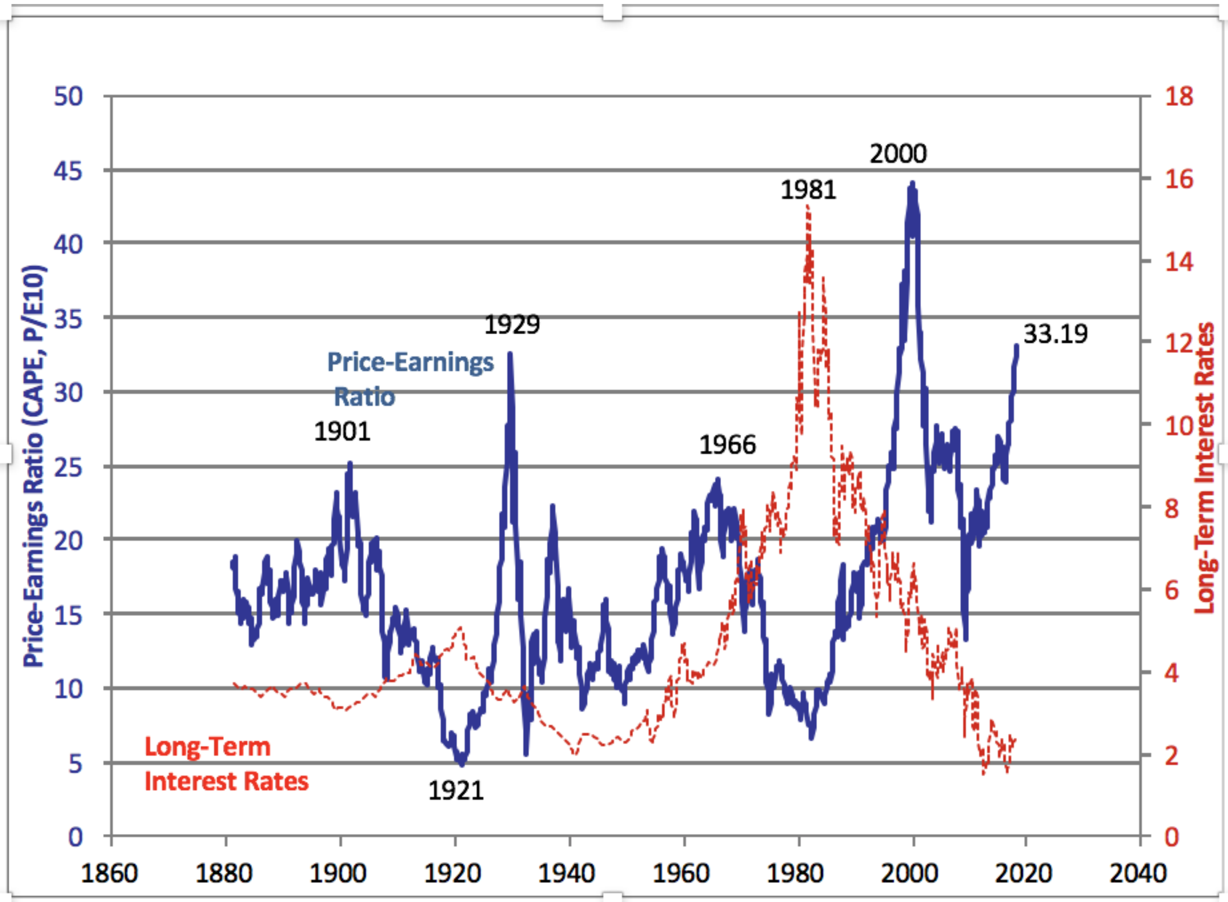
2017, Another Lesson in Investment Humility

Last year and the beginning of this year should remind us all to be humble when approaching the market. The experts were once again largely wrong in their predictions and have never been able to forecast the market with any consistency. Don't try to either time the market yourself (you can't…be humble) or listen to those that say they can. A good advisor should not only keep you on plan and stay the course during market swings but also keep tabs on your market anxiety and reduce your risk if it keeps you up at night. An honest advisor should also be aware of valuations and prepare you for potentially lower returns in the future.

Forecasting the annual direction of the market is virtually impossible no matter who you are. Nobel Prize winner Robert Shiller, lauded for having predicted the stock market collapse of 2001 and the housing bust of 2008, once again rang the bell warning of an overpriced stock market…for the 4th time! He first warning was in 2013 when his famous yardstick, the Cyclically Adjusted Price to Earnings (CAPE) ratio, was at 23, and again in 2014, 2015, and early 2017 at valuations of 25, 27 and 29 . It's now at 33.

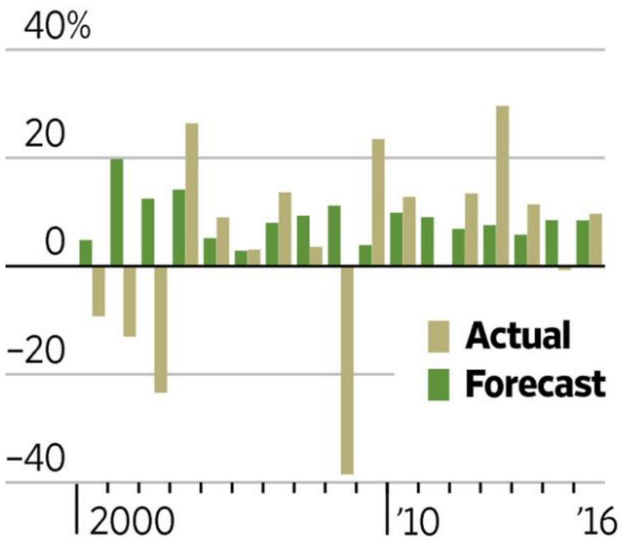


Wall Street banks are less apt to make bold predictions, but they too woefully under-predicted last year's stock market's performance with a median call of a 2.7% appreciation vs the actual near 20% appreciation. In fact, historically they simply extrapolate the last year's levels forward as this range of prediction from end of 2016 highlights shows. The S&P 500 closed the year at close to 2,700.

Forecasting Is Easy...Being Right Is Harder

The average Wall Street strategist forecast often bears little relationship to where stock prices go.

Annual S&P 500 gain forecast by average strategist against what actually happened*



S&P 500 forecast for end of 2017

J.P. Morgan	**2400**
Societe Generale	**2400**
Deutsche Bank†	**2350**
Citigroup	**2325**
Bank of America Merrill Lynch	**2300**
Credit Suisse	**2300**
Goldman Sachs	**2300**
Morgan Stanley	**2300**
UBS	**2300**
BNP Paribas	**2250**
Dec. 7 close	**2241.35**

*Based on average of strategists' forecasts at start of January for end of December
†Could be 2400 if corporate taxes are cut Sources: Bloomberg; Thomson Reuters; WSJ calculations; the companies

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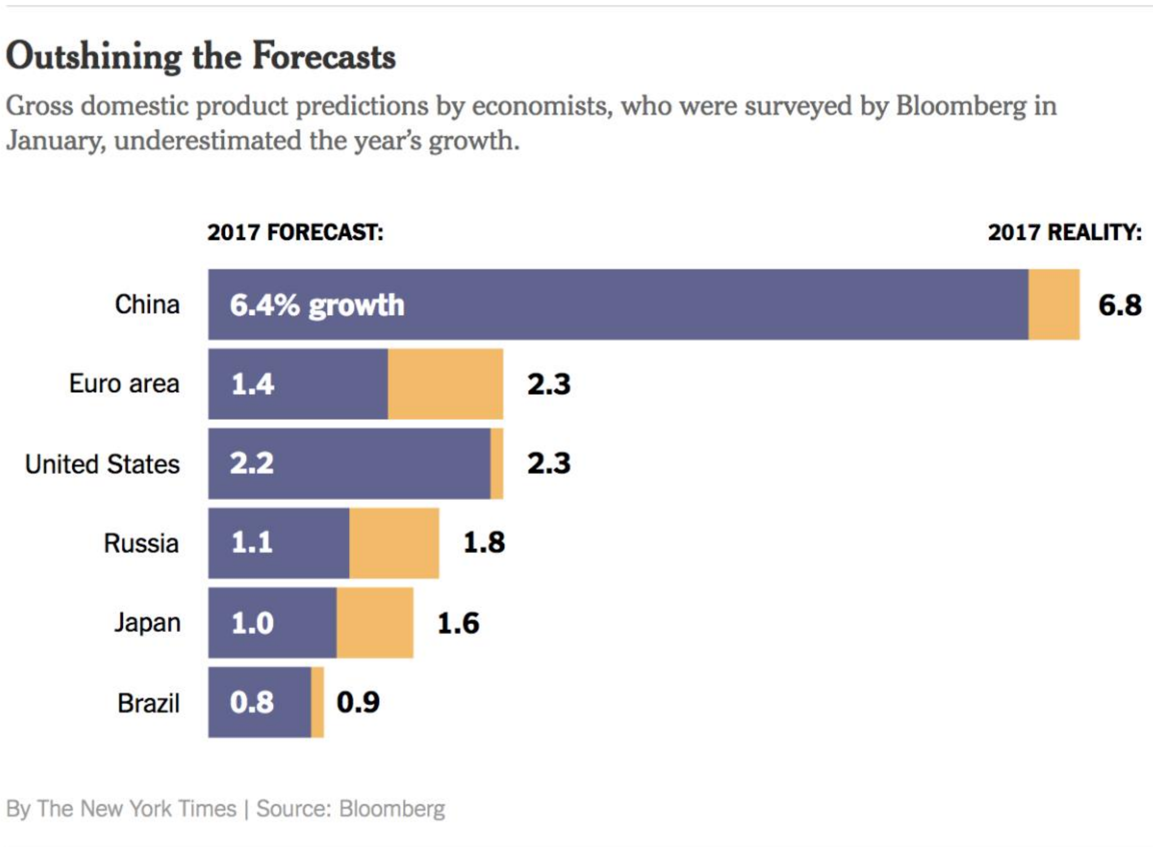
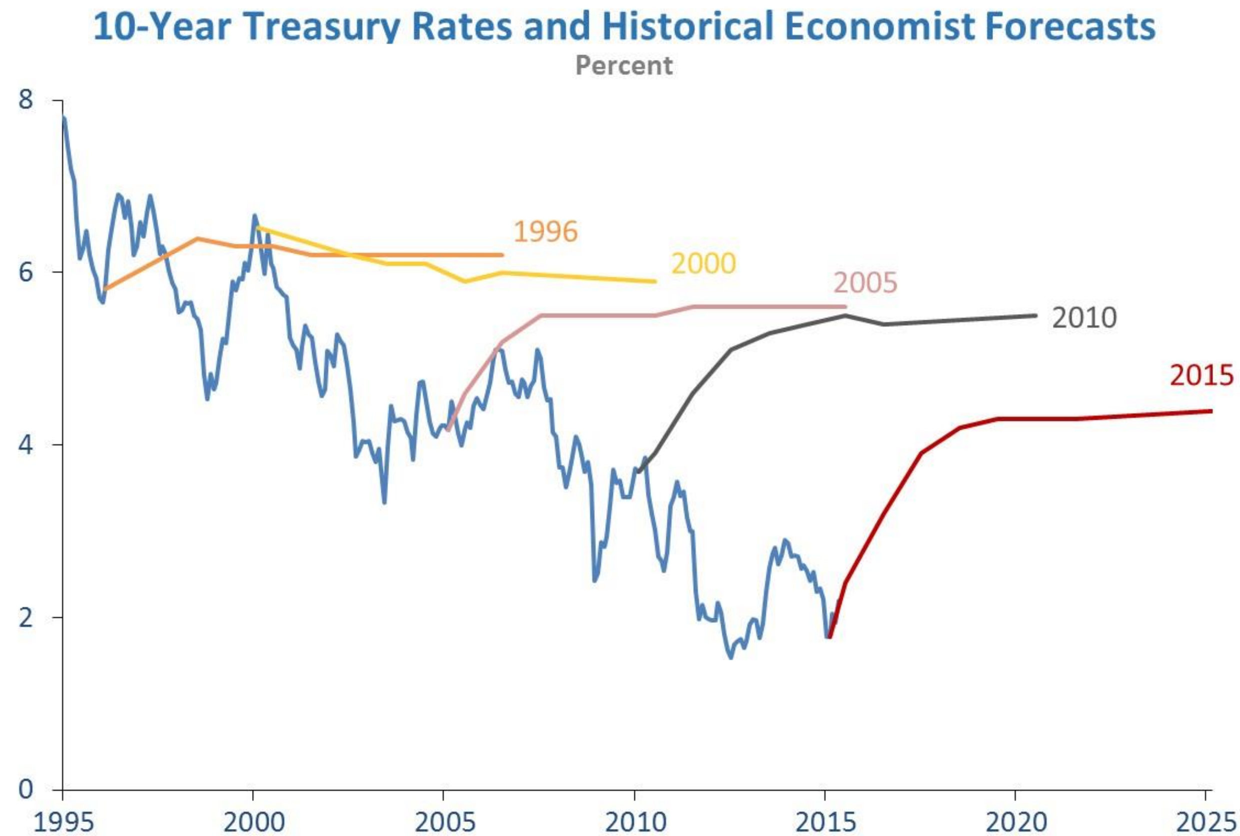
And Wall Street did no better predicting economic growth, failing to predict Europe and Japan's recent rebound from their respective slumps.



Their track-record of predicting interest rates based on reversion to a longer-term average is no better:

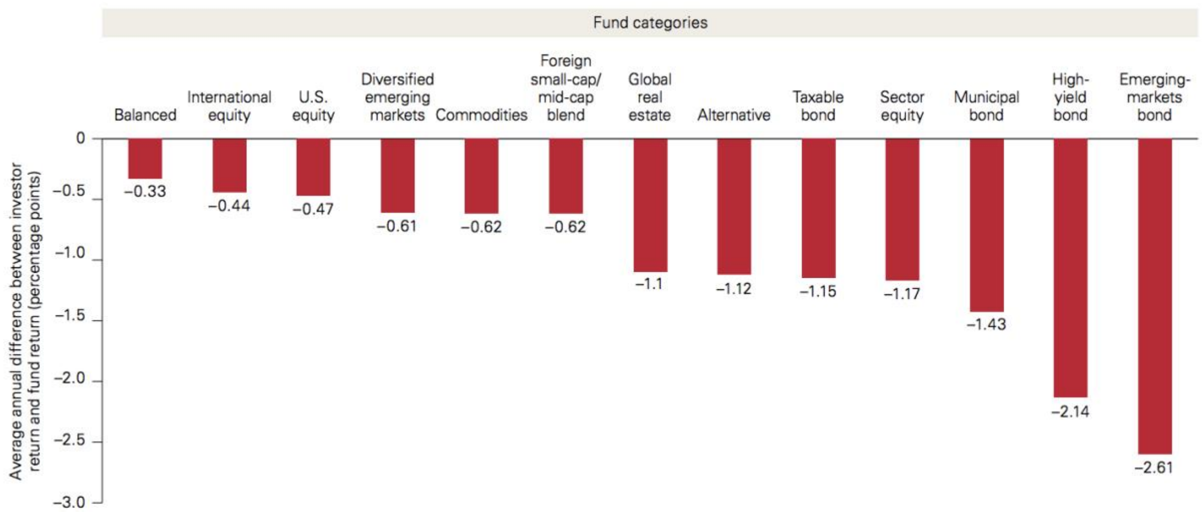


Note: Forecasts are those reported by Blue Chip Economic Indicators released in March of the given calendar year, the median of over 50 private-sector economists. Source: Blue Chip Economic Indicators, Aspen Publishers.

The point of this rant isn't to make fun of "experts". Instead, I hope to convince you that if "experts" can't time the market (let alone pick stocks with any measured consistency), then you shouldn't try either. [Vanguard](#) and [Morningstar](#), among others, have estimated that the costs to retail investors of trying to time the market are as high as 2.5% annually.

Figure 19. How investors' returns lagged their funds' returns, 2002–2016

When investors chase performance, they often get there late



Notes: The average difference is calculated based on Morningstar data for investor returns and fund returns. Morningstar Investor Return™ assumes that the change in a fund's total net assets during a given period is driven by both market returns and investor cash flow. To calculate investor return, the change in net assets is discounted by the fund's investment return to isolate the amount of the change driven by cash flow; then a proprietary model is used to calculate the rate of return that links the beginning net assets and the cash flow to the ending net assets.

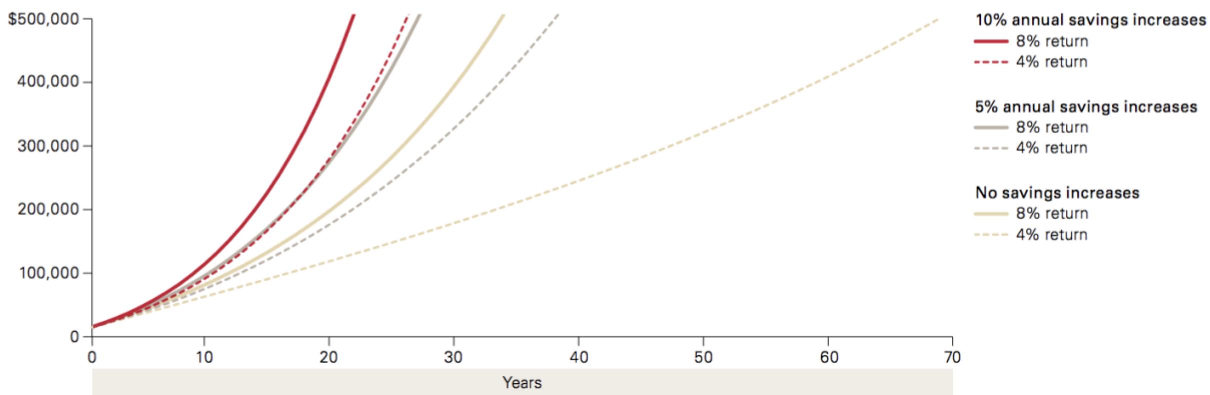
Sources: Vanguard and Morningstar, Inc. Data cover the period from January 1, 2002, through December 31, 2016.

Does this mean we should be blind to valuations? I'd argue no. In fact, I consider myself a value investor. For instance, without trying to predict interest rates, I detailed my view last year that investors weren't being compensated enough (more or less not at all!) for taking the inflation risk imbedded in long-term bonds. They still aren't. Likewise, we've historically invested in Closed-End Funds and more recently REITs backed by strong retail malls when they started to trade at significant discounts to the net asset they held.

Given current equity valuations, we are more cautious, but we are also staying the course. As I stated in my last letter, the right reaction for investors is to prepare for lower returns going forward. The only sure way of protecting your returns, as shown once again by Vanguard, is to save more.

Figure 20. Increasing the savings rate can dramatically improve results

Years needed to reach a target using different contribution rates and market returns



Notes: The portfolio balances shown are hypothetical and do not reflect any particular investment. There is no guarantee that investors will be able to achieve similar rates of return. The final account balances do not reflect any taxes or penalties that might be due upon distribution.

Source: Vanguard.

On sure way to save is pay less in taxes and management fees, our focus along with personal diversification. But perhaps our most valuable contribution to your success is helping you develop a plan appropriate for your risk tolerance and sticking to it.