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2021 in Review

2021 was a banner year for domestic stocks. There were 70 new all-time highs in the S&P 500 - nearly one-third of all trading days. Thus, 69 times someone could have said “Not today. I don’t want to invest at an all-time high” and been wrong. Avoiding stocks after a new all-time high is a silly idea that should be put to rest once and for all.

Including dividends, the S&P 500 rose 28.7% in 2021, the seventh best gain in the past 50 years. On the heels of total returns of 18.4% in 2020 and 31.5% in 2019, the index has doubled in the past three calendar years. Since the financial crisis bear market ended in March 2009, the S&P 500 has risen over 800% - an annualized rate of nearly 19%. Six times last year, the index experienced a drawdown of between 3% and 5%. All were reported in the financial media as the forerunner of something unusual and worrisome, but the largest peak-to-trough drop was a mere 5.2%. That puts 2021 in the bottom 10% of maximum annual drawdowns since 1927 and the fourth smallest in the past 35 years. The worst down day was a loss of just 2.6%. There was plenty of volatility in individual stocks inside the index, but none of it made it to the index level - just another reason to love diversification.

Had anyone received advanced knowledge of the inflation spike in 2021, they likely would have fled the stock market, sold bonds and bought gold. Yet gold lost 3.6% in 2021 while the Vanguard Total Bond Market Index ETF (BND) lost just 1.8%. As history reveals, when the unexpected happens the capital markets often do the opposite of what's anticipated. Even if we could know what lies ahead, we have no idea how the capital markets will react.

My Lazy Golfer portfolio contains five Vanguard index funds -- 40% in the Total Stock Market Index Fund (VTSMX), 20% in the Total International Stock Index Fund (VGTSX), 20% in the Inflation Protected Securities Fund (VIPSX), 10% in the Total Bond Market Index Fund (VBMFX) and 10% in the REIT Index Fund VGSIX). Rebalanced annually, it yielded an annualized average return of 10.1% for the past decade and 16.5% in 2021. You could have done worse.

My Fearless Predictions for 2022

We are attracted to voices that confidently claim to know what the future holds because we seek certainty in an uncertain world. Every January, "experts" pronounce their forecasts for the economy and the global markets in the New Year. They do this despite the dismal track record of their past forecasts. The 2021 winner of my "Most Embarrassingly Bad Forecast from A Wall Street Big Shot Award" is Morgan Stanley's chief U.S. equity strategist, Mike Wilson, who predicted that the S&P 500 would gain 4% in 2021. Peter Lynch, the legendary manager of the Fidelity Magellan Fund during its glory days, said that if he spent 13 minutes studying economic forecasts, he had wasted 10 minutes. Be skeptical of all predictions of extreme events which, by definition, are outliers and unlikely to occur – regardless of the number of their YouTube views.

The annual forecast issue of *Kiplinger's Personal Finance* magazine has arrived in my mailbox. First came this warning – *"Investors will have to pick their spots carefully in 2022 and may not be able to rely on a rising tide lifting all boats - either in broad index terms or even within a particular investment style or sector. It will be a decent year for stocks if you're a stock picker, a more modest year if you're an S&P 500 investor."* Nothing new here. Every January, there are assertions by active managers that the upcoming year is going to be a "stock picker’s market,” because (insert reasoning here). But by year-end 2022, most stock funds will have once again underperformed their benchmark index. Active managers will blame it on (insert excuse here). They will never admit that after subtracting management fees and trading expenses, the average actively managed stock fund does not add value. I have no interest in *Kiplinger’s* top stock picks for 2022 and either should you. But let's look back to the 2021 forecast issue and calculate the performance of last year's stock recommendations.

- A portfolio equally divided among the eight stocks *Kiplinger’s* recommended for 2021 would have returned 8.2% last year, trailing the 25.6% gain in the Vanguard Total Stock Market Index ETF (VTI) by an embarrassing amount.
- A portfolio equally divided among the five stocks that *Kiplinger’s* advised readers to avoid or sell last January would have returned 22.6% last year.

Like Casey Stengel used to say, "You can look it up." Not surprisingly, there is no mention of the subsequent performance of last year's recommendations in this year's forecast issue. *Kiplinger's* offers prudent advice about budgeting, managing debt, financing a car or home and other important personal financial topics. But when they start giving stock recommendations, it's time to turn the page.

Let's not be too hard on *Kiplinger's*. Their lack of predictive ability is typical of all forecasters because no one can foresee the unexpected events that produce changes in stock prices. In late 2020, *Barron's* surveyed market strategists and chief investment officers at large banks and money management firms for their S&P 500 forecast for 2021. Their forecasts averaged out to a gain of 9% - pretty close to its long-term average - but almost 20% below the return of the S&P 500 last year. If your advisor's 2021 recommendations didn't work out as expected, don't waste time asking for an explanation. Explaining underperformance using 20/20 hindsight is a Wall Street sleight of hand trick. It deflects attention away from the real issue -- that no one has the 20/20 foresight needed to outsmart the markets. Until the day comes when we live in a no-surprise world, it's best to keep your portfolio well diversified and consider all forecasts to be works of fiction. That said, I can't resist the temptation to throw my hat in the ring and give my Fearless Forecasts for 2022 -

- A few of this month's forecasts will prove to be accurate. Unfortunately, by the time we discover the identity of the lucky guessers, it will be too late to profit from their predictions.
- Stock pickers and market timers will waste great quantities of time and energy peering at charts trying to find patterns in historical data that academic studies have shown to be random.
- Sometime this year the stock market will begin an unexpected, rapid decline accompanied by nerve-wracking volatility. If the decline exceeds 10%, many investors will panic and sell their stock funds. By confusing volatility with permanent loss, they'll create permanent losses in their portfolios.
- Many clients will continue to be under the delusion that their advisor can protect them from the next bear market. Even though they may never have promised such a thing, few advisors will clarify this misunderstanding.
- Investment frauds will be pitched to gullible investors as unique profit opportunities. Numerous times in 2022, investments will be sold to people who won't ask enough questions when promised returns too good to be true.
- Wall Street firms will promote alternative investments as must-have, portfolio diversifiers. Cryptocurrencies, non-fungible tokens (NFTs), and SPACs are the new kids on the block, joining old stalwarts like hedge funds, private equity and commodities. Many alternative investments are laden with debt, make concentrated bets on companies or market segments, trade excessively, are illiquid (hard to sell quickly at fair market value) and rely on subjective backtests of questionable origin. No one can accurately assess the potential benefits of alternative investments and most owners of these products don't understand the risks that they are taking. Sadly, the depth of understanding that most financial professionals have of alternative investments goes no deeper than a marketing brochure. As in years past, complex, alternative investments will continue to be the playground of scoundrels.
- Wall Street's representatives will continue to make money the easy way — by exploiting the knowledge gap that exists between a client and a broker. The client comes to a meeting looking for solutions to financial problems and trusting the broker to provide the answers. The broker comes to the meeting with a briefcase full of products, sales training and worries about meeting quota. The inherent conflict of interest in this type of relationship never has, and never will, work in the client's best interest. In 2022 Wall Street's representatives will continue to offer a multitude of products disguised as financial planning.
- Wall Street and its media mouthpieces will continue to give the impression that the secret to long-term financial success is making correct short-term financial decisions -- something that just doesn't sound right to me. Investing is a long-term activity and is not enhanced by frequent portfolio tinkering.
- Sometime this year you will read or hear that that buy-and-hold investing is dead. If buy-and-hold means buying 20 stocks when you are 25 and then holding them until you are 65, I agree that's a foolish idea. But that's not what buy-and-hold means to me. Your portfolio allocation should be based upon a written financial plan that focuses on your goals, time horizon and risk tolerance. Your portfolio should be the servant of your plan. The stock portion of your portfolio should be globally diversified using index funds to eliminate individual company risk and keep expenses low. Once the portfolio is in place, keep on funding it, come what may, and review your plan on an annual basis. If goals or circumstances have changed significantly, your plan and portfolio can be modified. More often than not, there will not be significant changes and rebalancing your portfolio to its original allocation is all that will be required. By this definition, buy-and-hold will continue to serve investors well.
- Millions of times in 2022, Financial advisors will be asked, “What do you think the market will do this year?” The only true answer, “I don't know. I'm only human and cannot see into the future”, will rarely be uttered.
- The stock market will continue to do whatever is necessary to exasperate as many people as possible. It will never make you happy. Just when you think it will always love you, it will run off with a third of your money. Then it will return, ask for forgiveness and promise to love you forever. You will grant forgiveness and five years later it will run out on you again.

- Social media will continue to give every nut-job with an internet connection and a keyboard a global audience of gullible followers. Too much financial advice on social media is self-serving opinion offered by someone who doesn't know you and who might not know what they are talking about. There is no truth filter and each year, it seems that the financial lunacy promoted on social media can't get any worse. But it does.
- Financial journalism will spend most of 2022 hyping the inconsequential. Its reporting will be repetitive, superficial, performance focused and lead you to making decisions harmful to your long-term financial health. It will spout enough negative drivel to disturb and discourage even the most stouthearted investor. Rarely, if ever, will it mention the benefits of good financial planning because its job isn't to give sound advice but to entertain and sell advertising. Few of 2022's headlines will make it into the history books. Tune out the financial media. It needs something new to say every day but everything you need to know has already been said. Remember, most of its reporters got their start in the business covering traffic accidents, broken sewer lines, chili cookouts and family pets stuck in trees.

These aren't really predictions. They're just my way of saying that 2022 will be just like all previous years -- because there's nothing new under the sun. I have no idea where markets, inflation, oil prices, interest rates or the economy are headed in 2022. And neither does anyone else. Avoid anyone who pretends otherwise. I've read many economic forecasts for 2022. They bore me. Why does anyone believe that economists can predict the future? Because they look at numbers all day long? So do high school math teachers. Yet we don't expect them to be able to predict the future. We're silly to ask economists to peer into the future for us and it's idiotic that so many of them are happy to do so.

As we enter 2022, our nation is engulfed by a noxious mood of widespread apprehension and negativity. Many Americans, who have experienced a rising quality of life during their lifetime, see nothing but decline ahead. But this is nothing new. In 2022, just like in years past, there will be good news and bad news. There will be a case for optimism and a case for pessimism. Investing won't work if things don't improve slowly over time. A rising stock market requires a growing economy, rising corporate profits and a growing global middle class. If all these things suddenly stop, put your money in your mattress because even the banks will fail. All economic and financial pessimism is rooted in two basic mistaken ideas –

- The first is that today is the low point of human history - it has never been this bad - the biggest problems, the worst President, the most incompetent Congress - so that this time things are fundamentally different in new and terrible ways. This idea has always been with us and always been wrong.
- The second is the error of extrapolation. The belief that today's new and terrible negative trends are not cyclical, but permanent, that they have no solution and things will continue to get worse. This idea also has always been with us and always been wrong.

Were it not for these two delusions, long-term pessimism would be impossible because pessimism can never stand up to the study of history. It must be supported, from outside historical reality, by some essentially imaginary idea of the future, which is not just different from history, but the opposite of everything that has happened to date.

The tagline of On Course Financial Planning is "Facing the Future with Optimism and Courage". Those who see only a bleak future will never be successful investors. Optimism is a belief that things get better slowly over time. Each year, collectively, we know a little more and get better at fixing things and solving problems. Pessimists can list a litany of frightening scenarios, but they fail to account for our increasing ability to solve whatever problems may arise. We should be optimistic, not because our problems are small, but because our capacity to solve them is larger than most people think. To be an American declinist, one must believe that science, technology, and the unique combination of innovative genius and entrepreneurial energy that have been the hallmarks of American character are all spent forces. There's no objectively verifiable evidence for this bizarre notion; rather all the evidence of history contradicts it. History has shown that although the pessimists may sound smart, it's the optimists who have made the money.

In 2022, ignore all financial advice that you get from your neighbors, coworkers or relatives. Most of their portfolios are a junk drawer of investments purchased over the years for reasons they can't remember on the advice of persons whose names they have forgotten. Assume that all claims of having made quick riches to be, at best, exaggerations. I expect that, just as in years past, the stock market will continue to go up and down without any advance warning. But the lesson of history is that, over time, the ups will exceed the downs and that's good enough for me. Investors who maintain their discipline, stay optimistic and continue to fund a globally diversified portfolio in 2022 should do just fine.