



TSG Weekly Stock Market Watch

Week Ending May 25, 2007

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- [New home sales bring hope while existing home sales slide](#)
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More on Cycles, Boomers and Busts

In our [April 27 newsletter](#) we discussed Dan Arnold's demographic theory from his book *The Great Bust Ahead* about how those in their biggest earning and spending years have driven booms and busts throughout history. While interesting, we believe that it's imperative to find support for an idea that has such a potentially wide-reaching impact on our portfolio. This week we take a look at other demographic research and how it ties in with the spending bubble theory. Does the data support this conclusion?

The first is a book published in 1992 by Harry S. Dent entitled *The Great Boom Ahead* (I wonder if Arnold's title was in any way influenced by it?) that in a nutshell forecasted a Dow of between 8,500 and 12,000 in the next few years. Dent also predicted in 1988 that Japan would enter a long-term slowdown in the early 1990s that would last into the early 2000s. Other books on the topic include his *The Roaring 2000s Investor* (2000) and *The Next Great Bubble Boom: How to profit from the greatest boom in history, 2005-2009* (2004).

What is he saying now? Just 12 years after his 1992 book, Dent forecasted that the Dow would hit 35,000 to 40,000 and a Nasdaq of between 13,000 and 20,000 by the end of this decade in *The Great Bubble Boom*. His estimates were arrived at by comparing the boom in the 1920s with that of the late 1990s into the first decade of 2000 by lagging the Dow by 81 years (see Figure 1). A second correlation was done by comparing the Dow of the 1990s with Dow 2000s (lag of 11 years). He also predicted oil would peak in mid-August 2005 at \$66-\$68 which turned out to be a year early and \$10 short (crude's high to date was \$78 on July 14, 2006).

But in his October 2006 report entitled *Dow 15,000 by Early 2008 and 20,000 by Late 2009* Dent explained why he had revised his initial targets. The correlation between the Dow of the 1920s and 2000s had broken down rendering his earlier forecasts too optimistic. "Make no mistake, we still think the next bubble has been emerging since July 2006 and that most stocks will soar to unprecedented highs – most likely to around 20,000 on the Dow by 2009 – but geopolitical trends and tensions make out original forecast of 32,000 to 40,000, spelled out in the *Next Great Bubble Boom*, much less likely," he said in the report.

Dow Jones Industrials 1920s Recovery vs. 2000s Recovery



Source: Yahoo Finance

<http://www.hsdent.com/download/dow20000.pdf>

Figure 1 – Chart showing Harry Dent’s correlation between the Dow 1920s and Dow 2000s. His report shows a similar comparison between the Dow 1990s and Dow 2000s. Source - <http://www.hsdent.com/download/dow20000.pdf>

One major culprit he says is the terror threat that did not exist 80 years (or 11 years) ago, which helped drive oil to new highs negatively impacting the economy. His new forecast also includes another oil price spike of “\$100 plus” in 2008 or 2009. Dent still sees spending by the 45-54 year olds peaking in 2009 followed by a slowdown thanks to retiring baby boomers in Europe and America will cause not only stocks to drop but oil and commodity prices as well.

As anyone who reads Harry Dent soon learns, he loves to make forecasts but he is just as ready to revise them as new data becomes available. “Though the increased use of technical and cyclical indicators, our analysis has been much more accurate since the bottom in October 2002,” he explains.

Unlike the straight-forward approach by Dan Arnold who relies solely on demographics, Dent employs a number of methods including both short and long-term cycles, technical indicators and even Elliott Wave theory.

36-Year Rise and Stall Cycle Dow Industrials



Source: Global Financial Data

<http://www.hsdent.com/download/dow20000.pdf>

Figure 2 – Revised forecast by Harry S. Dent from his October 2006 report <http://www.hsdent.com/download/dow20000.pdf> showing his projected Dow peak around 20,000.

But if you step back and ignore the short-term noise and assumption errors, one undeniable truth emerges. When those in their greatest earning and spending years form the largest constituency of a population, bubbles happen and when they retire these bubbles burst. During these periods forecasters are wrong both about how high markets will soar and how far they ultimately plummet once the euphoria evaporates.

The devil is in the detail however. As calls by various forecasters have shown, no two cycles or periods in history are ever identical so it is a mistake to assume they will be and act accordingly. An unexpected event could cause the correction to come early or lack of one or even a change in the historic pattern (like baby boomers deciding to retire later) could see the trend last longer.

Here is what we can expect based on the past.

This demographic factor has the potential to minimize the impact of the sub-prime meltdown and softening housing markets on stocks and the economy. And it is this fact that will continue to give the bulls hope and keep the bears from jumping in with both feet at least until 2009. There will be corrections along the way, especially when

the unexpected happens and let's face it, with the optimism abounding these days the unexpected is bound to be negative.

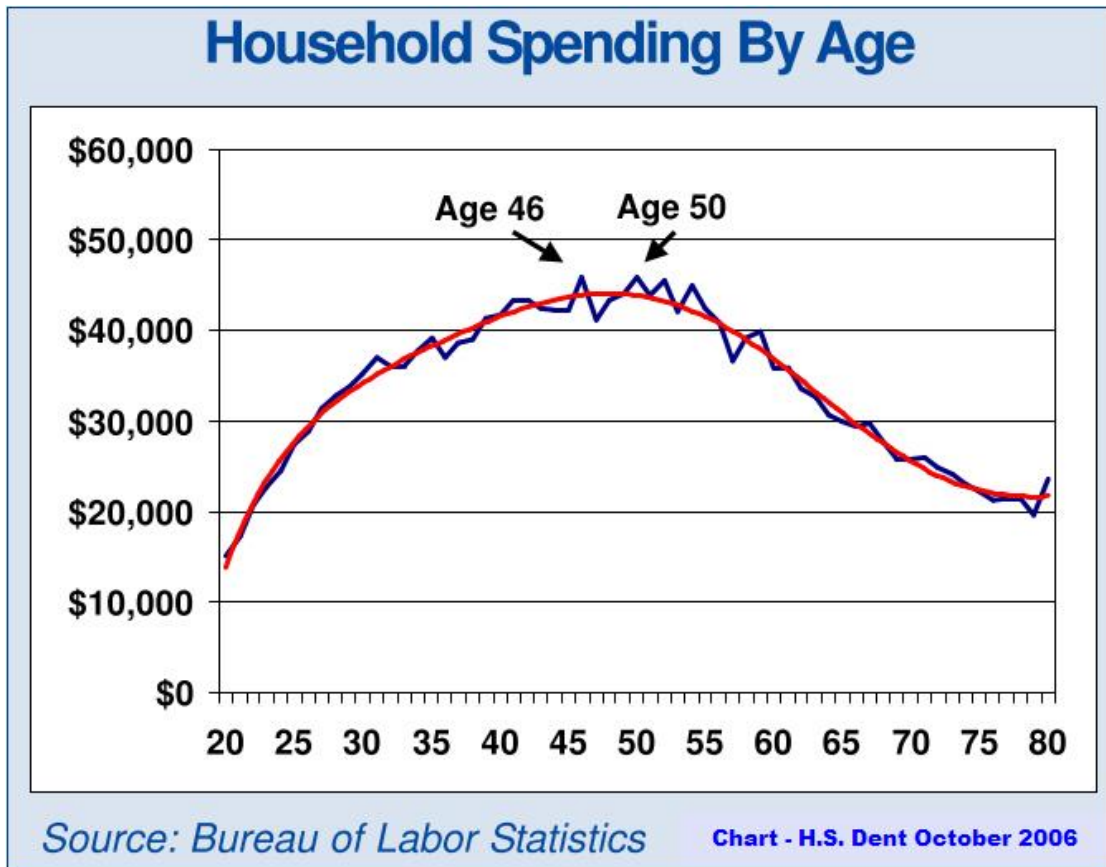


Figure 3 – Chart of spending by age showing peak spending years from ages 45-50.

But while they are the majority, big spenders and their money will continue to drive the market making it difficult to cash in on the short side of the market in any major way till they retire in large numbers. Given the other forces at work such as the presidential, technology and economic cycles plus geopolitical risks and commodity supply-demand relationships, the next major correction could come as early as 2008 or as late as 2012 and those who understand these forces and intermarket relationships will be in a better position to protect themselves when the current bubble comes to an end. Preservation of capital holds the key.

For another demographic perspective from Michael Alexander, author of *The Spending Wave*, go to <http://www.safehaven.com/article-70.htm> A word of warning, while Dent was forecasting much higher markets in 2001, Alexander predicted a Dow peak and the end of the secular bull market in 2002.

Now let's check in on what happened in markets this week.

INDEX	Weekly Close	Last Week	Change	Change%
INDU	13,507.28	13,556.53	-49.25	-0.36%
DJT	5,147.58	5,213.71	-66.13	-1.27%
SPX	1515.73	1522.75	-7.02	-0.46%
COMPX	2557.19	2558.45	-1.26	-0.05%
RUT	829.93	823.66	6.27	0.76%

Summary

This was the weakest week for markets in more than a month as of the five we cover in our table only the Russell 2000 managed to end in positive territory. But Friday also recorded the lowest volume of the year on the NYSE so investors and traders shouldn't be too concerned.

Technically Speaking

Stock momentum took a little breather this week as the Dow Industrials consolidated. It along with the NYSE, DJT, Toronto TSX and MSCI World Indexes are still just a few points from their 52-week highs and the SPX sits not far from its new all-time high. However, it was a bad week for the Dow Jones Utility Index as it dropped more than 4%, for its worst weekly performance since October 2005.

Commodities managed a higher close this week as the NYFE CRB Index closed at 405.38 from 404.14 last week. But it was only thanks to a weaker dollar.

Meanwhile gold dropped again this week closing at \$661.60 down marginally from \$661.70 last week. Our gold cycle shows strength from the end of January and to the end of May so we don't expect the metal to do well until the end of July when a second cycle picks up that should last until October or November. This outlook over the short-term is further confirmed by overall commodity weakness.

NYMEX crude oil (continuous) took a bit of a breather this week closing at \$65.20 down from \$65.98 last week but prices at the gas pump again moved higher across the country.

Meanwhile the greenback finished its fourth week of rallying as the U.S. Dollar Index closed at 82.27 from 82.11 last week. However, the rally looks to be tiring if declining momentum and volume are any indications.

The same thing could be said of the MSCI Emerging Market Index ETF (EEM) that closed at 125.75 down from 126.85 last week.

Earnings

With a total of 4037 companies (up from 3927 last week) having reported earnings for Q1-2007, results again held steady with an improvement this week coming of 9% versus the same quarter last year. But for a few stragglers, earnings season is over and with it any chance that earnings improvements will match the 33% level that occurred for Q4-06 season.

Economic Reports

Here's what the charts had to say this week.

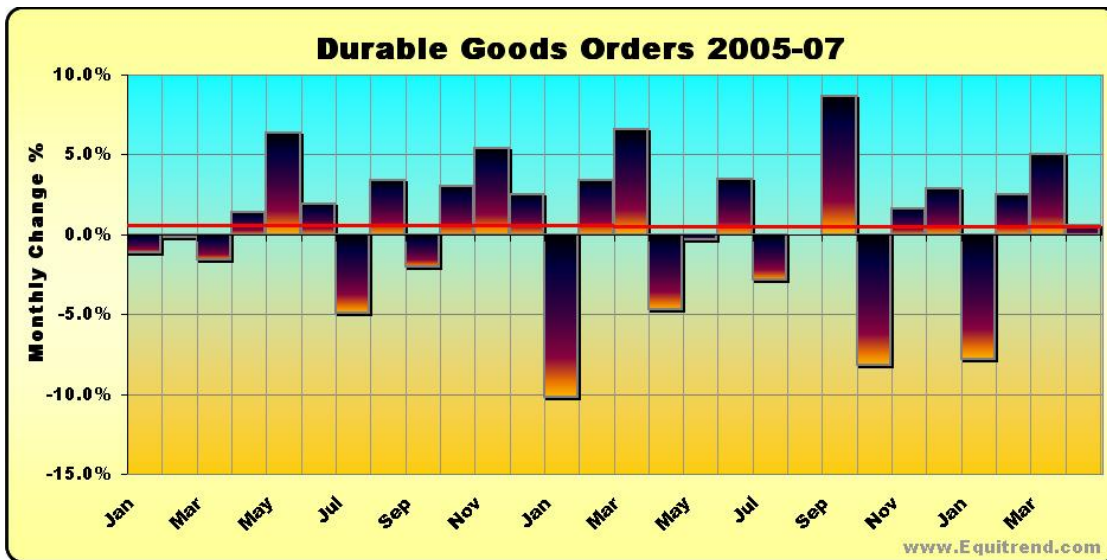


Chart 1 – After revising the March number from 3.4% to 5.0%, durable goods came in at a just 0.6% in April but the two-year trend is still flat. That durable goods are holding up however, is good news for the economy.

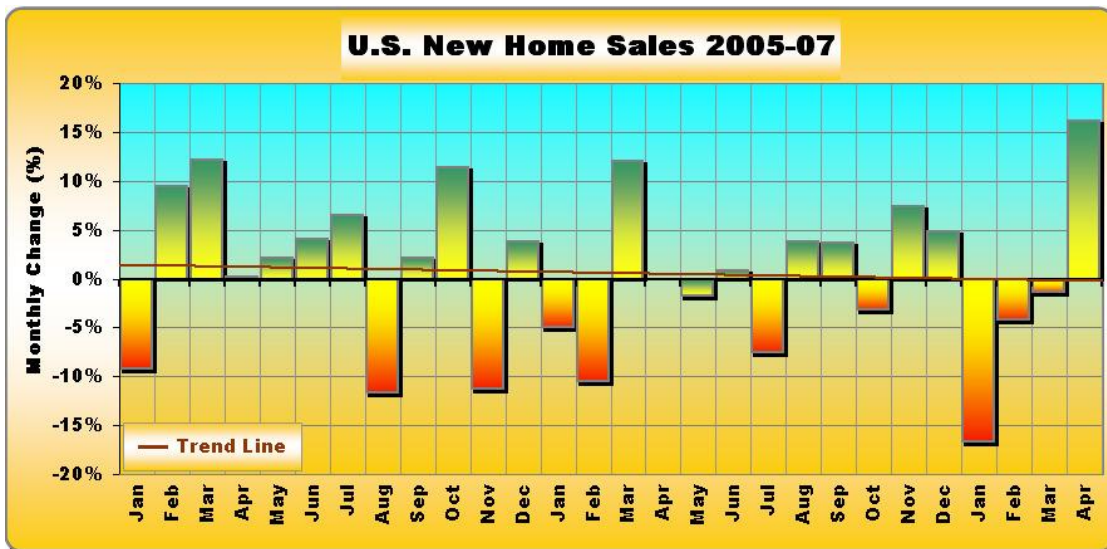


Chart 2 – It was a double-edged sword for new homes as sales jumped an impressive 16.2% for the largest monthly gain in 14 years. But this result was achieved on the back of continued generous concessions to make sales. The median price of a new home tumbled 10.9% over the same month last year to \$229,100 as builders jumped through hoops to make sales. Perennial industry realist, Robert Toll CEO of luxury builder Toll Brothers said, “I would say that we have not got the bad times behind us yet,” in the Wall Street Journal this week after it was announced that his company’s net income declined 79% for the quarter ending April 30, 2007. Not mentioned in the

media was the fact that the March new homes sales were revised down from +2.6% to -1.4%. Final new home sales can fluctuate more than 10% from month to month so I wouldn't put much stock in this month's number until it can be confirmed next month.



Chart 3 – But any new home sales optimism was not shared in used home sales, which represent 85% of the market. On an annual basis, existing home sales dropped 2.6% in April to 5.99 million, the lowest level since June 2003. The National Association of Realtors (NAR) blamed the drying up of sub-prime products and the resulting difficulty to obtain loans. The organization also reported a 10.4% increase in existing home inventories pushing the number of homes listed to 4.2 million and the average selling time from 7.4 to 8.4 months, which sobered even those most optimistic that the worst was over. The median price of an existing home dropped to \$220,900 down 0.8% from April 2006 according to the NAR.

Next Week

Even with the Memorial Day holiday on Monday, it will be a busier week for economic reports. Here are the ones we'll be watching.

- Wednesday, May Federal Open Market Committee minutes.
- Thursday, Q1-2007 preliminary GDP (previous 1.3%), May Chicago PMI (previous 52.9) April construction spending (previous 0.2%).
- Friday, May Non-farm Payrolls (previous 8,000), April personal income (previous 0.7%), April personal spending (previous 0.3%), May Reuters/University Michigan Consumer Sentiment Index (previous 88.7), April pending home sales (previous -4.9%), May ISM Manufacturing Business Index (previous 54.7).

Synopsis

When things are this good, it's hard not to get careless. But as we have seen lately, there is a complacency pandemic sweeping the investment globe and any shock from here will catch a lot of people off guard.

On a shorter-term basis, the Dow declined during Memorial Week in seven of the last eleven years but it gained 2.3% in 1999, 4.8% in 2000 and 2.9% during the week of

2003 according to the Stock Trader's Almanac 2007. The Almanac also commented that the Friday before Memorial Day tends to be lacklustre with light trading which was bang on.

On balance there is more to worry about than celebrate. Stocks are priced for good news going forward and any unexpected bad news could cause a run for the exits especially during the summer doldrums that are rapidly approaching.

The holiday also marks the beginning of the busy summer driving season and even with gas prices near all-time highs, there will be lots of folks on the road this weekend. Have a relaxing and enjoyable holiday and be safe if you are driving anywhere.

If you find this newsletter insightful, please feel free to forward this newsletter and share it with a friend (or simply have them opt-in free from our home page <http://www.tradesystemguru.com> to be added).

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