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Wall Street Strategists "Predict" Last Year's Equity Performance Instead of Next Year's – Unlike IFI

Richard M. Salsman, CFA
President & Chief Market Strategist

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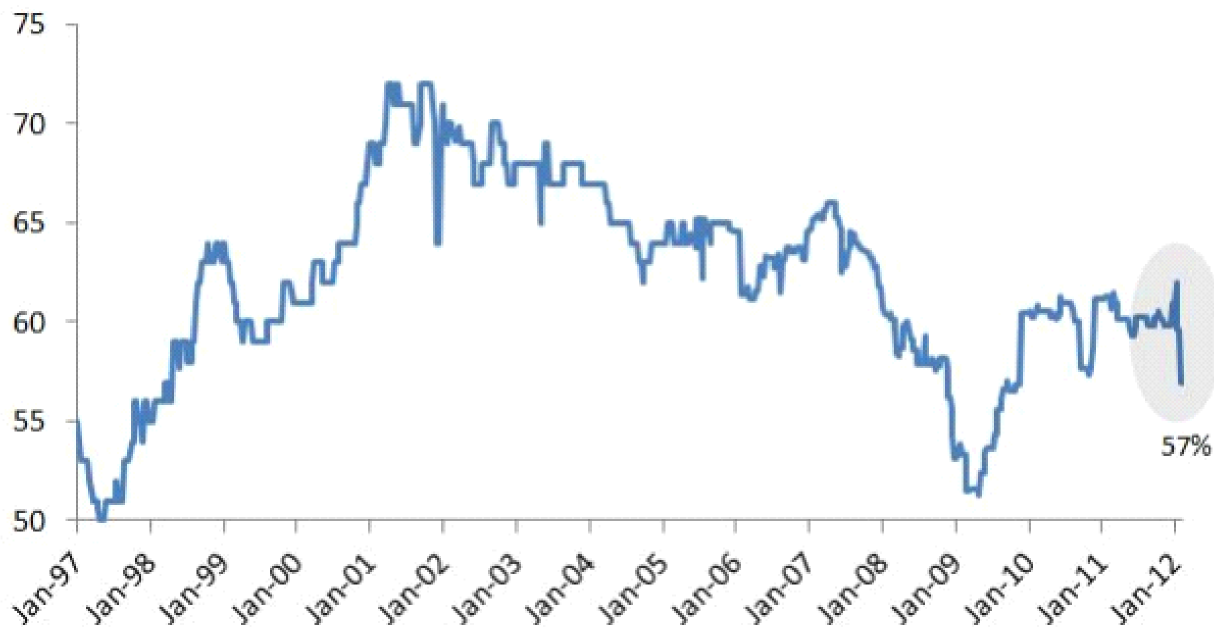
History shows that Wall Street equity *analysts* tend to be backward-looking in their "forecasts" of corporate earnings and likely year-ahead results for specific stocks; below we examine evidence gleaned from a long-term survey of Wall Street *strategists*, conducted weekly by Bloomberg since 1997, which shows a similar, backward bias and myopia: the strategists who forecast U.S. stocks broadly and recommend an optimal portfolio allocation tend to reflect what has *already* occurred instead of anticipating what *will* occur. Below we provide calculations of their track record and contrast it to our own record at IFI since 2001 (when we launched our forecasting and asset allocation advisory service). We also provide evidence on our relative forecasting record in areas beyond U.S. stocks. On all counts we tend to out-perform peers.

Figure One plots the average allocation in U.S. equities advised by the dozen or so Wall Street strategists polled weekly by Bloomberg since 1997. The advised portfolio shares correspond closely to their projected price gains on the S&P 500, as is true for IFI as well. A cursory glance at Figure One, to those familiar with how U.S. stocks have done since 1997, suggest that the allocations reflect the market's *trailing* results instead of foreshadow-

Figure One

Wall Street Strategists' Recommended Portfolio Allocation to Equities (%)

From Bloomberg's Weekly Strategist Survey, January 1997 - January 2012



101 CROYDON PLACE ▪ DURHAM, NORTH CAROLINA 27713
PHONE 919-942-2419 ▪ FAX 919-338-2652 ▪ RMSALSMAN@INTERMARKETFORECASTING.COM

ing its year-ahead results. Indeed, as we'll see, that's what the hard numbers show. But first notice, in Figure One (page 1) how Wall Street advised a mere 50% portfolio share for U.S. stocks during 1998, a year of turmoil; but in 1999 the S&P 500 rebounded by 20%. Thereafter the strategists' advised more than a 70% share, but the S&P 500 plunged by 46% in 2001-2002. Then, as the S&P 500 was soaring by 90% from 2002 to 2007, Wall Street was reducing its allocation. Finally, in early 2009, after the S&P 500 had plunged 53% (since 2007), the strategists advised only a 52% share for stocks, yet the S&P 500 boomed by 71% in 2009-2010.

Table One

IFI vs. Wall Street Strategists on U.S. Equity Advice

Source for Wall Street Strategists: Bloomberg Weekly Survey

Source for IFI: The InterMarket Forecaster (page 5)

Period: Each January, 2001-2011

January	S&P 500, Prior Year	WS AA Advice	IFI AA Advice	IFI vs WS: Difference	S&P 500, Next Year
2001	-10.1%	68%	75%	7%	-13.0%
2002	-13.0%	70%	65%	-5%	-23.4%
2003	-23.4%	67%	55%	-12%	26.4%
2004	26.4%	67%	80%	13%	9.0%
2005	9.0%	64%	65%	1%	3.0%
2006	3.0%	64%	15%	-49%	13.6%
2007	13.6%	64%	5%	-59%	3.5%
2008	3.5%	62%	20%	-42%	-38.5%
2009	-38.5%	53%	75%	22%	23.5%
2010	23.5%	61%	65%	4%	12.8%
2011	12.8%	61%	60%	-1%	0.3%
Correlations, AA Advice and:	**S&P 500, Prior Year**	**Correlation, IFI-WS differential & S&P 500, Next Year:**		**25%**	**S&P 500, Next Year**
WS:	**22%**	**64%**	**53%**	**WS:**	**-33%**
IFI:	**-18%**	Average Allocations		**IFI:**	**20%**

When 2012 began, thirteen strategists polled by Bloomberg predicted that the S&P 500 would gain just 6% for the year,[1] or roughly half as much as the gain we projected; after just one quarter the S&P 500 has gained 12%. Wall Street continues its habit of more accurately predicting what *has* occurred instead of what *will* occur.

The hard numbers are presented in Tables One and Two, and these include IFI's advice, as a contrast to Wall Street's advice. In Table One we show the U.S. equity allocation recommended by the Wall Street strategists and by IFI at the beginning of each year since 2001, and also record how the S&P 500 (price index) performed in the one-year *before* and one-year *after* these advised allocations. Our time horizon is one year, and here we assume, for simplicity, that so is Wall Street's; but even if not, our calculations reveal that strategists' forecasting accuracy isn't any better at shorter intervals.

Notice first, in Table One, that in the decade since 2001, amid a bad run for the S&P 500, Wall Street strategists advised an average equity share of 64%, while we advised an average share of just 53%. Second, notice how Wall Street's allocation range has been narrow (53%-70%), while IFI's has been wide (5%-80%); it seems that instead of calling things as it really sees them, Wall Street "plays it safe," although the narrow range may simply reflect the fact that this is an average of a dozen strategists. Individually there may be far more variation and range. We base our own allocation advice on likely year-ahead equity returns, as does Wall Street, no doubt, but our market-price signals entail a much wider range in possible result, and in fact, that's what the market actually delivers. We suspect what may seem obvious: Wall Street strategists tend to stay in a relatively high and narrow allocation range because their firms underwrite and distribute equities; thus strategists are more motivated to be optimistic than to be accurate in their stock forecasts.

If Wall Street strategists were better at looking ahead than behind, the correlation between their advised allocations and *next* year's S&P 500's performance would be both *positive* and *higher* than the correlation of their allocation advice with *last* year's equity performance. In fact, as Table One reveals, the correlation is -33% between its allocation shares and next year's results (and +22% with last year's results). Thus Wall Street's equity portfolio allocations reflect *last year's results* but *fail* to anticipate, even directionally, *next* year's results. In sharp contrast, the correlation between our advised allocations and next year's S&P 500's performance is positive (20%), which

[1] Inyoung Hwang, "Equity Strategists See Smallest S&P Gain Since 2005," *Bloomberg*, January 3, 2012 (http://tinyurl.com/74du35q).

Table Two IFI vs. Wall Street Strategists on U.S. Equity Advice			
Rank by Best to Worst Performance by the S&P 500 ----->			
January	WS AA Advice	IFI AA Advice	S&P 500, Next Year
2003	67%	55%	26.4%
2009	53%	75%	23.5%
2006	64%	15%	13.6%
2010	61%	65%	12.8%
2004	67%	80%	9.0%
2007	64%	5%	3.5%
2005	64%	65%	3.0%
2011	61%	60%	0.3%
2001	68%	75%	-13.0%
2002	70%	65%	-23.4%
2008	62%	20%	-38.5%
Average allocations in the year before S&P 500 had bullish vs bearish results:			
Bullish Result:	**62%**	**58%**	**17.0%**
Bearish Result:	**65%**	**48%**	**-14.3%**
Difference:	**-2%**	**10%**	**31.4%**

means we tend to advise *higher* portfolio shares *before* the S&P 500 is about to perform *better*, and *lower* shares before it's about to perform *worse*. In contrast, Wall Street's -33% correlation means it tends to advise a *higher* portfolio share before the S&P 500 performs *worse*, and a *lower* share before it performs *better* – which is the exact opposite of what their clients need to hear.

Of course, IFI would prefer to report a correlation higher than +20%, but at least our correlation is *positive*. But here's another test of the data: how allocations relate directly to S&P 500 performance. Table Two provides another perspective on the same data that's in Table One, but now we rank all the years since 2001 from "best-to-worst" S&P 500 performance (see the right-most column in Table Two). Question: what allocations were advised by Wall Street versus IFI prior to the S&P 500 doing well (top half of Table Two) or ill (bottom half of Table Two)? Obviously, the ideal case would be to advise a relatively *larger* equity share before the S&P 500 performs *better* than usual and a *smaller equity* share before a *worse* than usual result.

Well, Table Two clearly illustrates how Wall Street strategists have advised an average portfolio share of 62% prior to the S&P 500 doing better, but a still *higher* share (65%) prior to it performing *worse*. Clients would wish to see the *opposite* – a higher portfolio share being advised before a *good* run for U.S. stocks and a lower equity share advised before a *bad* run. That's what IFI has advised: an average equity allocation of 58% before the years of better U.S. equity performance and only a 48% share (average) before the worse years – a difference of +10% points.

Finally, we can contrast our track record with Wall Street's on other variables like profits, T-Bond yields, and Fed policy. The table below ("IFI Annual Track Records") includes those variables plus the S&P 500; it reveals a forecasting success rate averaging 64% and how, on average, we've outperformed 61% of our Wall Street peers. We aren't really any "smarter" than our Street peers; we simply leverage smartly off of the forecasting power of market prices.

IFI Annual Track Records				
Year	# of Variables	% Correct	Above/ Below Average	% of WS Peers Surpassed
2001	68	70%	6%	64%
2002	100	60%	-4%	79%
2003	140	84%	20%	58%
2004	136	78%	14%	48%
2005	148	70%	6%	83%
2006	148	65%	1%	54%
2007	126	49%	-15%	72%
2008	126	48%	-17%	63%
2009	125	79%	15%	54%
2010	126	72%	8%	52%
2011	129	33%	-32%	40%
AVG	125	64%		61%

Source: "Track Record 2011," February 3, 2012, p. 3
Source of Wall Street Forecasts: Barron's Annual Outlook (December)
Categories: S&P 500, Corporate Profits, U.S. T-Bond Yield, Fed Policy

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910 Constitution Drive, Suite 1012 ▪ Durham, North Carolina 27715
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Methodologically, IFI's research emphasizes the incentives and disincentives faced by producers, savers and investors and how these effect investments – the essence of classical or "supply-side" economics, in contrast to the flawed themes and track records of Keynesian economics. IFI views markets as global, inter-connected, and often politicized, so it also provides a rational framework for understanding and predicting how policies (monetary, fiscal, regulatory) will influence investment performance. IFI has no vested interest in rising or falling markets or in any particular investment styles. It offers clients an independent, objective source of investment research, forecasts and advice, in contrast to the bias often exhibited in brokerage firm material and salesmanship. Since its founding in 2000 IFI has delivered an average, across the board forecasting success rate of 66% and has outperformed its peers (Wall Street strategists) 61% of the time.

Richard M. Salsman, Ph.D., CFA®

Richard Salsman is founder, president and chief market strategist. Prior to IFI he was senior economist at H.C. Wainwright Economics, Inc. (1993-1999) and from 1981 to 1992 a banker and capital markets specialist at the Bank of New York and Citibank. Mr. Salsman has authored numerous articles and is an expert in market history, economics, forecasting, and investment strategy. His work has appeared in the Wall Street Journal, Investor's Business Daily, Barron's, Forbes, National Post (Canada) and the Economist. In addition, he has authored three books—Gold and Liberty (1995), Breaking the Banks: Central Banking Problems and Free Banking Solutions (1990), The Political Economy of Public Debt: Three Centuries of Theory and Evidence (2017) —plus many chapters in edited books. Salsman speaks regularly at conferences, investment gatherings and universities. He earned his B.A. in Law and Economics from Bowdoin College (1981), his M.B.A. in Economics from the Stern School of Business at NYU (1988), and his Ph.D. from Duke University in Political Economy (2012). In 1993 he earned the designation of Chartered Financial Analyst (CFA) from the Association for Investment Management and Research.

910 Constitution Drive, Suite 1012 ▪ Durham, North Carolina 27715
▪ 919.942.2419 ▪
Sales Office 586.275.6000 ▪ Sales@IMFCI.com