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Ghosts of Christmas past

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Although I have a lot of family photos of Christmases from my childhood, I would not necessarily remember them without the photos as a prompt, and certainly not the exact years. The only one I can pin down with certainty is 1968, when I was seven years old. That was the year when my mum struggled heroically to put Christmas lunch on the table and then collapsed in a heap before later being diagnosed with Hong Kong flu, which was the pandemic of the time. And if you want to hark back to the halcyon days of the National Health

Service, the diagnosis was made by a GP who visited the house on Boxing Day! Anyway, mum failed to reappear until the New Year and my dad was left to serve up a diminishing supply of leftover turkey, cooking not being his forte.

Christmas and New Year is traditionally a time both for looking back at the year gone by and for looking ahead. But we also know that humans are notoriously poor at remembering what they were predicting a year ago and that their recollections will usually drift closer to the actual outcome. I'm sure you will now find more people who will say that, for example, Donald Trump's victory in the US presidential election was a foregone conclusion or that it was obvious that the UK's Labour government was going to go heavy on the "tax and spend" agenda while doling out inflation-busting pay rises to public sector workers. But one can see from the reactions of markets and the shift in various sentiment indicators, that this was not the case.

Luckily (or, perhaps, unluckily) a lot predictions are preserved in print and pixels and so we can observe how good or bad both individuals and the hive mind were at making them. That is not necessarily with a view to criticising those who were off the mark nor to laud those who were on it, but more to see what turned out different to expectations and how we might learn from that. I guess I should start with myself!

My last Weekly Digest of 2023 was entitled "All's Well That Ends O.K." and looked back on a year during which the biggest "surprise" had been the fact that the US economy did not enter a recession, an outcome that carried a high probability at the start of 2023. Skipping back another year, the final missive of 2022 was sub-titled "Reasons To Be Cheerful". It followed a dreadful year for both bond and equity investors and was written at a point when confidence was at a very low ebb. However, the overriding message was that this was not the time to capitulate because the cycle would turn in investors' favour, as it always does.

I would observe that our message on markets a year ago was broadly constructive, but it's fair to say that I did not predict either the degree to which the US stock market would continue to outpace most others nor the extent to which that outperformance was driven, yet again, but a handful of leading technology companies, with the Artificial Intelligence theme being a primary driver. Perhaps I can forgive myself to some degree if I look back at what analysts were expecting for Nvidia, the leader in the AI industry in terms of processors. The average twelve-month forward price target last December according to Bloomberg was $67 (accounting for the stock split which occurred this year). The share price today is $134, exactly twice that! One could say the same for Broadcom, the latest entrant into the $1 trillion market capitalisation club. It's average price target a year ago was $111 and now it's trading at $237. There does seem to have been a collective failure to project both the size and speed of investment in the AI opportunity.

Let's go back and look at the average strategist's forward projection for the main indices over the last few years and how they turned out in reality. We'll look at the S&P 500 Index, for which Bloomberg provides historical strategists' forecast data, and I thought I had better start after 2020, because everyone deserves a free pass for the pandemic year. For 2021, the average forecast was for a capital return of 9%, and the outturn was +28%. For 2022, the respective numbers were +4% and -20%. For 2023, +6% and +24%. And for 2024 so far, +1% and +27%. That doesn't really fill you with much confidence, does it? One might initially think that strategists are just too cautious, which was the case in three of those years, but they were far too optimistic in their outlook for 2022.

It's not difficult to come up with narratives that explain away the errors. In 2021, not only did the post-Covid recovery exceed expectations, but there was also a massive speculative boom in unprofitable technology shares, fuelled by generous stimulus cheques. The problem in 2022, apart from Russia's invasion

of Ukraine (which provides some cover), was the inability to conceive just how high interest rates and bond yields could and would go in a more inflationary environment (which was evident pre-Ukraine) and the negative effect this would have on the present values of "long duration" shares and leveraged entities. It was very easy to have become anchored to low yields and high valuations. 2023 was all about pricing out the "left tail" risk of a US recession as well as sowing the seeds of the AI boom. And 2024 has seen some of those seeds begin to sprout and to bear fruit at a time when the US consumer keeps on spending.

Are those sufficient excuses for poor forecasting? I think we have to get away from anything that purports to be a precise target for something as volatile as an equity, the behaviour of which can be the result of numerous influences. These include, for example: earnings growth (itself dependent on even more interacting factors); valuation (a function of a readily observed risk free rate and a more nebulous risk premium); fund flows; investor sentiment; and government policy changes. I would certainly expect the investment community to have some handle on the general tone and direction of markets on a one-year view, but the magnitude of movements is much harder to predict, it seems. One should, perhaps, take a more Bayesian approach and keep adjusting ones sights as the market moves and the valuation inputs change.

One observation I have is that once a target has been established, it is very hard to move away from, not least because in doing so you have to admit that you were "wrong", which very few people are comfortable doing. Also, there are not many who are willing to go out on a limb (with a target well outside the consensus) and risk looking foolish. Weirdly, this seems to apply more to bulls than bears, with the latter camp often characterised as having better intellectual arguments for their gloomy case, rather than the former's members who are viewed as a bunch of unsophisticated cheerleaders.

Where are we today? The average forecast for the S&P 500 Index at end-2025 is 6614, or a gain of 9% from the close of business on 13th December. The odd thing about that is that it is an improbable outcome, despite seeming very sensible and being around the long-term average. Only eight years in the last hundred have seen returns for the S&P 500 fall into the 5-10% range. The average up year has delivered 19% returns, while the average down year has produced a loss of 13%.

We do not publish index targets. Indeed, the first piece of advice given to me by John Haynes, the Head of Research who hired me at IW&I, was never to give anyone a specific target as it would most probably be wrong and only provide the rope with which to hang me. What we do is first to evaluate the probabilities of making superior returns on either bonds or equities and to allocate accordingly relative to the specific benchmarks a client has chosen to reflect their risk tolerance. Within that framework we then allocate to specific sub-asset classes and individual stocks or funds as appropriate with the option to allocate to other diversifying assets which have less correlation to bonds and equities. It's not a process that guarantees to make the best possible return available from markets every year, but it should ensure decent returns in the long run whilst smoothing out some of the volatility inherent in investing in a single asset class.

And so that brings another year to a close (at least in terms of this publication). The next thing you will see from me will be the longer Monthly Commentary due to be published early January. That will contain a review of the key events and influences of 2024 as well as a look at how we are positioning portfolios heading into 2025. In the meantime, I wish you a relaxing Christmas and a Happy New Year and, as always, thank you for taking the time to read these commentaries.

Economic Commentary

FTSE 100 weekly winners

Diageo plc	8.1%
St. James's Place Plc	6.9%
J Sainsbury plc	4.9%
BP p.l.c.	4.8%
Lloyds Banking Group plc	4.3%
Burberry Group plc	3.9%
International Consolidated Airlines Group SA	3.5%

FTSE 100 weekly losers

Ashtead Group plc	-18.8%
Ferguson Enterprises Inc.	-12.5%
Just Eat Takeaway.com N.V.	-8.3%
SEGRO plc	-4.9%
JD Sports Fashion Plc	-4.4%
Vodafone Group Plc	-4.2%
Associated British Foods plc	-4.1%

FTSE 100 index, past 12 months

EuroStoxx 600 index, past 12 months

S&P 500 index, past 12 months

All data shown in GBP.

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