January 13, 2012

“It was a year that made the smart money look dumb.”
-WALL STREET JOURNAL REPORTER, JONATHAN CHENG

Special message: On Thursday evening, January 26th, we will be hosting the annual Evergreen Capital forecast event. It will be held at the Hyatt Regency Hotel in Bellevue, 10500 NE 8th (the northeast corner of Bellevue Way and NE 8th). There will be signs to follow. Wine and appetizers will be served starting at 5:45 p.m. Please RSVP to Tiffany Southworth at 425-467-4604 or email her at tsouthworth@evergreengavekal.com. Attendance has been rising each year so please respond ASAP. Space is likely to be limited.

Humility Check. Yes, it’s that time again when those of us who are foolish enough to issue forecasts, especially in public and in writing, have to “fess up.” Fortunately, even though most of my competition in this regard is of the expert variety, not many covered themselves in glory with their 2011 predictions. Consequently, my druthers would be to revert to that time-honored school days ploy, whenever a test was particularly taxing, of being graded on the curve.

Unfortunately, my readers are likely to strenuously disagree and hold me to a bit more straightforward standard such as: “Ok, wisenheimer, how did you do on a scale of 1 to 10?” Yikes, how I hate those kinds of direct queries, at least when I was somewhat accuracy-challenged!

For those who want the facts and nothing but the facts, the bottom line answer is 67.5%. Of course, in any normal grading system that would be a depressing D. But, as I’ve mentioned in the past and as any good forecaster knows (at least those who know what’s good for them)—getting 6 or 7 out of 10 predictions right is about all you can hope for, barring some unusual good luck such as I had back in 2009.

As usual, my predictions had multiple parts, so often a clear-cut hit or miss is difficult to determine. And, despite my middling score, I think my anticipation of the general scenario was fairly accurate. But now let me let you be the judge of that…

2011 Forecast Recap

1. Stocks

Prediction: Up 5% to 10%. Trouble in Europe, inflation challenges in the emerging markets, and some high-profile municipal credit problems, leading to an early sell-off followed by a late-year rally.

Reality: Almost a great call. The closely watched Dow came inside my range but, to be fair, the much broader S&P had a total return of just 2%. The problem areas were mostly right and the timing part turned out to be reasonable if not perfect; the market peaked in April, sold off hard after that, and then came back strong. **Score:** ¾

2. Bonds

Prediction: Robust returns from tax-free bonds, mid-single digits on corporate bonds, and flat to slightly down gains from Treasuries.

Reality: Great call, ditto, and a very big WHIFF!! Muni bonds did deliver a terrific return of 10.6%. This was outstanding, especially relative to nearly every other asset class known to man (and woman) save other high-grade bonds. Corporate debt produced 7.8% but, despite the US government's humiliating credit downgrade, the 10-year T-note returned a stunning 17%. Two out of three ain't bad, but I'm still giving myself only a partial. **Score:** ½

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4. Junk bonds and other higher risk investments

Prediction: Essentially, my call was that 2011 would be a year of living undangerously, at least if you wanted decent returns.

Reality: This might be a case where I deserve extra credit because I said junk bonds would struggle except for the highest quality segment and that turned out to be true, especially versus other fixed-income vehicles. Additionally, I felt commodities, extremely in-vogue at the dawn of the new year, would come under pressure, as would smaller, riskier stocks. Though both ran up early on, they were smashed in the summer and fall, leading to decidedly negative full-year returns. The only blemish with this call was that I should have been even more negative on emerging markets. **Score:** 1

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5. The Fed

Prediction: No rate hikes, QE2 halted early.

Reality: Another mixed outcome. Unlike many of my peers, I was right in expecting the Fed to leave rates at infinitesimal levels. However, I was wrong that it would halt its second round of quantitative easing ahead of schedule; instead, it continued to its counterproductive conclusion. Frankly, I underestimated Mr. Bernanke's stubbornness, but I do take solace in the fact that once it ended, and commodity prices crashed, US economic performance improved markedly. **Score:** ½

6. Inflation

Prediction: Up but gradually.

Reality: Despite some temporarily scary CPI headlines (caused by QE2), and the usual hysteria about inflation going bonkers that always elicits, at the end of the day (or year), inflation was largely a non-event. **Score:** 1

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7. Overseas markets

Prediction: The year of reckoning for Europe with plenty of spillover impact.

Reality: Despite a generally complacent attitude by the investment community about the alarming course of events in the eurozone, which persisted into much of 2011, this turned out to be the crisis that just kept on giving. As I suspected, it did morph into a banking debacle, requiring massive capital injections (with more to follow), triggering a serious sell-off in global markets. If I'd stopped there, this would be another ace but I went on to say that, even though I preferred US stocks (right), I thought emerging markets would be mixed (wrong). In fact, it was tough to find an emerging market that wasn't spanked but good. In basketball parlance, the long beloved BRIC countries (Brazil, Russia, India, and China) shot a very big brick. **Score:** 3/4

8. Currencies

Prediction: Down on the euro and the yen.

Reality: Even though the euro had already pulled back at year-end 2010, it did go on to be the worst performing major currency (and has further stumbled in early 2012). The yen, however, continued to appreciate. While I was off on that call, I prefer to think I was “prematurely correct.” Betting on a weaker yen, perhaps dramatically so, remains one of my favorite profit-making ideas for 2012. **Score:** 1/2

9. The Budget Deficit

Prediction: Budget restraint at state and local levels (helping muni bonds), increasing European austerity, and, eventually, a plausible federal deficit reduction plan.

Reality: The first two parts panned out, but even though federal spending is falling at the fastest rate since the war in Vietnam ended, I overestimated the chutzpah of US politicos to embrace comprehensive budgetary reforms. I felt that a movement toward bipartisan rationality, such as the Bowles-Simpson plan from the president’s own commission, would catalyze a powerful confidence surge but alas, thus far, no dice. **Score:** 1/2

10. Unemployment

Prediction: Expect hiring to pick up dramatically, led by strong corporate profits and improving confidence.

Reality: It took longer than I thought for this trend to accelerate, likely due to the deleterious impact of QE2, but as the year drew to a close the jobs market clearly had some momentum on its side. But I’m the first to concede it’s a most imperfect recovery with the quality of the job gains in question. On the plus side, given the drag from public sector layoffs, as well as those still impacted by deleveraging (such as housing and finance), the fact that we are now seeing solid employment growth is heartening. **Score:** ¾

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In next week’s EVA, I’ll go over what we see on tap for 2012. As in 2011, it’s likely to be a very strange brew. Now, here’s to seeing many of you on the 26th! The beer—and wine—will be flowing freely!!

David_Hay_Signature

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