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RICHARDSON Wealth

Market Ethos

The latest market insights from Richardson Wealth

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Filtering forecasts

Investors often look for a playbook, a way to help guide them through times of uncertainty. History is often used to write that playbook. However, markets are just like any sport – rules change, equipment improves, and what worked best in the past may not always apply to the current situation. Playbooks need to be constantly revised but despite changes, any research created to guide investors is really based on two fundamental questions: what will happen, and more importantly, how will the market respond?

There is no shortage of forecasts and inane opinions in the financial media. Just sound smart, maybe say something controversial, and you can get plenty of coverage. Individuals can also be incentivized to make a name for themselves, build their personal brand, and bring more revenue to their firm. **Fear drives eyeballs and eyeballs bring in the advertising dollars.** Unfortunately, it can be easy to conflate the opinions that get the most coverage with those that are the most precise. Forecasting is difficult, and as history shows, often not accurate, especially when it comes to the stock market.

Forecasters' folly

Market strategists at the largest banks typically all have year-end S&P 500 targets. These get a lot of attention at the beginning of the year, and any time they get materially revised. Consensus targets for the S&P 500 tend to follow prices, not the other way around.

Using just the past couple of years as an example, you can see that forecasters were eager to hike estimates as markets moved higher off the Covid lows. At the beginning of each year, the estimate was moved higher to provide a larger cushion. Whether the targets are generated by estimating forward EPS and applying an average multiple to it, or simply by taking a year-end value and increasing it by 5-10%, these targets have poor accuracy and should carry little weight when constructing a portfolio.

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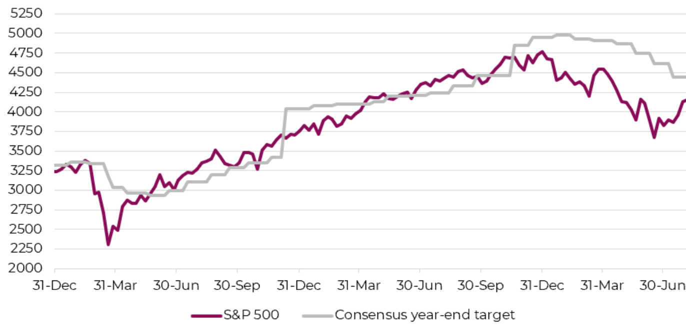
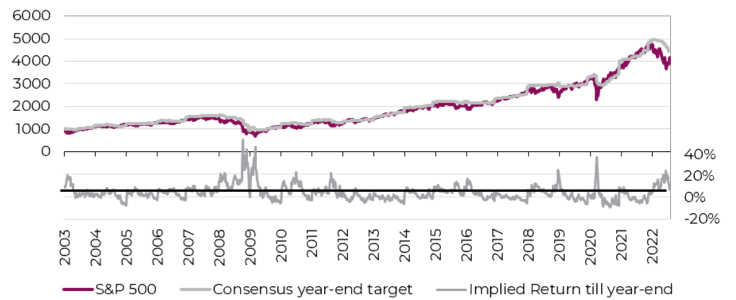
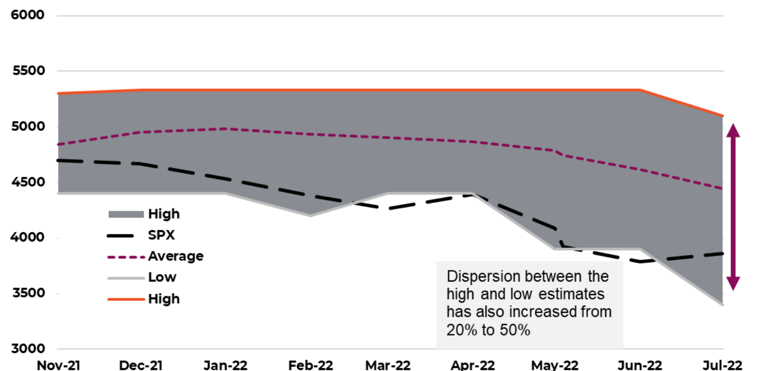




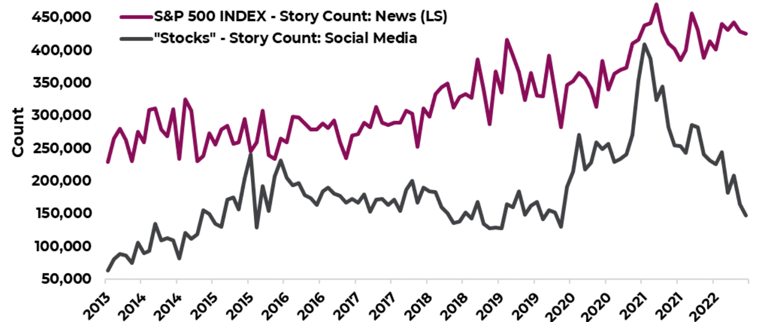
The implied return on the year-end forecast to current prices recently peaked at 26% – an attractive entry point based on the past 20 years. For all the folly of forecasters, an expected forward return like that can seem tempting to even the most sophisticated investor. Remember though, **forecasts tend to follow price and not the other way around**.

At the beginning of the year, the difference between the high and low-end S&P 500 year-end target was 20%. As volatility surged and markets plummeted, the bears have become significantly more bearish, but it wasn't until July that the most bullish strategist lowered their target. The dispersion has widened significantly over the year, with a staggering 50% gap. This introduces a significant amount of noise into the street's consensus, which can make it more difficult for investors to determine the potential path ahead.



Information overload

We live in the information age: a bombardment of news, forecasts, and opinions can impact how we make decisions. All too often we hear of exploding inboxes and an inability to simply stay on top of the news.



The flow of information continues to grow. Consider the chart below, which simply plots the daily news stories mentioning the S&P 500 on Bloomberg. Though a little erratic, the trend is clearly up and to the right. Social media also increasingly dominates our time spent consuming information. The social media story count for "stocks" hit its peak during the meme stock bubble in early 2021 and has since fallen, but interest will probably rebound again during the next mania. The increasing amount of news makes it even harder for investors to find high-quality opinions backed by solid analysis.

Echo chambers

Confirmation bias causes investors to seek out and evaluate information in a way that fits with their current beliefs and preconceptions. Essentially, it's human tendency to pay more attention to information that supports your view and discount information and evidence that is contrary.

As a media example, Fox News caters to right-wing-oriented viewers with content that confirms their views. Likewise, the far left tends to gravitate to news sources that reinforce their views. Absorbing multiple sources of media – those that agree with preconceptions and those that offer contrary views – provides a better holistic understanding.

Confirmation bias can narrow an investor's focus and cause us to miss a big risk or change in direction. It can also embolden investors to take on more concentration risk in an asset class, sector, or position.

So, how can you defend yourself against confirmation bias? Force yourself to consider why an investment or strategy may not work out (prospective hindsight). Think: what could go wrong with an investment? This makes you more open to seeing and considering contrary views and evidence.

Portfolio implications

Persuasive commentary about the markets is perhaps one of the biggest traps for even the smartest investor. As Warren Buffet once said, "You can't get rich with a weathervane." Put the work in and do quality research of your own. **Be wary of bold predictions and those claiming to know more about everything, seeing what no one else sees**. The best approach is to identify and blend knowledge from trusted experts together with your own research and thinking. While this approach may be more challenging, it is much more rewarding.

At Richardson Wealth, we would also stress the importance of continuous advice, tailored to your current portfolio. How often do you come across a useful piece of research recommending certain stocks or sectors? **Without continuous advice and monitoring, it is easy to hold for too long**. Create a solid plan to revisit and stay on top of current research and rely less on point-in-time recommendations.

Source: Charts are sourced to Bloomberg L.P., Purpose Investments Inc., and Richardson Wealth unless otherwise noted.

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*This report is authored by Derek Benedet, CMT a Portfolio Manager at Purpose Investments Inc. Effective September 1, 2021, Derek Benedet has transitioned to Purpose Investments Inc.

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