OUTSIDE THE FLAGS

Tomorrow's News, Tomorrow's Markets

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It's that time of the year again. With the long summer looming, economists and other market forecasters are peering into the crystal ball to project what might happen in 2022. This is a tough ask. Just *how* tough can be seen when you look back at what they predicted a year ago.

To be fair, many forecasters were left a little shy of making big calls after the pandemic came along in March 2020. Global equity markets sank 30-40% in the space of a few weeks and then promptly rebounded to reach record highs just six months later. How do you forecast that?

By the end of last year, some analysts were saying the market had gotten ahead of itself, though the consensus view was for firming growth and rising asset prices on the back of fiscal and monetary stimulus, and increasing vaccination rates.[1]

But once you dig down into the details of Bloomberg's survey of more than 500 professional forecasters in the US market, you can really find whatever story suits your view of the world.

For instance, one panellist predicted healthcare stocks would be among the top performers in 2021. As it turned out, they were one of the worst, while 2020's worst performing sector, energy, came out near the top. Another panellist picked Chinese stocks to be among the leaders. But China struggled all year amid a government crackdown on multiple industries. A third thought that US equities would underperform the rest of the world. By early December, the S&P500 was up more than 20% or at about twice the rate of the Australian and UK markets.

On bonds, a common view was that central banks would successfully keep the yield curve anchored and that inflation, while creeping up, would stay contained. In the words of one large bank - "we expect few inflationary threats in 2021 and expect interest rates to remain low for the foreseeable future". As we now know, US inflation jumped to its highest rate in 30 years and central banks accelerated their policy tapering.

In Australia, the forecasts were also patchy. Each January, the academic website *The Conversation* assembles a panel of esteemed economists to project economic and market variables for the coming year. The 21-member panel this year included former Treasury, OECD, and Reserve Bank economists alongside financial market and academic experts.[2]

This year, the panel was more upbeat than usual, but even so not upbeat enough. For instance, we were told by the forecasters that Australia's unemployment rate would likely remain stuck near 6.6% throughout 2021. As it turned out, the jobless rate hit a 13-year low of 4.5% by mid-year, before creeping up above 5% as lockdowns were imposed again.[3]

On house price growth, the forecasters fell *way* short. The panel on average picked a 4.9% increase in Sydney prices and a 4.4% gain in Melbourne. By the middle of the year, however, prices in Sydney were already 19.3% higher over 12 months and Melbourne was up 15.0%.[4]

On inflation, the average forecast for the CPI was a rise of 1.6% in the year to December. By the third quarter, however, Australia's inflation rate had hit a six-year high of 3.0%, above the single highest individual forecast of 2.7% and well above the lowest of 1.0%.

On interest rates, the panel correctly predicted (having been told by the RBA) that cash rates would not shift in 2021. But they over-cooked their currency forecasts – predicting the AUD would end the year around 76.5 US cents. It was just above 70 cents by early December.

For the local share market, the average forecast of the experts for the S&P/ASX 200 index was a modest rise of 3.5% in 2021. By early December, the gain was nearly three times that. For 10-year Australian Government bonds, the view was the yield would end the year around 1.1%. Nearly 12 months later, it was around 1.6% and the Reserve Bank of Australia, under market pressure, had abandoned its yield curve targets.

To sum up, the nation's top economists way undershot their 2021 forecasts for shares, bond yields, unemployment, inflation and house prices, while overshooting their forecasts for the currency. (This is not something you would want to put any money on.)

To be fair to the experts, as well qualified as they are, it's an extremely tough business making forecasts like this. So many things can throw your assumptions out of whack – a pandemic, a breakdown in supply chains, a trade war, an inflation breakout.

But that really is the point of this exercise and it's one worth keeping in mind as you are confronted by "lookaheads" in the financial media about what to expect for 2022. At time of writing, there are any number of themes to fret over, including central bank tapering, inflation, Chinese growth, the US debt ceiling, and the ongoing uncertainties over COVID-19.

This is not intended to downplay the real impact of any of those important issues, by the way, but it does serve as a reminder that markets price news instantly. Unless you can forecast tomorrow's news, it's unlikely you'll have any success in forecasting tomorrow's markets.

Think of it this way: While not as eventful as 2020, the past year has still been full of major news events – the attack on the US Capitol, the resurgence in inflation, the IPCC report and the COP26 summit on climate change, China's property strains, and the Delta and

Omicron variants, to name just a few. Yet equity markets have still delivered solid returns.

The fact is we don't know what 2022 holds in store. We *do* know that as an investor, your most reliable tools are diversification, discipline and a financial advisor who knows you, your family and your aspirations, understands what you can live with and builds you a portfolio to maximise the chances of you reaching your goals.

Forecasts will come and forecasts will go. But those truths don't change.

1. 'Here's (Almost) Everything Wall Street Expects in 2021', *Bloomberg News*, 4 Jan 2021
2. '2021 Economic Survey Points to Brighter Times Ahead', *The Conversation*, 31 Jan 2021
3. 'Unemployment Falls Again', *ABC News*, 16 Sept 2021
4. 'Residential Property Price Indexes', *Australian Bureau of Statistics*, Sept 14 2021