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Monday Morning Outlook

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Dow 14,000 Remains on Tap

With the Dow Jones Industrial Average very near 13,000, the title of our January 4, 2007 Wall Street Journal Op-Ed – “Dow 14,000 on Tap” – no longer elicits wide-eyed reactions, like it did a few months ago.

The skeptics became even more emphatic after the sharp drop in equity prices that occurred in late February and early March. At that point, some were even talking of a new “global bear market,” caused at least partly by a recession in the US.

But the US stock market, and much of the globe, has reversed course and boomed. The Dow Jones Industrial Average climbed to a new all-time high last Friday, and is up 7.6% from its recent bottom on March 5, 2006. During this same time frame, the S&P 500 jumped 8.0%, while the Nasdaq rose 7.9%.

While it’s impossible to explain every zig and zag in financial markets, the recent run-up seems to be based on strong reported earnings and clear evidence that the economy is not falling into recession, as many feared.

On the earnings front, through Friday, 134 of the S&P 500 companies had reported. The results are interesting. So far, 66.4% of reporting companies had positive earnings surprises – a nice improvement from last quarter. While earnings growth has slowed to just 5.2% on a year-over-year basis, all the positive surprises suggest analysts are underestimating both micro- and macro-forces.

The micro-force is productivity growth, as companies ride a wave of new technology. At the same time, there

are two important macro-forces. First, global growth is on a tear as capitalism and freedom spread. Second, the US economy refuses to be toppled.

Pessimists continue to argue that productivity growth is slowing, or will slow for good very soon. But the technology boom continues. And while it is true that productivity growth has waned in recent quarters, this appears to be driven by slightly weaker GDP growth due to a housing correction. Employment growth remains robust. As in 1995, we expect this slowdown to be temporary. The negative impact from sub-prime foreclosures is overblown.

Moreover, the global economy is experiencing its fourth year in a row of spectacular growth. Given the international focus of many US companies, this global growth is boosting returns even while the domestic economy slows.

Finally, our models – based on overall corporate profits and a conservative estimate of the current discount rate – continue to show that the broad US stock market is 20 to 25% undervalued.

Tax rates remain low, Fed policy is still accommodative, global growth is strong, and technology remains a major force. As a result, corporate profits and economic activity will continue to expand more rapidly than conventional wisdom predicts.

While tempted to raise it, we will stick with our original forecast for now. Dow 14,000 remains on tap.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
4-24 / 9:00 am	Existing Home Sales - Mar	6.435 Mil	6.643 Mil		6.690 Mil
4-25 / 7:30 am	Durable Goods - Mar	+2.2%	+6.4%		+1.7%
7:30 am	Durable Goods Ex-Trans - Mar	+1.1%	+2.4%		-1.0%
9:00 am	New Home Sales - Mar	0.890 Mil	0.863 Mil		0.848 Mil
4-26 / 7:30 am	Initial Claims - Apr 21	330 K	329 K		339 K
4-27 / 7:30 am	Q1 GDP Advance	2.0%	2.7%		2.5%
7:30 am	Q1 GDP Chain Price Index	3.1%	2.5%		1.7%
7:30 am	Q1 Employment Cost Index	0.8%	+1.0%		+0.8%
4-30 / 7:30 am	Personal Income - Mar	+0.6%	+0.3%		+0.6%
7:30 am	Personal Spending - Mar	+0.6%	+0.5%		+0.6%
9:00 am	Construction Spending - Mar	+0.2%	-0.5%		+0.3%