

Northern Trust | Focus on the climate, not the weather

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Now that equity markets are off to a roaring start in 2019 after a disastrous December, various market pundits are coming out to make some very explicit forecasts about where the S&P 500 will be trading in the next six months, or predicting the timing of the next recession. That's like forecasting the weather on a certain date in the future. We prefer to focus on the climate.

Asset managers are in the business of predicting the future. And let me tell you something you already know, predicting the future is really difficult. The key is to know that some things are easier to predict than others.

You also need to continually recalibrate your predictions and fine tune your process so you can improve over time. This helps you figure out what you're not good at and, therefore, shouldn't be doing. For us, making a big splash about where we think equities will trade this June or forecasting a recession at the end of this year fall into the we're not good at that camp. It truly is like predicting the weather on a certain date in the future in order to plan a wedding.

So what are we good at, and what do we predict? We focus on longer term horizons and likely conditions in the future based upon both empirical research and forward looking analysis. Focusing on likely conditions is akin to focusing on the seasons and the climate. It may have been difficult a year ago to forecast a record setting minus 25 degree day in Chicago like we had a few weeks ago, but you would have reasonably predicted uncomfortably cold weather in February, and you know that conditions tend to be pretty ideal in September, a great time for wedding planning in Chicago.

These are the key factors which we are forecasting and which we think will drive the market climate over the next year, resilient economic growth, accommodative monetary policy around the world, reasonable equity valuations, and low credit defaults in the US. When these conditions are present, we do not need to get overly acute or precise with our predictions. We just know it bodes well for risk assets, such as high yield bonds, global REITs and US equities, which we are overweight.

You don't need to predict the date in September with the best weather for a wedding. You just need to know that September is a pretty nice month here in Chicago to get married.

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