'Tis the Season for 2020 Market Forecasts - Transcript

Tom Mullooly: Welcome back to the podcast. This is episode number 287 of the Mullooly Asset Management podcast. Your loyal co-hosts are here, Brendan Mullooly and Tom Mullooly. Brendan, hello.

Brendan M: Hey.

Tom Mullooly: So we're putting in the final episodes of 2019 here, putting a good rap on a pretty good year for podcasts and looking forward to episode 300 which will be early in 2020.

Brendan M: Yeah, pretty good.

Tom Mullooly: So let's kick off this week's episode. You want to talk about something we were both looking at?

Brendan M: Yeah.

Tom Mullooly: Before we turn the mics on?

Brendan M: Our friend Phil Huber did a good blog post just this morning and a lot of good charts in it and topics. And so Phil wrote this one because this time of year you get a lot of predictions in terms of price targets for the S&P 500 and predictions on the tenure yield. And usually, it's a one year thing. So we're going to do it this time of year at the end of 2019 and project, what's going to occur in 2020 as if anybody can actually do that.

Tom Mullooly: So the other thing is that he raised a good point. Like if you say you didn't like the market in 2019 that was your stand for the year. Like I said, someone was out there saying the market's going to go down or not be positive for 2019 and then they flip the calendar one page into January 1st of the next year. How can things suddenly change just because the calendar changed?

Brendan M: Right, like the market doesn't know that we've orbited the sun one full time now and we're entering another year. These are arbitrary things that we put on ourselves to measure periods of time. To your point, I mean I saw something just this morning and it was Stanley Druckenmiller who a year ago was very negative on the market and railing against the fed. To his credit today, still railing against the fed, because he always probably will, but admitted that a year ago he was absolutely, totally wrong and he's had to adapt over the course of the year. So predictions over a one year time frame are really hard because Stanley Druckenmiller is by all accounts one of the best investors of this generation, I would think most would agree with that. So really tough to do. Nonetheless, we get these research pieces from every investment bank and mutual fund shop out there on earth and we laugh at them.

So instead of laughing at them, Phil put together this piece and he said let's think about some trends over the next decade as opposed to one year. Because it's easier to predict things when you've got a longer runway, a bigger picture topics. And there were a handful of really good charts and some insights from Phil here, but one in particular that caught my eye and this again maybe going back to the futility of one year, predictions, looked at analyst predictions from a year ago in December. The analysts were trying to predict where they felt the tenure treasury yield was going to end this year. And I don't know if you want to generally describe this chart, we'll, link to this so you can check out the visual, but man.

Tom Mullooly: Yeah, you don't even need the actual numbers down the side of the graph to see it, because all the lines are above it. I mean they basically started at where the tenure yield was a year ago and started a straight line. Virtually everybody had said interest rates were going to be skewing higher and some much higher.

Brendan M: So let's rewind the clock about a year ago, I think we had just got, not not far off the mark, we had just got our third rate hike of the calendar year and the tenure at that point was around, it looks like 2.6 maybe 2.7%. And let's also remember at the beginning of December, a year ago, chairman of the fed came out and said, we are nowhere near neutral, I envision several more rate hikes in 2019. Was going to add the same thing because we recently heard from the very same man who says that they don't really see themselves doing anything next year. So I would take that and throw it out the window too, because who knows? They have to adapt to new data as it comes out and they're going to do what they have to do, but we demand these predictions. I'm not here knocking on Jay Powell, that's a really hard job to do is to stand up at the podium and answer these ridiculous questions where people expect him to predict the future.

Unfortunately, you get backed into a corner and you have to say something and then you say something and it ends up being the opposite of what you do. He probably would've said, we're probably going to continue the hiking cycle. If we were 12 months ago right now, and it's exactly what he did, so why didn't that happen? Well, things changed.

Tom Mullooly: It's so funny when-

Brendan M: Stop talking ahead on that stuff. Yeah, you can't.

Tom Mullooly: When you're talking about the fed in particular and interest rates, the press bashed Janet Yellen, because she always used the term data dependent. The direction of rates is data dependent. We have to wait and see what the numbers are going to give us before we can determine what to do. The hilarious thing is if you look at the comments from her predecessor, Ben Bernanke, there's that phrase again, data dependent. Then you go back to Greenspan, data dependent. You go back for the last five fed chairman, they all use the same phrase, data dependent.

Brendan M: So I think that the problem is that we all want answers. Nobody wants them, because basically what data dependent means to me is we don't know. We'll get back to you, when we do now.

Tom Mullooly: It depends.

Brendan M: When the future becomes the present, we'll tell you what we want to do, which is a non-answer and people hate non-answers. They want the certain answer which says, hey, we're going to meet in March and we're going to hike then because of this, that and the other thing. I'm sorry that doesn't, that's not how the world works.

Tom Mullooly: The addendum to that is you will then hear people say the fed is always behind the curve, meaning-

Brendan M: How could they possibly be anything but behind the curve?

Tom Mullooly: They have to be behind the curve because they're data dependent. They have to wait for the numbers to come out, exactly right. They completely whiffed this year.

Brendan M: I mean not even close. Where's the tenure, meaning back to the analyst here protecting the tenure. Yeah, I was going to say before with is the one word description of this chart? I mean the tenure yield is hovering down around 2 % now. And a lot of these predictions headed up North of 3%. I mean, I know a also about a year ago, that's what a Jeff Gundlach was saying, one of the smartest bond managers out there.

Tom Mullooly: Wrong again. Right.

Brendan M: And again, I would never sit here and say that Jeff Gundlach is not a smart guy. Think anybody who's heard him speak and looked at the performance of his DoubleLine funds over the years would say, this guy knows what he's talking about. This is just a really hard game to play and you don't have to play it. That's, I think the important thing for a lot of people to take away from this is, you don't have to have a view on where the tenure going to end 2020 to invest your portfolio in a sensible way.

Tom Mullooly: So let's talk about being sensible. When interest rates go up, like most bond analysts predicted 12 months ago, when rates are going up, what happens to bond prices or bond values?

Brendan M: They go down.

Tom Mullooly: Right, what happened this year with bonds?

Brendan M: The opposite of that.

Tom Mullooly: Right.

Brendan M: I also would say that through three hikes in 2018 the carnage or lack thereof-

Tom Mullooly: You're being sarcastic.

Brendan M: Yeah.

Tom Mullooly: There wasn't any.

Brendan M: There wasn't carnage in bonds in 2018 and we have three rate hikes, meaning that you don't need to, you don't even need to have a directional view on what rates will do over the next 12 months. Because the amount of money that you have between stocks and bonds should be determined by something completely different than anyone's 12 month outlook on the direction of interest rates. Anybody who thinks they can predict that is out of their mind.

Tom Mullooly: Kind of felt like I was wandering off the reservation with that leading question, but thanks for bringing it all home because that's right. That's really what your bond allocation should come from, stem from is how does this fit into your picture? Everyone's picture is different, right? All right. What else was in Phil's post? They always say picture is worth a thousand words. This graph is going to be worth a million words.

Brendan M: Yeah. And there's a couple more charts that I want to talk about. We can give you the details and certainly discuss here, we'll link directly to Phil's post and you can scroll through this. And Phil is a advisor out in the Chicago area, CFA, CFP. I respect him a lot. Super smart guy.

Tom Mullooly: One of the champions of Twitter, for sure.

Brendan M: I would check out his commentary too because I largely agree with what he had to say too. But another one that Phil outlined here, and again this is over the 2020s let's call it. He posited that politics will matter much less to your portfolio than you think they will. Seems unbelievable at this point in time with the news cycle the way things are.

But markets are going up and down based on every tweet that's out there. Seems like it. And I know everyone's going to get riled up over elections next year too, but Phil shared some numbers here and these were courtesy of, I think BlackRock and Morningstar had put together this stuff. But in election years, the numbers for stocks and bonds in terms of their annualized returns in years where a new president is elected versus all election years versus when the incumbent president wins. The story here is that they're positive across the board.

Slightly different in some of these scenarios, but I don't really think that there's anything on average to show here that the outcome of an election should have you making binary decisions about whether to be in or out.

Tom Mullooly: But Brendan, a couple of clients have told us that if Trump doesn't get reelected, this stock market's going to zero.

Brendan M: Right. We had very same message four years ago when people said that if he did win, the stock market was going to go to zero and people were wrong then. And I would imagine that most of the hot takes coming out over the next eight, nine, 10 months here as we ramp up for the 2020 election will look very stupid in hindsight too. It's really impossible to predict how the world is going to react to that and let alone the initial reaction after an election doesn't always have to be what then turns into a longer term trend. Right. This time, meaning back in 2016 we saw a ramp up following the election and then a continuation of that trend in 2017. But four years before that in 2012 we saw the market drop initially and then go on a terrific run for 2013. 2013 is one of the only years in recent history that's better than this current year that we're experiencing right now.

That was a terrific year, so there's not a lot to discern there. I think it's more noise than signal when it comes down to it and a follow-up chart to that from Phil was just the annualized returns during every president's term going back to Hoover. One thing that that you pointed out that I thought was, was pretty wise is that these are four year blocks of time that we have mapped out here and-

Tom Mullooly: So let me just give the backdrop for the listeners. So what Phil did was he, I don't know if Phil did this or it came from-

Brendan M: It's from Dimensional.

Tom Mullooly: From Dimensional. So it shows that for each four year term, starting with Herbert Hoover going right through Trump, what have the returns been? It doesn't matter if you're red or blue, what have the returns been?

Brendan M: And I think the insightful thing that you added was that sure, we've had some different periods, higher and lower in terms of returns, but there are only three outside of the initial one. When, we had Hoover right at the beginning here entering the great depression. Aside from that, there are three periods of negative returns over four year blocks of time here.

Tom Mullooly: It's covering like 80 years.

Brendan M: Yeah, that's a lot of time, and so I think to just strip out like whether this person, specifically the president or their political party had an impact on what was happening with stocks or the business climate at the time. Your general point I think was that, if you give the stock market four years, your odds of earning some kind of positive average return on your money pretty good.

Tom Mullooly: Pretty good.

Brendan M: Not a guarantee for sure. Nobody would say that, but pretty fricking good. And if we're talking about two presidential terms, that's almost a decade and I can tell you the odds are above 90% if we're talking about historical. What has the S&P 500 done over periods of time when you stretch it that long?

Tom Mullooly: So who were the negatives?

Brendan M: The negatives were one of FDRs four year terms was negative because we entered the great depression and then it had like a second wind in the back half of the 30s. And it came, everyone thought it was over and then it came back. So you got that one that was 37 to 40, bad stretch there. Annualized like negative looks like not quite 10% but pretty bad over a four year stretch. And then the other two were a debut, back to back in the early 2000s and we know too that I believe this is, and it's looking at the S&P 500 and 2000 to 2009 was a lost decade for large cap US stocks. There were other places, hopefully you were diversified, if you had small caps value stocks did well over that period.

Tom Mullooly: International stocks killed it.

Brendan M: International stocks were great. So a lost decade for that specific slice of the pie, hopefully from your portfolio.

Tom Mullooly: It's interesting to note just because Bush, George W. Bush, it's more recent. I wasn't around when Herbert Hoover was, but even though I feel that way sometimes. The first term really produced like a, his first term produced a zero for the first four years and that would be 2000 to 2004.

Brendan M: And that had, but it, you know what I mean? Like it didn't have anything to do with him specifically. He caught the tail end of the internet bubble.

Tom Mullooly: Did he create the internet bubble?

Brendan M: No, he didn't. He definitely didn't.

Tom Mullooly: Come on.

Brendan M: So he was getting edumacated. The beginning of 2000 right as he was inaugurated was the top of the NASDAQ market at 5,000 and I mean the internet bubble completely popped in 2000 then we had 9/11 in 2001. We had a pretty tough recession in 2002 so I'm not making excuses, but this is kind of how these things snowball. And then 2000 his second term, 2005, 2006 and even the first two thirds of 2007 were actually really good but wiped out in summer of 2008. This largely comes down to just timing and when you step into the shoes and where we're at in an economic cycle, that tells the story. So to point at stock market returns and say that the good ones are yours and the bad ones are not yours, that's total nonsense.

Tom Mullooly: When the red parties in things are good or when the Democrats get in, things are good. It honestly-

Brendan M: Whoever's telling you, regardless of what party they're from, that narrative works, fake news. Yeah, that's totally bunk and I don't put any faith in it at all.

Tom Mullooly: Before we leave that, it's unscientific when I look at the graph, but at the bottom of it, they had the numbers for Hoover and Roosevelt. And I mentioned to you at first glance, I'm like, Hoover and Roosevelt, if you look at those two lines, they almost cancel each other out.

Brendan M: Yeah, that was a really long stretch of time where if you look at something like the Dow Jones, there was not progress. There was tons of volatility and maybe, maybe there were stretches where you made money during that-

Tom Mullooly: You're talking about 17 years.

Brendan M: You need to go from the great depression through world war II fully to experience positive returns. So as we noted before, no promises over longer stretches of time, but that was a particularly rough one. Last one from Phil's piece that I wanted to bring up was the chart that he linked from research affiliates talking about the top dogs and how they're constantly changing over time.

Tom Mullooly: This is great because he showed the decade of the top names, the top 10 names in terms of capital, in terms of size, market cap in the 80s, 90s, 2000s and now the current decade. And this covers my entire career span.

Brendan M: Yes. So the 10 biggest companies in the world at the beginning of each of these decades.

Tom Mullooly: Just do me a favor, just read the list from the 80s.

Brendan M: All right, so in the 80s we've got IBM, AT&T, Exxon Mobil, Standard Oil, Schlumberger, Shell, Mobile, Atlantic Richfield, GE and Eastman Kodak. Out of the top 10, six were oil companies. So the world has changed a lot since then. The overarching theme of these list is, while it seems at the time, and we'll read the one from this year just to drive home this point, it seems that at the time, like in 1980 those names were the biggest and best companies out there. And probably nobody would have told you not to put your money into them but-

Tom Mullooly: Can't go wrong.

Brendan M: Yeah. Right. So, but if you made a specific bet-

Tom Mullooly: Brendan, Kodak's not going anywhere.

Brendan M: That one's particularly easy to dunk on in hindsight here, but they all seemed really great at the time. It's not necessarily that all of them are gone. They're not all gone, but a lot of them have merged or they are literally gone like bankrupt, like Eastman Kodak, just their business is obsolete now.

Tom Mullooly: I think those six oil companies are now, they're all like one company. They're all, I think they're two. But yeah.

Brendan M: Point being that like these companies either disappear or they just go on from that point forward to vastly underperform what you could do by just being more diversified. So while it may seem like a slam dunk to own the biggest and brightest names individually, the stat here is that typically only two of the top 10 remain 10 years later.

Tom Mullooly: How would you like to be wrong?

Brendan M: That's a bad bet.

Tom Mullooly: It is.

Brendan M: So let's just read off the names of today, because I think this drives home because I look at this list and I'm like, yeah, those are the best companies out there, but it just speaks to the need for diversification. As of today ff we're going to make this list, it would be Microsoft, Apple, Amazon, Alphabet, Berkshire Hathaway, Facebook, 10 cent, Alibaba, Johnson and Johnson, JP Morgan. The fact that Johnson and Johnson is still on that list makes even a guy like me underestimate how gigantic they really are. I mean, we look and we see their earnings from quarter to quarter and we're like, oh, that's terrible. But you know, a company like Johnson and Johnson to grow 10%, yeah. All the different businesses they've rolled up over the years and brought under their umbrella. Again, I don't have any specific views on which are going to be the two of these 10 that are still on this list come 10 years from now.

There's no guarantee that any of them disappear, but if we're going to use history as any guide, I wouldn't be looking to make concentrated bets on any of these companies today. Because the world changes and the leaders will not remain the leaders forever. Nobody stays on top forever. I mean if you think about the list from the 80s the two, I'm using air quotes now. The two technology companies on there where IBM, which was still doing hardware at the time. They hadn't even started the personal computer in 1980 so they were still doing mainframes hardware and AT&T. Which looks nothing like it did 40 years ago and they had to divest all of their baby bell spinoffs, that happened in '84. Then we had all of these other Bell Labs, Lucent Technologies, all of these companies, Avaya, remember Avaya? And all of these things got spun off and then put back together again. It's insane.

So you look at these technology companies that are now at the top of the current list and you say Facebook is now under the microscope for the FTC. They're looking at, maybe there are monopoly. There are people out there, Scott Galloway from the professor from NYU says that they should break up Amazon. They should break up all of these technology companies. What are they going to look like? We don't know. I mean, Microsoft has been pretty constant on this list for most of these decades, but there was a period of time from, I think it was 1997 through 2005 or 2006 almost 10 years, where they were under antitrust examination from the FTC. Their stock went nowhere. 10 year period now, now great. So hard to tell.

Tom Mullooly: So we have to make room on our prize shelf and put room for Phil Huber up there. Thank you for contributing as a source now for our podcast, and hopefully we'll have him on some day as a guest. Has he been on Tim's podcast?

Brendan M: No, his colleague Maureen, was a guest and-

Tom Mullooly: It was not just that long ago.

Brendan M: Yeah, I know Tim would like to get Phil on there, so we'll have to talk to him sometime soon.

Tom Mullooly: All right. Thanks again for tuning into episode 287 and we will catch up with you on the next episode.