Where is my 35,000?
And since it didn't happen, why believe the downturn?

Starting in the late 1990s we forecast that the Dow Jones Industrials Average could reach as high as 35,000 before the economic boom was over. We were wrong. Many people have asked us where that forecast went and, if we could be so off on the upside, shouldn't our downside forecast be viewed with skepticism? This deserves an answer.

HS Dent research does not start with the equity markets. The research has always been based on predictable consumer spending patterns determined by age and family formation (what people buy at what age), demographic trends (how many people are at each age and the trends going forward), and technological innovation and acceptance rates (productivity gains). Out of this, many forecasts can be made in a myriad of areas including real estate, interest rates, equity markets, etc. The equity markets have always been one of the outcomes of the research, not the research itself.

Our forecast, starting back in 1988 when Harry S. Dent, Jr. published his first book, *Our Power to Predict*, was that the United States was in the midst of the greatest economic boom in its history because the largest generation – the baby boomers – were near the beginning of their peak spending cycle. This spending cycle, or wave, would continue to grow until the end of the 2000s, when this same group would have finally passed the spending stage of life and would be fully into the next phase, where they would be focused on paying down debts and saving for retirement.

Our view was that many obstacles and hurdles would appear along the way, but we would as a nation continue to "grow ourselves out" of these situations because the stage of life of the boomers called for more spending. Conversely, at the end of the 2000s, after the spending wave had crested, there was no amount of persuasion or prodding that would make this group spend more, thereby leading to a long economic decline until the next generation was far enough into their own spending to counterbalance it.

Throughout the 1990s and 2000s we held fast to our basic research. The early 1990s recession? Asian contagion? LTCM? Tech bubble bursting? 9/11? Wars? Hurricane Katrina? Oil over $100? In the face of them all, on average we as consumers spent more (as measured by the Federal Reserve's report of quarterly consumer expenditures). If adjusted for inflation, only in 1991 did we have even a slight dip in consumer expenditures. Through every other setback, including 9/11, we spent more. There is no doubt that consumers felt bad about the situations at hand, as consumer confidence clearly illustrated, but we continued our spending. It is that resilience that we at HS Dent were highlighting in our research. It proved itself to be true time and again.

There can be no question that the basic forecast of HS Dent has been correct: spending by boomers through good and bad times over the last 20 years has kept our economy growing, indeed booming, despite what seemed at times to be overwhelming circumstances. Many of the forecasts that came out of this – real estate trends, interest rate trends, even the balanced budget of 1998 (in 1992 Harry Dent forecast that the US govt budget would be balanced in 1998 due to rising tax receipts from the growing economy) – happened nearly exactly as predicted. The equity forecast from the late 80s and early 90s was for the Dow to reach possibly 8,000 during the boom – later revised to 12,000 – which seemed outlandish at the time. We all know what happened next. Throughout the mid to late 90s the markets soared. What pushed them? At first the basic tenets of our research, which was ever-increasing consumer spending driving earnings higher, and in turn being recognized in the equity markets – this was before the tech-craze of 1999.

In 1997 we published *The Roaring 2000s*, which forecast that consumer spending would keep rising. Believing that we had another 10+ years of increased spending in front of us, we considered what we might have done wrong in our forecast of equities, as we had already reached our top range. Knowing that a dollar of increased earnings has a multiplied affect on stock prices due to the P/E multiplier, we adjusted our estimate of what level the Dow might reach by changing our scale on the Dow from arithmetic to logarithmic. This changed our top number of our Dow channel from 12,000 to 35,000 or even a little higher. Did we think there would be “reasonable” valuations at 35,000? No. We thought it would be an asset bubble concentrated in equities that would take the market to those lofty heights as investors wrongly believed that the spending would always go up. This theme was continued in *The Next Great Bubble Boom*, published in 2004 where we outlined the same basic principles, noting that consumer spending had indeed kept rising, but that we had been experiencing a rotating asset bubble that had moved from stocks (90s), to housing (early 2000s), to commodities (2004 forward), that would end up with one last asset bubble in equities. The bubble indeed continued, moving commodities even higher and also growing overseas where markets such as China grew over 50% annually!

By mid 2006 we were certain that we were wrong about the potential for growth in the US equity markets. The basic tenets of the research told us that the growth in consumer spending only had a few short years left. Because of that, the window for equity growth was closing. Even though spending had continued to increase in spite of all of the issues of the 1990s and 2000s, rising earnings during the 2000s were being accompanied by falling P/Es instead of leading to rising stock prices. Our view, as outlined in our research update in the Spring of 2006, was that we have been in a geopolitical cycle that has skewed market psychology toward extreme pessimism, keeping a lid on what could have been a more optimistic view in the equity markets and instead the bubble boom continued to march higher in other areas – housing, commodities, and international markets. We drastically cut our upside forecast to 20,000, and then to 16,000. All the while, we kept in front of us the basic research – spending would begin to slow at the end of the decade, cascading through the economy, causing huge dislocations and other issues.

As the third quarter of 2008 progressed, the credit crisis began to take its toll, finally crashing down on consumers, helping to usher in the first decline in consumer spending in decades, and beginning what we think will be a multi-year process of dealing with slower/lower spending and excess capacity as boomers save more and spend less.

So, back to the question – "We never reached near your projected highs, why should we give credence to your forecasts now?"

Considering all of the background above, it is clear our forecast of continued increases in consumer spending throughout the 1990s and 2000s based on age and stage of life did happen, as did many of the outcomes that we had forecast. What did not happen, even with higher spending, was higher equity prices. We are now at the point where our forecast is for lower personal spending. The next several years will be marked by continued declines in spending, rising savings rates, and reductions in debt. We then project lower asset prices, including equities. If we are right on consumer spending, as we have been for many years, then for us to be wrong on equity prices from here would mean that equities actually ***go up*** in the face of a continued difficult economy and falling GDP. How likely is that?