PRATO CAPITAL

STOCK MARKET PREDICTIONS FOR THE NEW YEAR

JANUARY 2019

The start of each calendar year brings predictions of the future.

Over the last few weeks, investors have been bombarded with predictions about what the future, and specifically the new year, may hold for stock markets and their portfolios. These outlooks are usually accompanied by recommended investment strategies and actions that are aimed at trying to avoid the next crisis or missing out on the next great opportunity. When faced with recommendations of this sort, it would be wise to remember that investors are better served by sticking with a long-term plan rather than changing course in reaction to predictions and short-term calls.

PREDICTIONS AND HEADLINES

One doesn't typically see a forecast that says: "Capital markets are expected to continue to function normally," or "It's unclear how unknown future events will impact prices over the short-term." Predictions about future price movements come in all shapes and sizes, but most of them tempt the investor into playing a game of outguessing the market. Samples of recent business publications have included: "Why stocks could rise more than 10%," and "Our 10 favorite picks for the year ahead." And of course, to appeal to a different audience there are other publications and 'experts' predicting the collapse of the global economy and how to save yourself from this crisis. None of this is new. There are so many ways now to get their messages in front of investors with the 24-hour news and financial media outlets.

Bold predictions may pique our interest, but their usefulness for an investment plan is less clear. The 10 favorite picks selected last year to 'outperform' by a business publication have lagged the S&P 500 by about 4%.

Steve Forbes, the publisher of *Forbes Magazine*, once remarked, “You make more money selling advice than following it. It’s one of the things we count on in the magazine business—along with the short memory of our readers.”[1] Recommendations attempting to identify value not currently reflected in market prices may provide investors with a sense of confidence about the future, but how accurate are these predictions and do they have a place in an investment portfolio?

PORTFOLIOS

The financial media often spotlights professional money managers with their insight and market forecasts and which individual securities are over or under valued. The track record of these money managers attempting to profit from mispricing suggests that making frequent investment changes based on market calls may be more harmful than helpful.

Exhibit 1, shows how the mutual funds managed by some of these experts have fared over the longer term. Although there seems to be an endless number of equity funds to choose from, not all survive and even fewer are able to outperform their index benchmarks. The results below illustrate that the vast majority of professional money managers have underperformed over longer time horizons.

Exhibit 1

Few Equity Funds Have Survived and Outperformed

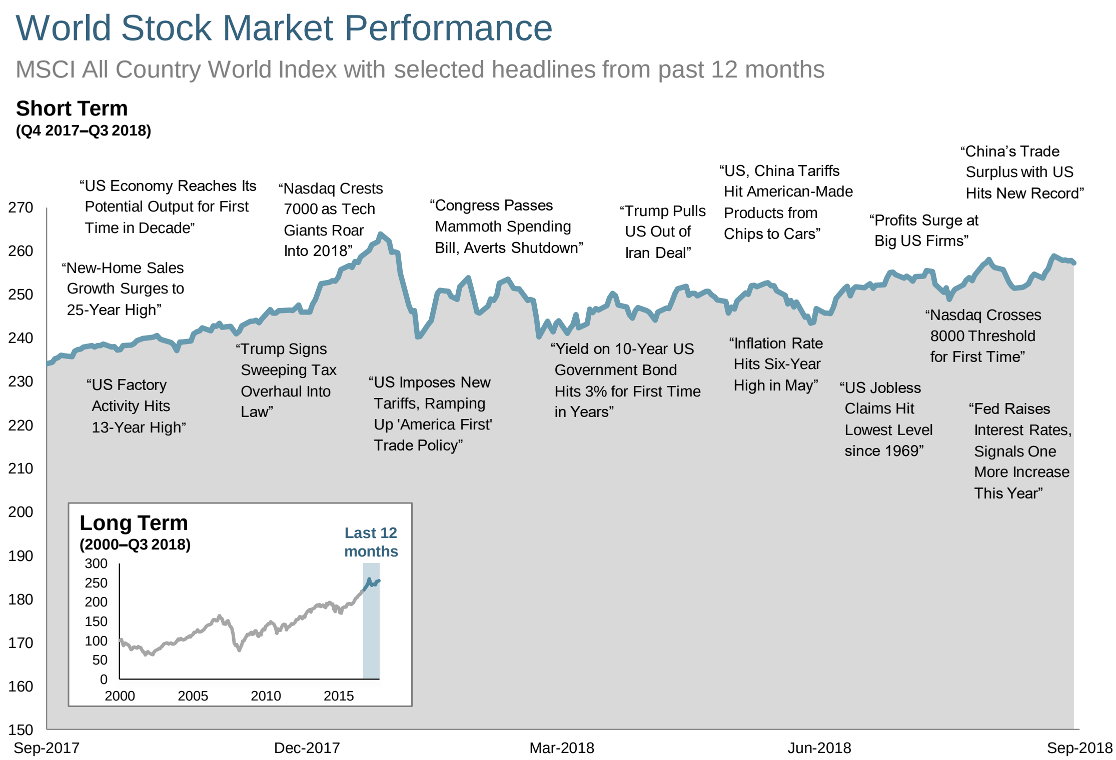
Performance periods ending December 31, 2017

The sample includes funds at the beginning of the 5-, 10-, and 15-year periods ending December 31, 2017. Survivors are funds that had returns for every month in the sample period. Winners are funds that survived and outperformed their respective Morningstar category index over the period. US-domiciled open-end mutual fund data is from Morningstar and Center for Research in Security Prices (CRSP) from the University of Chicago. Past performance is no guarantee of future results. See Data Appendix for more information.

1. Excerpt from presentation at the Anderson School of Management, University of California, Los Angeles, April 15, 2003.

Sometimes the predictions for the new year are based on today's news headlines and the impact they may have on the future direction of the stock markets. Exhibit 2 below shows news headlines for a 12-month period ending September 30, 2018 in relation to a broad global stock index. The smaller chart in Exhibit 2 shows the returns of same global stock index from 2000. Including the downturns of the stock markets in 2001 and 2008, this index is still up over 150%. It is important to put any news headlines or other short-term events into the context of your long-term financial plan.

Exhibit 2



These headlines are not offered to explain market returns. Instead, they serve as a reminder that investors should view daily events from a long-term perspective and avoid making investment decisions based solely on the news.
Graph Source: MSCI ACWI Index [net div.]. MSCI data © MSCI 2018, all rights reserved.
It is not possible to invest directly in an index. Performance does not reflect the expenses associated with management of an actual portfolio. **Past performance is not a guarantee of future results**.

Conclusion

Starting a new year, it is natural to reflect on what went well last year and what one may want to improve this year. Within the context of your financial life plan, it is important to remember that Prato Capital Management focuses on tuning out the noise and maintaining a broadly diversified portfolio based on your risk tolerance for the long-term. Making changes to a long-term investment strategy based on short-term noise and predictions will likely result in a disappointing outcome.

In the end, the only certain prediction about markets is that the future will remain full of uncertainty in the short term. History has shown us, however, that through this uncertainty, markets have rewarded long-term investors who are able to stay the course.

We are so thankful for the confidence and trust you show us throughout the year. This is something we will never take for granted.