

- Treat the annual investment outlook show mainly as entertainment, although it can give you a good sense of the consensus view and of crowded trades.
 - Listen to the market more – sometimes it can do a better job than economists and strategists of telling you what is really going on in the economy and asset fundamentals.
 - Valuation matters a lot, but mostly only for the long term.
 - Wait for high conviction investment ideas and don't expect them to come frequently or easily.
 - Given the uncertainty confronting us, sensible diversification always makes sense.
 - "I don't know" is sometimes the right answer, especially about the short term.
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