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What Will the Stock Market Return in 2021?

2020 was a wild ride in the stock market, with the S&P 500 dropping 35% early in the year and then rebounding by 60% to notch nearly an 18% total return (as of 12/28/20).

The double-digit return is especially remarkable given that during 2020 a global pandemic killed 325,000 Americans and 1.8 million people worldwide. The economic effects of the pandemic were huge as hundreds of thousands of companies went out of business, tens of millions of people lost their jobs, unemployment spiked to over 10%, the U.S. economy shrank by an annualized rate of 31.4% in the second quarter and is on pace to contract over 3% for the year.

Such a crazy year in the economy and stock market highlights an important lesson about predictions: they are worthless, and we shouldnâ€™t pay any attention to them. Case-in-point, Wall Streetâ€™s 2020 predictions were ludicrously bad.

How Bad Were Wall Streetâ€™s Predictions for 2020?

One year ago, prognosticators predicted a stable, growing economy and single-digit stock market returns. According to the New York Times, â€œIn December 2019, the median consensus on Wall Street was that the S&P 500 would rise 2.7 percent in the 2020 calendar year.â€•

Specifically, these were some of the predictions of the biggest Wall Street firms:

Citigroup: â€œWe are not forecasting a global (or U.S.) recession in 2020â€• as the â€œglobal economy appears to be stabilizing.â€• For the U.S. stock market, Citi predicted â€œupper single-digit returnsâ€• and said that â€œvalue stocks are largely expected to outperform their growth counterparts.â€•

JP Morgan predicted that there was little chance of extreme market swings and that weâ€™d see â€œmid-to-high-single-digit returns for stocksâ€• in 2020. Like Citigroup, JP Morgan recommended that investors overweight value stocks as they would outperform growth stocks in 2020.

Goldman Sachs expected a 3.4% increase in GDP and â€œcontinued labor market improvement.â€• Goldman strategist David Kostin predicted that â€œa durable profit cycle and continued economic expansion will lift the S&P 500 index by 5% to 3,250 in early 2020. However, rising political and policy uncertainty will keep the index range-bound for most of next year.â€•

Morgan Stanley predicted that the economy would grow by 2.3% and that active managers would outperform the indices in 2020. They also predicted about a 4% decline in the market in 2020 and that international stocks would outperform U.S. stocks.

These predictions by the titans of Wall Street were comprehensively wrong:

- Market returns: The 2.7% consensus forecast undershot the 2020 stock market price return by more than 10%.
- Value vs. growth: Not only did value underperform growth, but growth stocks outperformed value by nearly 40%! An investor who followed J.P. Morganâ€™s and Citigroupâ€™s advice to overweight value would have found it very costly.
- International vs. domestic stocks: U.S. stocks continued their dominance, outperforming non-U.S. stocks by nearly 10%, so to have followed Morgan Stanleyâ€™s advice to shift funds from domestic to international stocks would also have been costly.
- Active vs. passive: Active managers struggled in the face of the market volatility and most trailed the index. Predictions that active managers can better navigate choppy waters have yet to be realized.
- Economic growth: None of these firms predicted the global recession or that the Fed would engage in rate-cutting and massive monetary stimulus.

We can forgive forecasters for not predicting a global pandemic, but their revised forecasts once they knew what was happening confirm how truly useless market predictions are. In April when the economic effects of the pandemic were becoming clear, a survey by Bloomberg found that forecasters had reduced their 2020 year-end prediction for the S&P 500 to an average of -11%, almost the opposite of what happened, and 28 points off the mark.

Therefore, there are two main lessons to be drawn from the expert predictions of 2020: (1) predicting the future is tough because unexpected events such as global pandemics, wars, and natural disasters regularly occur which render predictions inapplicable, and (2) even when unexpected events become known, predicting how the stock market will react to such events is problematic. For more on these points, see my article from this past June titled Why The Stock Market Doesnâ€™t Make Any Sense.

2021: Prediction Redux

Last year at this time I published my prediction for what the stock market might return in 2020: it would likely be up but it was possible that it would be down. I made this prediction based on historical data that the market is up about two-thirds of the time no matter what happened the prior year.

My prediction for what the market will return in 2021 is the same as my 2020 prediction: it will probably be up, but it might be down.

While such a non-specific prediction is unsatisfying, it is about as precise as anyone can be about predicting market returns. Predictions that are more exact than that cannot be accurate and mislead investors.

What Should Investors Do if They Canâ€™t Trust Predictions?

We all crave certainty, and we want to know what the stock market will return in the future so that we can make profitable investment decisions. But since next yearâ€™s market return is not knowable, there are better strategies than paying attention to deceptively accurate predictions. These include:

- Structuring all-weather portfolios that will share in the upside when the market is up, but preserve value when it is down.
- Having an adequate margin of safety to ride through down markets.
- Taking a long-term view of the markets and not looking often at our portfolios.

Weâ€™re all better off spending less time reading market news and drinking from the firehose of financial and economic data, which is mostly noise, and devoting more time to reading investment wisdom. Above all else, we should ignore expertsâ€™ forecasts.