Forecasts of 2021 Stock Market Performance Are Overly Optimistic

- Two basic underlying assumptions are uniformly optimistic.
- Threats to the economy and stock market are rarely discussed or reflected in forecasts.
- There's a widely held belief that the Federal Reserve will "fix" whatever goes wrong, but the Fed is creating an inflationary threat.

It's that time of year again when everyone is forecasting this new year's stock market performance. I believe investors are being Gaslighted more than usual this year because the basic underlying assumptions are optimistic and unlikely. As I show in this article, there are two basic assumptions being made in most forecasts:

1. Current Price/Earnings ratios will remain at their lofty levels throughout 2021
2. Earnings will grow by more than 8%.

Sample Forecasts

The following table summarizes typical return forecasts for 2021.

WALL STREET YEAR-END 2021 TARGETS FOR S&P 500

Strategist	Firm	S&P 500 Target	% Above 2020 Close
Dubravko Lakco-Bujas	JP Morgan	4400	17.14%
David Kostin	Goldman Sachs	4300	14.48%
Brian Belski	BMO Capital Markets	4200	11.82%
Keith Parker	UBS	4100	9.16%
Sam Stovall	Center for Financial Research and Analysis	4080	8.62%
Jonathan Golub	Credit Suisse	4050	7.83%
Julian Emanuel	BTIG	4000	6.49%
Barclay's Bank	Maneesh Deshpande	4000	6.49%
Binky Chada	Deutsche Bank	3950	5.16%
Mike Wilson	Morgan Stanley	3900	3.83%
Wells Fargo	Darrell Cronk	3900	3.83%
Savita Subramanian	BofA Merrill Lynch	3800	1.17%
Tobia Levkovich	Citi	3800	1.17%
as of 01/08/21	Median Target	4000	6.49%

Source: Lance Roberts 95-year Average: 10%

Wall Street **Optimism:** We Are Being **Gaslighted**

Gaslighting: The act of undermining another person's reality.
Targets of gaslighting are manipulated into turning against their cognition & their emotions

The average forecast for this sample is a 6.49% return, which is low by historical standards since the US stock market has returned 10% per year on average over the past 95 years. Most importantly, the narratives that accompany these forecasts are optimistic in seeing only the positives, namely:

- Vaccines will cure the pandemic
- Earnings will soar in an economic recovery
- The Federal Reserve will support stock and bond markets

There is little or no mention of the threats we face, as discussed below, so hence my Gaslighting assertion. Wall Street needs investors to stay invested.

The Arithmetic of Return Forecasting

As shown in the following picture, forecasters need to make assumptions about three outcomes in the future: dividends, earnings and end-of-year Price/Earnings ratio. The green highlighted section of the table locates current forecasts that are consistent with the assumptions that P/Es remain near 30 and earnings grow by 8% or more.

Components of Stock Returns

Earnings Growth

+ Dividends

+ Price/Earnings Expansion or Contraction: Investor Sentiment (Currently above 30)

Wall Street is forecasting no change in P/E and Earnings Growth above 8%. Market will lose 50% if P/E returns to normal (15).

	Earnings Growth								
End P/E	-4	-2	0	2	4	6	8	14	24
10	-69	-69	-68	-68	-67	-66	-66	-64	-61
15	-55	-54	-53	-52	-51	-50	-49	-47	-42
20	-40	-39	-38	-37	-35	-34	-33	-29	-23
25	-26	-24	-23	-21	-20	-18	-17	-12	-5
30	-11	-9	-8	-6	-4	-2	0	5	14
35	3	5	8	10	12	14	16	22	33

The table also shows a 50% loss if P/Es return to their historic average of 15. In other words, it's what could happen if the current bubble bursts. But a pandemic didn't burst the bubble, so what could? There are reasons the bubble exists, and dangers that could spoil the fun.

Bursting Bubbles

When COVID-19 was recognized as a pandemic in February 2020, the stock market plummeted 35%. Many said COVID was the match that lit the overvalued tinder, but the flame was extinguished quickly, and the bubble inflated more even though the economy suffered. The stock market disconnected from the economy, but this is probably temporary. COVID is only one of many threats to the economy and stock market.

We warned of 10 threats summarized in the following picture.

No one knows how or when these threats will explode, but it's unlikely that none will occur in this decade, a critical decade for baby boomers, as discussed in the next section. Two of these threats are especially dangerous: Per Capita World Debt Has Surged To More Than $200,000 and the US Stock Market Has Gone Crazy

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When the stock market fell in the first quarter a throng of articles advised investors to "stay the course" and that advice worked out this time despite the fact that it was not good advice for baby boomers.

The Baby Boomer Conundrum

There has never before been 78 million Americans worth $50 trillion all simultaneously in the Risk Zone spanning the ten tears before and after retirement during which lifestyles could be devastated by investment losses. At this stage in their lives, the number one investment objective of baby boomers should be to protect their lifetime savings, but the average boomer is invested 60/40 stocks/bonds, which is too risky; it's a mix that lost more than 35% in 2008. In other words, baby boomers are on the wrong course, so advice to stay the course is plain wrong.

The conundrum in moving to safety is two-fold: safe assets pay no interest, and, even worse, current money printing could radically reduce the purchasing power of money by bringing serious inflation. Consequently, baby boomers should consider protecting themselves with the following inflation hedges:

- Precious metals, especially gold
- Other currencies, especially cryptocurrencies
- Treasury Inflation-Protected Securities: TIPS
- Commodities
- Certain real estate, like farmland

Staying the course could work out for younger investors with long time horizons because recoveries are likely, but some recoveries, like the Great Depression, take a decade to materialize.

Conclusion

Most stock market forecasters choose to ignore the threats that are facing the US economy and stock market, but investors should not allow themselves to be Gaslighted. Younger investors will probably come through the next crash unscathed, but baby boomers cannot be that cavalier because they could find themselves "living under the bridge eating cat food."

Please see **How to Minimize the Impact of Inflation, Recessions, and Stock Market Crashes** for some thoughts on protecting yourself. Also, Peak Prosperity is a good source of economic analysis that says it like it is.