Northern Trust | Bob Browne: The Three Big Events of 2016: Lessons Learned

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When I look back on 2016, I see three big events for the markets that offer lessons for 2017 and beyond. Let's take a look at them and see how we can become better investors as a result.

After 2016 ended with robust positive returns for most risk assets, it's easy to forget that we started the year in a near panic. The energy sector was melting down, creating fears of contagion risk, and newspaper headlines frequently talked of recession risk in the US. Before you knew it, US equities were down 12% in February and the rest of the world markets were equally in shambles. But this was all noise. There was no debt crisis, beyond some select companies in the energy sector, and there was no objective evidence to support the recession fears.

We told clients to stay fully invested and stay focused on the longer-term horizon. The likely base case scenario, not the noise, is what deserved attention-- modest but sustained economic growth and accommodative monetary policy. Both were supportive of risk assets, and investors who focused on the facts were rewarded.

"Lies, damn lies, and statistics" is one of Winston Churchill's more memorable quotes, and I'm sure no one would have been more amused and bemused than he by the polls and pundits leading up to the Brexit vote. How wrong they all were. Even worse, many investors immediately sold their risk assets when the unexpected news arrived, only to see the market turn around and rally sharply within just a few days.

We encouraged investors to pause and gather more information before coming to any firm conclusions. It wasn't clear to us that this news, shocking as it was, was indeed negative for the markets, and our prudence was quickly proved correct. Remember, just because you're surprised doesn't mean you should assume the worse.

Speaking of polls and pundits being wrong, how about the US presidential election? Similar to the Brexit vote, the unexpected happened. But in this case, we knew the news represented an immediate change in policy and would shift market expectations for economic growth and monetary policy. We dropped our lower-for-longer interest rate theme the day after the election and advocated a pro-growth narrative that would boost equity markets, even though many fear the potential consequences of a Trump presidency. And we were right. President-elect Trump was a nontraditional candidate and he will be a nontraditional president, and investors should be ready for that.

So what does it all mean for investors? Well, we had three unexpected events, but we reacted in three different ways. Why is that? First of all, a good investor should always absorb new information and factor it into one's forecast for the future. But the mistake most people make is assuming that information today is more important than information from yesterday or tomorrow, let alone a year from now. Information gathering and forecasting is a cumulative process. Once in a while, dramatic, unexpected information such as the Trump election needs to be weighted heavily, and new market implications determined quickly. At other times, such as with Brexit, new information is still part of a cumulative process and a more prudent reaction is appropriate.

The general rule is that a clear framework of analysis is absolutely necessary. We do that every day, with discipline and consistency. And as we begin 2017, our analysis reveals a world heading into a pro-growth narrative, the end of eight years of monetary accommodation, and politics trumping monetary policy. We think this will be a good year for equities and bad for bonds, and we continue to feel that US equities, US high-yield bonds, and global natural resource equities will provide solid returns.

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