Irish Jokes Aside… This Stock Market Is No Laughing Matter

Retrieved Friday 17th of March 2017 07:41:33 PM

Markets were calm overnight.

The Dutch election went to the incumbent People’s Party for Freedom and Democracy.

Investor nerves have been steadied.

In Europe, it’s a case of ‘one down, two to go’.

France and Germany go to the polls in the coming months.

Anti-establishment parties in both countries represent a threat to the EU status-quo.

An uneasy calm will prevail until the outcomes of these major elections are known.

While we’re on the subject of Europe, today belongs to Ireland.

St Patrick’s Day is a worldwide celebration of all things Irish.

My research into this day, when beer turns green and Guinness is consumed by the gallon, uncovered this gem from the St Patrick’s

‘*St. Patrick, the patron saint of Ireland, is one of Christianity’s most widely known figures. But for all his celebrity, his life remains*

‘*The Irish culture ed around a rich tradition of oral legend and myth. When this is considered, it is no surprise that the story of Pa*

What the heck…never let the truth get in the way of a good story (and reason to enjoy a tipple).

No one does blarney better than the Irish…but the investment industry does give them a good run for their money.

A story in *The Australian* yesterday was a perfect example of ‘folklore over fact’.

The line read: ‘Sharemarket gloom is misplaced: Bulls can outpace these bears’.

The article tells us:

‘*Bullish sentiment among US individual investors recently hit a 30-year high, according to Investors Intelligence, and Conference*

The last time Investors Intelligence registered such optimism was back in 1987.

Remember what happen on 19 October of that year? Black Monday.

But let’s put that fact to one side.

The Aussie Recession Survival Guide: How to protect your wealth in a fast-shrinking economy

In this urgent investor report, *Daily Reckoning* editor Greg Canavan shows you why Australia is poised to fall into its first 'official' rec

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The Sharemarket is "Way Overpriced"

We are then told:

> '*A of an expected interest rate hike from the Federal Reserve today, Nobel Prize-winning economist Robert Shiller warned that t*

> '*Both economists are renowned for anticipating the end of two of the biggest bubbles of all time — dotcom and subprime — but*

Here are a couple of guys that anticipated the two previous Fed-sponsored bubbles — which both ended spectacularly badly — but we'll dismiss their naysaying this time because they missed the market run since 2009…

The fact is that this is only partially correct.

Robert Shiller (Noble Prize-winning economist and of Shiller PE 10 and Case-Shiller Index fame) did not miss the market.

This from a CNBC interview on 1 July 2015:

> '*Despite the high valuations, Shiller told CNBC's "Squawk Box" that he does have personal investments in U.S. stocks, but warn*

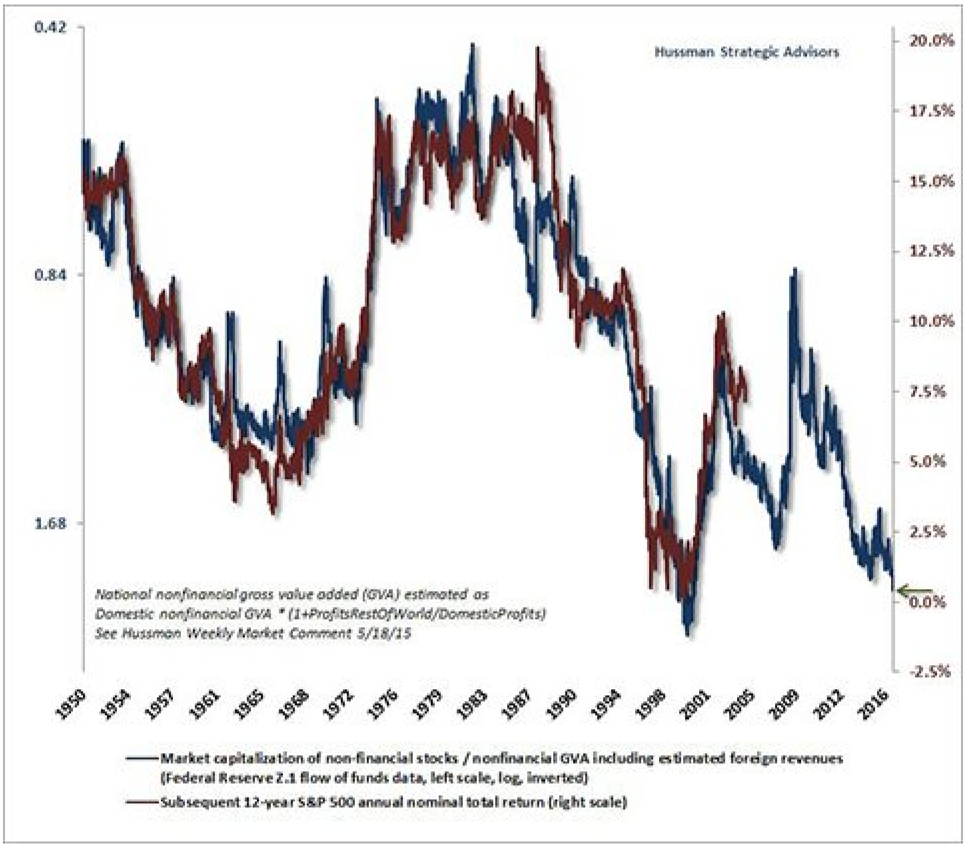
What Shiller said on 24 February 2017 when talking about the US market being way overpriced was: '*Long-term* [US] *investors ought to use the recent market rally to cut back on their equity holdings…*'

Taking profits by selling into a rising market…personally, I thought that was prudent advice.

It is true that John Hussman has missed most of the gains from the S%26P's meteoric rise since 2009. Hussman is a seriously smart guy, but he was caught completely off-guard after 2009. He did not expect the Fed to do what they did — zero-bound interest rates and trillions in newly-minted dollars. This was without precedent.

On an almost weekly basis, he acknowledges the fact that he misread the market after 2009 and has corrected his investment models accordingly.

Hussman produces the following chart that predicts the subsequent 12-year return (blue line) with an overlay of the actual 12-year return (red line).



Source: Hussman Strategic Advisors
[Click to enlarge]

For example, in 2005, the predictor was for a 12-year return (to 2017) of around 6% per annum. The actual return from 2005 to 2017 (red line) has been just below 7.5% per annum.

Since 1950, there has been a 93% correlation between the predicted 12-year outcome and the actual rate of return. Pretty impressive, in my book.

What does the model predict for the next 12 years?

Brace yourself for ZERO returns

If you look back at the previous time the blue line (the predictor) was around the zero mark, it was just before the dotcom bubble burst in 2000. What did investors actually receive from 2000 to 2012 (the red line)?

You guessed it…0% per annum.

The S%26P 500 index was 1500 points in March 2000; in March 2012, the index was around 1450 points.

When the Fed blew bubbles in the past, Hussman warned of the dangers a.

But, as always, when the party is in full swing, no one wants to hear that it's time to close the bar…especially on St Paddy's Day.

However, according to the press, there's no need to be alarmed. Other experts see the potential for a 'dip' or 'pullback', but higher markets await:

> '*Locally, AMP Capital's Shane Oliver has warned that shares are vulnerable to a "short-term pullback" because investor sentime*
>
> '*Similarly, Deutsche Bank's Tim Baker warned yesterday that shares were "vulnerable to a dip" because the S%26P 500 has go*
>
> '*However, Mr Oliver and Mr Baker still see sharemarkets trending higher over the next 12 months amid rising earnings estimates*

Based on this expert assessment, share market gloom is ‘misplaced’.

Hmmm, the media points out the naysayers’ shortcomings, but has failed to analyse the track record of the ‘experts’.

This next extract, from AMP Capital’s Shane Oliver, comments on the likely returns of major asset classes in early 2008 (remember what happened that year?):

> ‘*While the Australian share market is likely to be volatile in the first half of the year in response to US worries and Chinese tighte*

> ‘*Overall, Oliver states that AMP’s return expectations suggest a gain of 9.5% for diversified growth investment strategies in 2008*

Oliver predicted the ASX 200 to be at around 7300 points by the end of 2008. The actual outcome…3500 points. Just slightly missed the target.

Do you think the AMP fund return 9.5% for the year? Not even close.

But it wasn’t just AMP that failed to live up to expectations.

According to a Super Guide — an independent superannuation information service — report titled ‘Sharp drop in long-term returns due to lingering GFC fallout’:

> ‘*Before the Global Financial Crisis (GFC) hit in October 2008, around a third of Australian super funds delivered returns averagi 2009 financial years…*

> ‘*In contrast, for the five-year period up to 30 June 2013 (financial years 2009 to 2013), not one of the 200 superannuation funds*

The prediction of a 9.8% return in 2008 was a prime example of extrapolation — projecting past returns into the future. The reality is that the ‘worm turned in 2008/09’.

The market conditions that produced the stellar returns from 2004 to 2008 resulted in an overpriced market that needed to be corrected.

The fact that markets rise and fall seems to escape the investment industry’s attention.

Why?

The investment industry sells ‘performance’.

Never let the truth get in the way of a good story

If you believe the industry experts, there is never, ever, ever going to be a year when markets go down, or in which below-average returns can be expected.

Look at Hussman’s performance chart going back nearly 70 years and you’ll see that the industry’s rose-coloured view is not warranted.

But, as I said earlier, never let the truth get in the way of a good story, and, for the investment industry, there’s no better story to tell than a market that’s been on the up and up for an extended period. This gives them past performance to sell and extrapolate.

The article goes on to state:

> ‘…*they missed a 250 per cent rise in the S%26P 500 since the global financial crisis’,* that’s true. But those gains are only lasting

What happens if, once again, Shiller and Hussman are correct and we have another bubble that’s about to burst?

The two previous bubbles have wiped out 50% in market value. This bubble appears to be even bigger than its predecessors; therefore, a 60% fall is not out of the question, or without precedent.

A fall of that magnitude would take the Dow back to 8000 points…wiping out all gains made since April 2009. The paper gains are shredded.

Then, the Dow spends the next decade clawing its way back to 20,000 points, resulting in a zero rate of return over the next 12 years.

If you believe the industry — with a vested interest in keeping you invested in their products — you have nothing to fear except a 'dip' or 'pullback'.

On the other hand, you have two people who have correctly identified these overvalued market conditions on two previous occasions and are cautioning investors to take defensive action, reducing exposure to a market that represents far more risk than reward.

The decision you make on how best to allocate your capital in the coming months will determine whether you'll be in a position to shout the bar…or whether you'll be drowning your sorrows in the years a.

Getting this decision right is no laughing matter.

That's why I have written my new book, *The End of Australia*. It shows you how to make the right decisions with your money now — before it's too late to do anything. To learn more about my new book and how to earmark a hardcopy (which we'll mail to you), click here.

Happy St Patrick's Day.

Regards,

Vern Gowdie,
Editor, *The Daily Reckoning*

Publisher's Note: At the moment, we are mailing hardcopies of *The End of Australia* to any eligible reader that requests one. This is a very costly exercise for us. But, we believe, a worthwhile one. To claim your copy immediately, click here. To learn more about the book, click here.

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Vern Gowdie has been involved in **financial planning** in Australia since 1986. In 1999, *Personal Investor* magazine ranked Vern a
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