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Forecasting 101

Investing is all about the future. Every investment decision is a vote for or against an asset based on expectations for how it might behave in the future. Thoughtful investing involves forming expectations about what might happen down the road and how it might impact different investments. Expectations are an educated "guess" combining present conditions with observations about how similar conditions have played out in the past.

Forecasting Involves Uncertainty

Investors must keep in mind that their expectations could be wrong and plan to help manage their portfolios against unexpected outcomes.

Many Factors Feed Into Each Forecast

Economies and markets are a web of factors that influence each other. Forecasts reflect strategists' understanding of how markets and economies operate generally and in different environments, for example, when interest rates are rising, etc. The challenge for investors is to figure out what is important in those forecasts and incorporate all significant factors into their own forecast.

Events Can Change Expectations

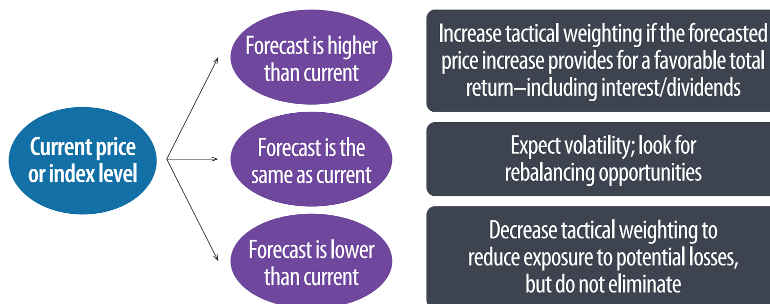
It's important to stay flexible as unforeseeable world events can change the investing environment and cause forecasts to be altered. Because change is constant, investors need to be aware of the ever increasing pace of change to help ensure their portfolios are properly positioned. This doesn't mean reacting to every event but rather focusing on the big picture and thinking through the implications of what is happening in the world and how changing global conditions can affect their investment portfolios.

How Can I Use Forecasts in Investment Decisions?

Key Takeaways

- Forecasts are meant to inform investors about the direction, magnitude, and timing of an index's or economic indicator's expected movements.
- Forecasts for performance of asset classes in relation to each other can support tactical portfolio adjustments of exposure to those assets.
- Tactical positioning is intended to exploit near-term opportunities. It is not a substitute for a sound long-term allocation strategy.

Interpreting and Using a Price Forecast



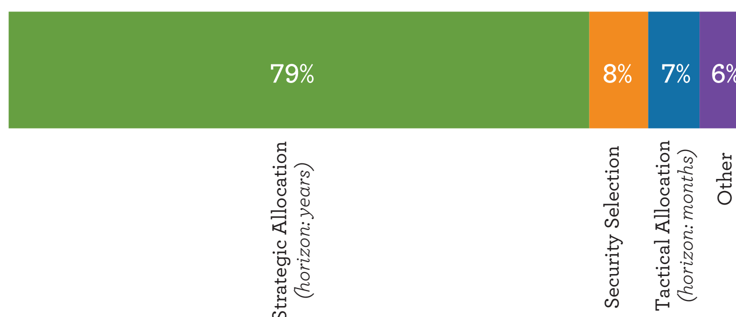
Price forecasts can help determine how to position a portfolio given certain economic conditions, such as an increase in volatility in the market or rising interest rates. The typical responses shown in the chart may not apply to every investor's situation. All forecasts are subject to change.

Strategic Asset Allocation—Perhaps Your Most Important Investment Decision

Even if you believe you have good insight into future events, you can still benefit from tactical decision making. Of course, you need to get your strategic allocation right to potentially realize gains and avoid losses.

While tactical positioning is important, and many investors devote the majority of their time to this aspect, it is only a small piece of an overall strategy. Strategic allocation is a much larger driver of long-term returns, as shown by multiple academic studies. Great tactical decisions—or great stock-picking, for that matter—are usually not enough to rescue a portfolio from poor strategic decisions.*

Wells Fargo Study Shows Long-Term Asset Allocation Has Been the Dominant Driver of Portfolio Return Variability



Source: Wells Fargo, "Determinants of Portfolio Returns," February 2010. Study is the most recent available and WFII believes the findings are still relevant.

** Tactical Asset Allocation means making short-term adjustments to asset-class weights based on shorter-term expected relative performance. Strategic Asset Allocation: means an investor's return objectives, risk tolerances, and investment constraints are integrated with long-term return assumptions to establish exposure to permissible asset classes. Asset allocation, including tactical and strategic asset allocation, do not guarantee investment returns or eliminate risk of loss.*

Investment and Insurance Products:

NOT FDIC Insured | **NO Bank Guarantee** | **MAY Lose Value**

Economic and Market Forecasts

Expectations about economic and market conditions in general form the backdrop for stock price, commodity price, interest rate, and currency exchange rate forecasts. Because of their strong influence on asset performance, getting this part right is often the most important part of an outlook and investment strategy.

	Main Influences	Likely Impact	Potential Investment Strategy
Gross Domestic Product (GDP)	• Labor-market flexibility and productivity • Tax increases or cuts • Government debt levels • Central-bank stimulus or tightening • New technology • Credit availability • Geopolitical uncertainty	Increases and decreases in GDP can affect: • Interest rates • Bond prices • Stock prices • Commodity prices	• Higher growth: emphasize stocks and real assets (commodities and real estate) • Lower growth: emphasize bonds
Inflation	• Money supply • Consumer and business confidence • Capacity utilization • Unemployment • U.S. dollar's strength	Erodes value of fixed-income investments	• Higher inflation: seek real return (return above inflation) from stocks and real assets (e.g., commodities/real estate) • Lower inflation: seek a balanced approach using stocks and bonds
Interest Rates	• Supply and demand for credit • Short-term rates: central-bank action • Long-term rates: inflation expectations • Rate spreads based on credit ratings: economic conditions	• Higher rates reduce bond prices • Lower rates boost bond prices	• Rising rates: short-terms bonds • Falling rates: long-term bonds
Stock Earnings	• Economic growth in general • Revenue opportunities in specific industries • Strength of corporate balance sheets • Previous capital expenditures • Corporate operating efficiency (margins) • Exposure to commodities or foreign currencies	• Higher earnings usually boost stock prices • Lower earnings usually depress stock prices	• Faster-growing earnings: emphasize stocks • Slower-growing earnings: reduce stock exposure
Commodities	Changes in: • Supply and demand • U.S. dollar • Interest rates	• Higher prices generally benefit producers and hurt consumers • Lower prices tend to hurt producers and help consumers	• Higher prices: investments such as exchange-traded funds that favor companies or countries that produce commodities • Lower prices: investments that favor companies or countries that use or import commodities
Currency	Relative: • Interest rates between countries • Growth rates between countries • Inflation rates	Influences interest rates and commodity prices	• Stronger dollar: favor domestic investments and companies that earn money domestically • Weaker dollar: favor companies that invest or are domiciled abroad

Risk Considerations

All investing involve risks, including the possible loss of principal. There can be no assurance that any investment strategy will be successful. Investments fluctuate with changes in market and economic conditions due to numerous factors some of which may be unpredictable. Some of the risks associated with the strategies noted above include the risks associated with investments in:

Stocks: Stocks are subject to market risk which means their value may fluctuate in response to general economic and market conditions, the prospects of individual companies, and industry sectors.

Bonds: Investments in fixed-income securities are subject to market, interest rate, credit/default, liquidity, inflation and other risks. Bond prices fluctuate inversely to changes in interest rates. Therefore, a general rise in interest rates can result in the decline in the bond's price. Credit risk is the risk that an issuer will default on payments of interest and/or principal. This risk is heightened in lower rated bonds. If sold prior to maturity, fixed income securities are subject to market risk. All fixed income investments may be worth less than their original cost upon redemption or maturity.

Foreign Investing: Investing in foreign securities presents certain risks not associated with domestic investments, such as currency fluctuation, political and economic instability, and different accounting standards. This may result in greater share price volatility. These risks are heightened in emerging markets.

Real assets are subject to the risks associated with real estate, commodities and other investments and may not be suitable for all investors. The **commodities markets** are considered speculative, carry substantial risks, and have experienced periods of extreme volatility. Products that invest in commodities may employ more complex strategies which may expose investors to additional risks.

Real estate investments have special risks, including possible illiquidity of the underlying properties, credit risk, interest rate fluctuations, and the impact of varied economic conditions.

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