Why Warren Buffett Is Wrong

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When a mere mortal tilts at a god, he or she is on dangerous ground.

My hands hovered over the keyboard as I typed the ing for today's article.

'Buffett' and 'wrong' rarely appear in the same sentence.

That's not to say his judgement is always correct, or that his assumptions should not be challenged.

But, as we all know, he does have an excellent track record in identifying investment opportunities.

Last month, Reuters reported on his latest long-term prediction (emphasis mine):

> '*Buffett said* ***he expects the Dow Jones Industrial Average to be "over 1 million" in 100 years****, up from Tuesday's close of 2*

By 2117, Buffett expects the Dow Jones to be *over 1 million* points.

Let's look at some arithmetic:

Year	Dow Jones level	Dow Jones point level in 100 years' time	Annual Compound return
1917	81 points	22,370 points	5.8%
2017	22,370 points	1 million points	3.9%

When comparing the past growth rate of 5.8% per annum with the expected growth rate of 3.8% per annum, Buffett's prediction look

However, let's assume the current overvalued and overbought market actually completes a full market cycle (going from boom to bu

Let's say this happens within the next five years.

Year	Dow Jones level	Dow Jones point level	Annual Compound return
1917	81 points	10,000 points (in 2022)	4.7%
2022	10,000 points	1 million points (in 2117)	5.0%

When start and finish point levels and timeframes are adjusted, you get a different result.

In fact, from 2022 to 2117, the Dow would need to outperform the compound rate of return from the previous century.

How likely is that?

In my opinion, very unlikely.

In May 2017, *The Gowdie Letter* outlined why history will judge the 20th century a 'purple patch'. A unique period that's unlikely to be

The combination of mechanisation, sanitation, medication, population and financialisation delivered an unrivalled era of prosperity.

The legacy of this remarkable period is an ageing population, a mountain of debt, trillions in unfunded entitlement payments, and the

Expecting the growth rates of this period to be reproduced over the next century is an error.

Here's an edited extract from the May 2017 edition of *The Gowdie Letter:*

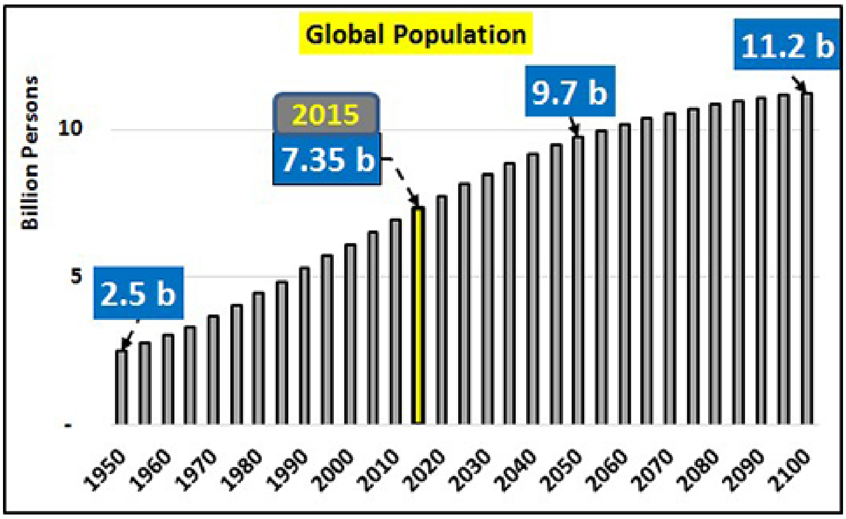
‘*My desire to understand long term cycles, valuations and investor psychology motivates me to research economic and market h*

‘*Which brings us to the biggest cycle in recent history…the 20th century.*

‘*Mechanisation. Sanitation. Medication. These three factors all contributed to a period of extraordinary human progress.*

‘*To appreciate the prosperity created during the 20th century, it is important to note this golden rule:*

‘*Economic growth can **only** come from two sources — an increasing workforce and/or increasing productivity…*



Source: Economica
[Click to enlarge]

‘*Over the next 100 years, UN data projects the global population will be over 11 billion…another four billion people.*

‘*…the rate of population growth is slowing. The population nearly quadrupled over the past century and will only rise by 50% in t*

‘*…The beauty of long term trends is you can stand back and appreciate the broader landscape.*

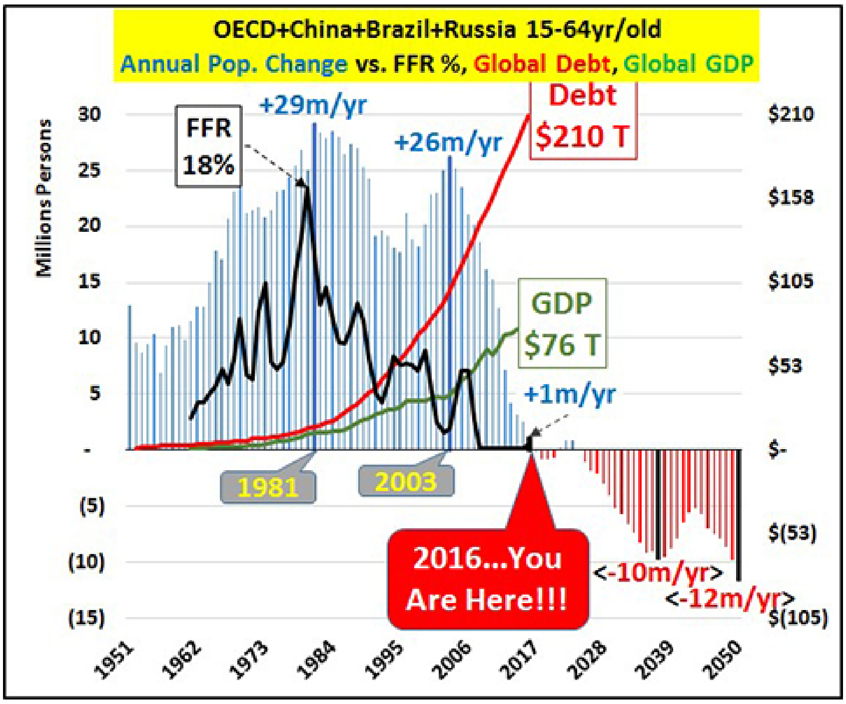
‘*This next chart is a graphic of the interplay between demographics, interest rates, debt levels and GDP growth over the past 65*

‘*The blue (and red) bars represent the annual increase/decrease in 15–64 year olds in the major economies. This cohort is cons*

‘*The black line is the Federal Funds Rate (FFR) — the US cash rate.*

‘*That exponential red line is global debt.*

‘*The green line is global GDP.*



Source: Economica
[Click to enlarge]

‘*From 1951 to 1981, the industrial world largely prospered from the “golden rule”.*

‘*Workforce increased.*

‘*Productive output grew thanks to mechanisation.*

‘*A dollar of debt produced a dollar of growth.*

‘*It’s little wonder that nostalgic voters want to return to that period of shared prosperity.*

‘*After 1981, the global workforce continued to increase. However, the West no longer had it on its own. The workforce increase*

‘*Productivity gains had succumbed to the law of diminishing returns. Making machines faster only delivered marginal gains in ou*

‘*Slowly but surely, the “prosperous” West resorted to financing their lifes with debt.*

‘*Consumption increased. The East was the “maker” and the West was the “taker”.*

Thanks to the East exporting its low labour cost to the West, inflation was on a downward trend.

‘*Lower inflation resulted in lower interest rates. Lower interest rates fed into more borrowings. A virtuous cycle of debt and consu*

‘*The world — West and East — became hooked on debt for growth.*

‘*This dependency has reached an unhealthy and destructive level.*

‘*The addicted economy now needs more than four dollars of debt to get a dollar’s worth of GDP “buzz”.*

‘*The legacy of the 20th century is too much debt, too many government promises, and too little future growth.*

‘*Where to from here?*

‘*In January 2017, the* Smithsonian Magazine *published an article titled:*

“When Robots Take All of Our Jobs, Remember the Luddites —

What a 19th-century rebellion against automation can teach us about the coming war in the job market”

‘*The article begins with:*

“Is a robot coming for your job?

“The odds are high, according to recent economic analyses. Indeed, fully 47 percent of all U.S. jobs will be automated ‘in a c

‘*Let’s err on the side of caution and reduce the expected carnage in the US job market from 47 percent to 30 percent…that’s stil*

‘*Without employment, how do you go into debt? If less people take on less debt (because they’re not sure if their job is next to b*

‘*With less people in the 21st century workforce, who’s paying taxes to finance 20th century entitlements?*

‘*The good news is history shows us that new jobs will replace the old ones.*

The bad news is that’s going to take a generation or two to occur.

‘*We are more concerned with here and now. And that’s looking to be a whole lot different to the world of recent times.*

‘…*To maintain the illusion of growth we are seeing ballooning levels of public debt.*

A fair percentage of this is being incurred for recurring expenditure…health and welfare spending.

‘*Much has been said about borrowing for infrastructure spending. My guess is this will not be as economically productive as it is*

‘*In summary, the components for growth are not there. The immediate outlook for the 21st century is it will be an equal and oppo*

Perhaps the Dow could rise to a million points in 2117. However, most of that compound growth may occur in the second half of the

The problem for today’s investors is that they don’t have the luxury to wait 50 years before markets resume normal compounding op

Buffett and I will not be here to see which one of us is correct.

But hopefully we are both still around in the next five years to witness whether the Dow continues rising… or whether it completes a

Regards,

Vern Gowdie,
Editor, *The Gowdie Letter*

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Vern GowdieEditor at Markets %26 Money

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

His previous firm, Gowdie Financial Planning, was recognized in 2004, 2005, 2006 %26 2007, by Independent Financial Adviser ma

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