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Dow 12000 in 2006

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There...I said it...in print

I may live to regret such an optimistic forecast for the stock market, but there it is

If I'm wrong, I fully expect many of my readers to remind me of same at this time next year

However...I think it will happen in this year's second half

Most stock market forecasters expect little from the American stock market in 2006. They see the combination of high energy prices, a slowing U.S. economy, and the infamous "inversion of the yield curve" curtailing the market optimism that is necessary to fuel a record closing in the Dow Jones Industrial Average (DJIA).

For the record, the Dow closed at 11722.98 on January 14, 2000, roughly six years ago. During 2005, the Dow average ultimately moved sideways, with its smallest overall move in 79 years, a decline of 49.48 points (0.46%) to 10717.50, marking the Dow's first decline since 2002.

Other market measures performed somewhat better, with the Nasdaq composite index up 1.37% to slightly above 2205, its third consecutive gain. The widely followed Standard & Poor 500-stock index ended the year up just over three percent.

At yearend 2005, the Dow average of 10717.50 was 1005.48 points, or 9.4%, below the all-time high of 11722.98 (don't ask me why commas aren't used for these numbers...I don't know the answer). In order to reach my 12000 forecast, the Dow would have to rise 1282.50 points this year, or roughly 12.0%.

...piece of cake

Long-time stock market historians are now quoting all the reasons why the Dow historically goes up or down depending on where we are in the Presidential election cycle, how markets respond to what the Fed is up to, how markets respond to rising corporate earnings, how markets respond to investment alternatives in the U.S. such as bonds, and to investment options around the globe...fine and dandy.

My forecast is more of a "seat of the pants" feel, driven by a handful of major factors...

Point #1...the Federal Reserve will soon finish its Chinese water torture approach to monetary tightening. At yearend 2005, the Fed had tightened following 13 meetings of its Open Market Committee (FOMC). These moves have come roughly every 45 days since late June 2004.

The current federal funds rate of 4.25% is widely expected to move to 4.50% following the January 31-February 1, '06 FOMC meeting. Most forecasters then expect one or two additional moves, the first on March 28. A 16th and likely final move, should it occur, would follow the FOMC meeting of May 10, 2006.

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One of many market sayings is "Don't fight the Fed," meaning it is tough for markets to move higher when the Fed is in tightening mode. Won't it be nice at some point in a few months to see the Fed move to the sidelines, with discussion thereafter of when the Fed might begin to reduce the federal funds rate?

...in my mind, good news for the stock market

Point #2...the performance of foreign stock markets in 2005. While the U.S. equity market did essentially nothing in 2005, and really nothing over the past 4-5 years, such has not been the case globally.

The Nikkei 225 index, the primary measure of Japanese stock performance, rose 40% last year, its best annual

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performance since 1986. Germany's DAX rose 28% last year, while England's FTSE 100 rose 16.7%.

Stock markets in France, Switzerland, and the Netherlands had gains exceeding 20%. The major Italian index rose 15.5%, which was actually the worst performer in Europe *(The New York Times)*. Note: any of these gains enjoyed by American investors would have to be trimmed by roughly half when converted back to U.S. dollars. The dollar gained nearly 13% versus the euro in 2005, after declining a larger amount in the three prior years.

My point here is that as investors look at global alternatives, they will see the U.S. market as potentially more attractive than many other major foreign markets.

Point #3…the rising awareness that aging "baby boomers" in the U.S. need to save more aggressively. A great deal of media attention is currently focused on two major developments regarding those 78 million of us born between 1946 and 1964. The first is that the oldest boomers hit 60 this year. Are they anywhere close to being ready to finance their retirement years?

I expect stock mutual fund inflows to rise sharply in 2006 and beyond as boomers race the clock to be ready for partial retirements. Note: 85% of boomers say they never want to retire (at 65 or so), but plan to work flexible, and fewer, hours in their skill areas. Employers who offer this part-time flexibility in coming years will be able to retain quality workers for years to come.

American mutual funds attracted more than $20 billion in new money during November 2005, the second highest monthly gain of 2005. I am firmly in the camp believing that such additions to mutual fund investments in coming years will be enormous. One reason supporting this notion is that bond yields near 4.35% for two to 10-year investments into U.S. Treasury Notes are not going to excite many people.

The other development here is anxiety about pension programs. Limitations to pension payouts, and ongoing shifts from "defined benefit" programs to "defined contribution" programs…such as 401(k) programs…will scare boomers and younger workers as well into saving more for retirement. In this case, the media's negative bias will actually promote more savings for the future.

Where, in my opinion, will tens of billions of aggressive U.S. and global investment dollars go this year and next as more "evidence" is seen that the profitable ride in home price appreciation has largely run its course on both coasts and in the SW? Answer… back to the stock market!

Point #4…the expected shift of aggressive investment money from housing back to the stock market. Think about it… where were tens of billions of aggressive American investment dollars parked in the late 1990s? Answer…the stock market.

Where did tens of billions of aggressive U.S. and global investment dollars go over the past 3-5 years when the stock market tanked? Answer…into real estate, primarily on both coasts and in the Southwest.

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These four points could also be supported with my view that A) U.S. economic growth in 2006 will be slightly above 3.0% after inflation, thereby leading to significant job and corporate earnings growth, and B) that I expect some additional relief in energy prices.

So there it is…Dow 12000 in '06

…may the force be with us

Jeff

"TEA"ser

Thanks to the stock market, we don't have to go to a health club to sweat

—American Speaker

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