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Woodhall's 2020 Year Ahead

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2020 is likely to be another good year for equities

ASX 200 forecast to grow by 8.0%
S&P 500 forecast to grow by 7.2%
US-China trade and Brexit may improve expectations during 2020

The forecast process

We continue you use our proprietary method for forecasting the returns on the ASX 200 and S&P 500 using Refinitiv's survey of broker forecasts of dividends and earnings by company. The process is described in a document posted on our website.

The forecasts for the end of 2020 based on data up to and including the end of 2019 are presented in Table 1.

Table 1: Eoy 2020 forecasts

Forecast	ASX 200	S&P 500
Capital gains	6.7%	11.2%
Dividends	4.1%	2.0%
Total returns	10.4%	12.9%
Exuberance	-1.3%	4.0%
Adj. cap. gains	8.0%	7.2%
Adj. tot. ret.	11.7%	8.9%

Forecasts made on 31st December 2019

We only produce these forecasts to assist in the formulation of our investment decisions. We understand that the inherent volatility in market indexes makes it bold to make just a single point forecast – as shown in Table 1.

Therefore, we augment our forecasts with the predicted highs and lows shown in Table 2. The low is the forecast of the lowest point we expected during 2020. Similarly, the high is the highest point we expect during the year.

Table 2: 2020 low and high forecasts (rounded)

Category	ASX 200	S&P 500
Low	6,350	3,060
High	7,550	3,630
End	7,200	3,450
Fair value	6,750	3,100
Exuberance	-1.3%	4.0%
eoy 2019	6,684	3,231

Forecasts made on 31st December 2019

The low and high forecasts are not independent. If one is met or breached, the other is then much less likely to occur. We use these low and high forecasts to monitor whether or not we believe the forecasts are on track. If the trace of the index lies between these two forecasts then we have little reason to suspect forecast failure.

If there is a material breach of the low then we might consider reducing our exposure to that index (and accumulating if the index subsequently returns to the low-high range). Since the low and high are derived from simulations assuming normal volatility of 12.5%, it is sometimes prudent to consider new lows and highs based on a high volatility assumption of 25%. Conversely, if the high is breached we might consider taking profits.

We show our recent track records in Charts 1 and 2. Each year, the low, high and eoy forecasts are updated (and not changed within each year). The diamonds and dashes indicate values of panel forecasts reported on major websites. These data are not meant to be definitive but only to give us some idea if our views fit with the market or not.

Chart 1: Track record of ASX 200 forecasts

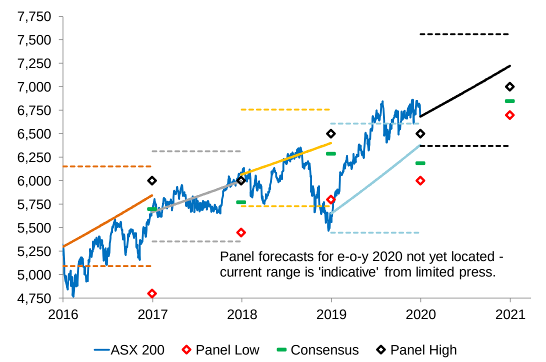
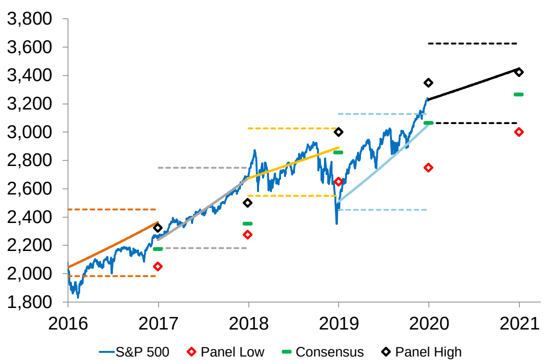


Chart 2: Track record of S&P 500 forecasts



We have found our forecasts particularly useful in our decision making but it is up to each individual to form his or her own assessment. For example, the eoy 2018 forecast could be viewed as a failure by some but at the time we saw buying opportunities and not failure! Our measure of exuberance indicated that the markets were very cheap.

Other factors

At the end of each year each broker is free to make its own assessment of the macro factors that may alter the course of the market over the year. In this section we list a few of the major 'known unknowns' to help our monitoring of the forecasts.

The Phase 1 US-trade deal is scheduled to be signed on January 15th 2020. It is less than entirely clear what is in the deal or whether the parties will stick to it. Phase 2 negotiations are meant to start shortly afterwards. Presumably much of the deal has been priced into earnings forecasts. However, we think it is more likely that, after all of the goings on, pricing-in is on the conservative side. Therefore, we see a skewed bias to the upside.

The US Federal Reserve (Fed) has reported that it expects to be on hold in 2020. According to the CME Fedwatch tool, the market is pricing in a cut or two at less than 50%. There is more harmony between the Fed and the market than in recent years. We see this harmony as positive for the market.

There is little doubt that the Brexit uncertainty has weighed heavily on investment decisions. With an exit almost certain on January 31st 2020 and a deal in place by eoy 2020, we again see this as more likely to be positive for the market than not.

China macro data turned the corner in December 2019. If this positivity continues, we see further upside for the market.

We do not see a recession in the US or Australia in 2020. The RBA may well cut rates once or twice in 2020 – again helping the market.

It is an unusual state of affairs for us to see the main 'known unknowns' to be more likely to be positive for the market. Given the strength of the forecasts in Table 1 and our perceived upside skew in the narrative, we start the year overweight in both markets.

Interested readers should refer to our Weekly and Monthly postings (saved in the archive) on our website to understand our reasonings in more detail.