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Why Does Anyone Pay Attention to These People?

Optimism is supposed to be a virtue, and nowhere is this virtue stronger than Wall Street. Market strategists most commonly assess stock index valuation by comparing current prices to the level of future earnings predicted by the consensus of investment analysts. Stock prices are supposed to discount the present value of everything we expect is coming. Why pay attention to the past when what matters is the future?

The problem is that nobody, including investment analysts, is good at predicting the future. Even so, you might think that guesses of future earnings are as likely to be high as low, so everything should even out.

You would be wrong.

Ned Davis Research, Inc. and Goldman Sachs each chart the consensus estimates by analysts of operating earnings over time for the S&P 500 Index of large U.S. companies.

Each year, analysts begin optimistic but most often become more sober as we approach the actual reporting of audited earnings.

For example, for calendar year 2017, the S&P 500 earnings estimates in early, pre-election 2016 were about $142 and have declined to about $130 now. We will know the actual reported 2017 earnings early next year.

Over the 33 completed years back to 1984, initial analyst earnings estimates exceeded the eventual reality in all but six years, more than 80 percent of the time.

Even the current, reduced estimate for 2017 earnings represents operating earnings growth of *more than 20 percent* over 2016, despite actual compound earnings growth

over the past 10 years of less than two percent annually.

Investment analysts still expect earnings growth this year greater than the *combined* growth of all years in the past decade.

Reality changes slowly, so the recent past usually is a fair guide for the future. Instead of relying on the actual, recent audited earnings and their trend that we know for sure, though, analysts insist upon a process of predicting the future incorrectly (always) and too optimistically (more than 80 percent of the time).

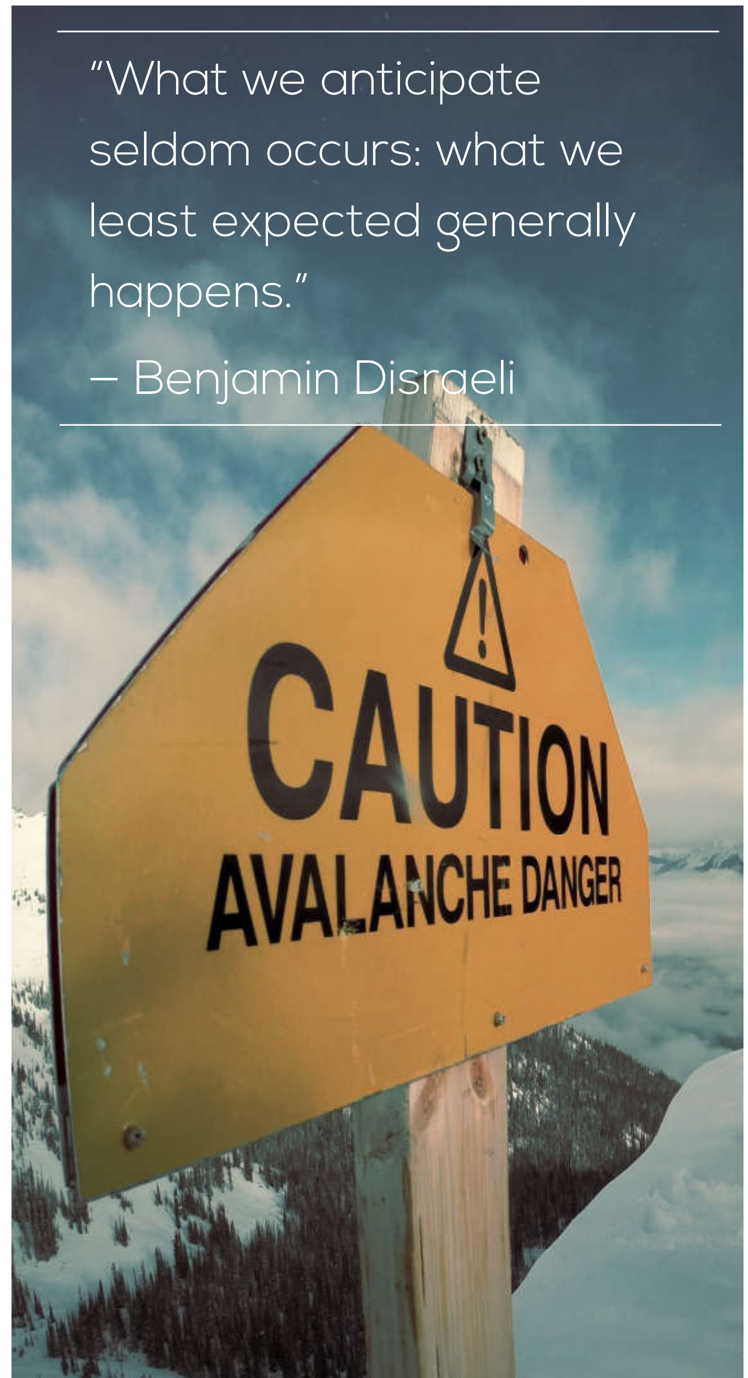
They are *very* optimistic about 2017 earnings growth (more than the cumulative growth over the past decade), but already have reduced expectations from their starting predictions.

We understand the sales reasons Wall Street might have for analysts predicting rapid earnings growth, trying to keep everyone fully invested in stocks.

Given the record, though, why does anyone pay attention?

If the optimism of Wall Street analysts is a virtue, investors currently are relative saints.

Since the presidential election, the stock market is up despite creeping analyst reductions of predicted earnings, projections *still* wildly optimistic relative to recent history.



The market has gone up despite predicted fundamentals going down, solely because investor optimism has grown faster than analyst pessimism.

This should be an interesting year.