The Rennie Quarterly Return

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Forecasts

We receive many questions from our clients, a good thing. Some have to do with forecasts made by economists, market mavens, etc. Clients want to know what we think of these forecasts and what, if anything, should be done relative to their investment portfolios. Some recent contacts pertained to Meredith Whitney's trashing of the municipal bond market. Others centered on the forecast upcoming bond bubble. While we take all forecasts seriously, we consider them as just one more important data point in the inscrutable investment mosaic.

In 1987, William J. Hudson published an important book on the subject, Business Without Economists. In the Introduction, Hudson says "but no matter who makes them, forecasts are almost always wrong. I have just asserted that the mind is much better than the machine, but forecasts of whatever origin are almost always wrong. And yet, forecasting continues."

We all can remember the names of forecasters in the past who called major market movements in advance. And in recalling these names, we also recognize that their successes were one-time events in their careers.

Market analysts develop sophisticated mathematical computer models based on historical data. While these work reasonably well, these same analysts then tweak the outputs based on what they think are new influences on markets. Bad idea. Indeed, according to the Wall Street Journal*, one study found that an unvarying computer model of stock analysts' estimates of future returns was more accurate than the analysts themselves 72% of the time.

We think that the best way to look at forecasters is in aggregate. The Research Department of the Federal Reserve Bank of Philadelphia surveys the major forecasters in the U.S. and publishes the results quarterly. The results are contained in the "Survey of Professional Forecasters" which can be found at www.philadelphiafed.org. So what does the First Quarter 2011 Survey say about the future? Here are a few data points worth considering.

	Real GDP-%	Unemp'ment-%
2011	3.2	9.1
2012	3.1	8.5
2013	3.0	7.8
2014	3.4	7.3

	CPI-%	10 Yr. Tsy Yield-%
2011	1.7	3.6
2012	2.0	4.1
2013	2.1	4.5
2014	NA	4.9

	Long-Term (10 Year) Forecasts
Real GDP Growth	2.8
Stock Returns	7.3
10 Yr. Bond Returns	4.9
T-Bill (cash) Returns	3.0

If these Professional Forecasters, all highly educated and experienced—the best in the business really—are correct, the future looks reasonably good. The economy (GDP) will grow at about the same rate as the last 50 year average of 3.2%. GDP growth higher than about 2.7% usually results in job growth. Therefore, the forecast of steadily declining unemployment is not surprising.

Because of the high and rising government debt, many forecasters expect raging inflation. However, given the mild CPI above, the Professional Forecasters disagree. Likewise, the gentle forecast increases in the 10 year Treasury yield refute the bond bubble enthusiasts.

Even the long-term forecasts foretell a slow-growth economy. Most of the Professional Forecasters' numbers are below long-term norms: 50 year Real GDP growth—3.2%; 85 year S&P 500 Index (stocks) returns—9.8%; 85 year 10 Year Bond returns—5.3%; 85 year T-Bill returns—3.6%.

Even though the forcast numbers are lower than the past, investors would probably be happy if they are realized, but with moderate levels of volatility. Remember, however, that they are forecasts…which are almost always wrong.

* "Making Sense of Market Forecasts," Jason Zweig 1/8/11

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Our Two 

When plunder becomes a way of life for a group of men living together in society, they create for themselves in the course of time a legal system that authorizes it and a moral code that justifies it

Frederic Bastiat

Quarterly Trivia:

Two noted Economists have earned the dubious title of "Dr. Doom." Who are they?

Nouriel Roubini, Henry Kaufman