H.S.Dent Forecast - In Review

December 6, 2005

The Economic Guide for Effective Financial Decision Making

Feature Articles

Dent's Forecast for the Dow to Reach as High as 40,000 in 2010 – Is That Just Too bullish?

From the late 1980s to the early 1990s Harry Dent forecasted that the boom that started in the early 1980s would accelerate into the greatest boom in history into the end of this decade due to the spending and productivity/technology trends of the massive baby boom generation. When he forecast that the Dow would go to 8,500 to 12,000 in *The Great Boom Ahead* in late 1992 most people thought — despite his compelling demographic logic – that there was no way that the economy could be that strong or that stocks could rise that high given such high levels of consumer debt and government deficits, and the slow recovery at first from the 1990s recession and real estate slowdown.

Dent stood virtually alone in forecasting the incredible boom and stock market bubble of the late 1990s. He also forecast in the late 1980s that Japan would enter a long term slowdown and bear market in the 1990s and early 2000s, and that the U.S. Federal deficit would turn into a surplus between 1998 and 2000.

But now economists and analysts argue that we have seen the great bubble in stocks burst and that the best days are over for the economy and stock market – and that we would never repeat such a cycle in this decade. They are forecasting that we will see more modest growth at best and a longer term slowing at worst – and that stocks will be lucky to generate returns of 4% to 7% as they regress back to longer term trends at 10% to 11%. Dent again is forecasting what no one else is forecasting — that we will see another, even greater bubble boom from late 2005 into mid to late 2010, after calling the bottom with his strongest buy signal ever in October of 2002.

It's not that we have seen a bubble burst . . . but that we are in a bubble boom!

We have seen a series of bubbles from inflation, real estate, oil and gold in the late 1970s, to the first stock bubble from 1985 to 1987, to another minor real estate bubble in 1990, to a greater stock bubble into early 2000, to the greatest bubble in history for housing into 2005, and a second oil and commodity bubble that is recently peaking. Dent has been forecasting the peak of these recent bubbles, as you can see in The Appendix. Since the massive baby boom generation hit the scene accompanied by the most powerful new technologies since automobiles, electricity and phones, we have seen one bubble after the next. We saw similar bubble booms from the early 1900s through the Roaring 20s due to the last great technology revolution before the Great Depression hit in the 1930s – but you have to look that far back to see a bubble boom comparable to today's. This bubble boom will continue until the baby boom generation reaches its peak spending trends around 2010 and the current technology revolution reaches 90% penetration of households by around late 2009.

Dent's Forecasts Since the Bottom in October 2002 Have Been Very Accurate

Now you can ask again, why should we trust Dent's very bullish forecasts even after his track record for forecasting the 1990s bubble boom? Didn't his forecasts peak earlier than he thought given the extreme stock bubble into early 2000? Dent forecast in his 1999 book *The Roaring 2000s Investor* that the Dow Channel would hit its peak by around late 1999 with a sharp correction to follow (page 26-27). But he didn't see the magnitude of the crash until early 2001 in his newsletter when his technical indicators deteriorated and where he warned that the stock markets could go back to their 1998 lows, or as low as 1,100 on the Nasdaq.

But Dent gave the strongest buy signal in the history of his newsletter (dating back to 1989) in early October of 2002. He forecast the 50% advance in the markets in 2003. He has given strong buy signals at every major bottom since – in March of 2003, August of 2004, April of 2005, and more recently in October of 2005 as we show in Chart 1 and confirm in The Appendix. He is extremely bullish for US stocks over the next year, forecasting a similar near-50% advance ahead comparable to 2003. He is forecasting a Dow of 14,000 to 15,000 by August of 2006 and the Nasdaq to reach 3,500. By 2010 he is forecasting a Dow of at least 32,000 and more likely 40,000. This is even more contrary to conventional wisdom than his forecast in the late 1980s and early 1990s of a Dow around 10,000. But if we do see such a strong advance into 2006 then Dent's forecasts will look more credible.

Nasdaq Composite
Oct 2002 – Oct 2005

Source: Yahoo Finance

Chart 1

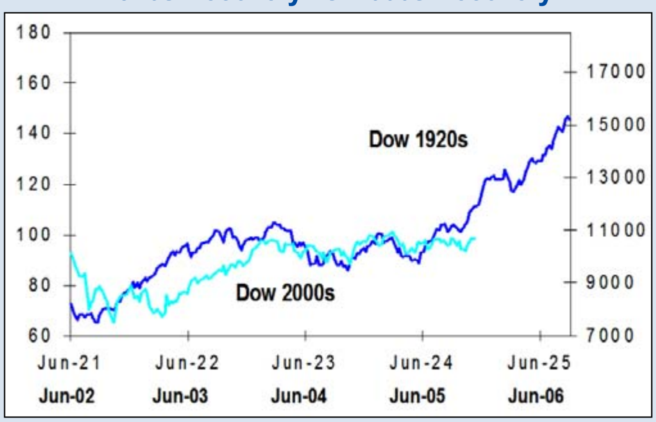
Even if Dent is too bullish, all of the fundamental, cyclical and technical indicators strongly suggest a major bull market ahead. If the Dow only goes to 20,000, or the Nasdaq only retests its highs of 5,050, investors will get much stronger returns in stocks than from bonds or real estate, as Dent has been warning of a flattening in real estate trends and housing appreciation that is already slowing in late 2005 and should slow more dramatically into 2006.

An End to the Long Trading Range Is Imminent in Late 2005

Since January of 2004 and into this year, the markets have traded sideways in a narrow range and have been very frustrating for investors. But the markets have stayed surprisingly buoyant in reaction to the oil bubble, the housing bubble, a surge in commodity prices, the worst two hurricane seasons in American history, and the Fed raising rates longer and higher than long term bond markets and inflation trends would suggest. But the truth is that investors have gotten as pessimistic as they were between July of 2002 and March of 2003, which is building the foundation for another sudden and rapid advance in stocks between October 2005 and the summer of 2006 – just as occurred in 2003, as Dent forecast.

Stocks have been trading in a relatively tight range for 21 months now, and even the most patient of bulls would begin to lose faith after nearly two years of aborted rallies. The good news is that this loss of faith - and ultimate capitulation – is exactly what is needed to give stocks the firm launching pad they would need to hit 14,000 plus by August of 2006 – and as high as 40,000 by 2010. Every stock market bubble in the last century — 1915 to 1919, 1925 to 1929, 1935 to 1937, 1985 to 1987, and 1995 to 1999 — was preceded by a major correction or crash, a strong initial recovery rally, and then a one- to two-year trading range sideways. These trading ranges were typically 19 to 22 months.

Dow Jones Industrials
1920s Recovery vs. 2000s Recovery



Source: www.globalfindata.com; Yahoo Finance Chart 2

The 2000s have thus far followed a very similar pattern to the 1920s scenario in Chart 2, that witnessed the greatest single bull market in U.S. history from late 1924 into late 1929. Stocks first crashed in early 2000 to late 2002, rallied 50% in 2003, and stalled through most of 2004 and 2005. The conditions are right for this market to launch again as much as 50% into 2006 and then continue into a stronger bubble into 2010, fueled in part by a reverse in speculation from housing back into stocks.

The long-term demographic and technology cycle models, which correctly forecast the incredible and unexpected 1990s bubble boom, are pointing toward a sustained bull market starting this year with rising spending and productivity gains into 2010. But the cyclical models are also pointing towards a strong advance in the second half of this decade and the technical models are seeing extreme pessimism similar to late 2002 and early 2003, and the end of the trading range in late 1994 before the 1995 to 1999 bubble. Valuation models are showing stocks to be almost 40% undervalued vs. bonds.

Dow Jones Industrial Average
Lagged 81 years
2005-2011

Source: www.globalfindata.com Chart 3

Chart 3 illustrates what the markets can do when they break out of a long trading range. In the fourteen months from November 1924 to December 1925, the Dow rocketed 53% - and that was before the Roaring 20s entered the strongest bubble years from 1927 to 1929. If the Dow continues to follow the pattern of the 1920s on an 81-year lag, it would peak around 40,000 by mid to late 2010 – before crashing to a greater degree than the 2000 – 2002 correction into 2012 to early 2013. This scenario would also be consistent with the Dow Channel projection that also forecasts near 40,000 by the end of this decade in Chart 4. If the advances are not as strong as in past bubble scenarios then the forecasts would have to be adjusted accordingly.

If Dent is right about a sudden advance in the Dow to as high as 14,000 to 15,000 by August of 2006, and the Nasdaq as high as 3,500 — then the stock markets would be closely following the bubble boom markets that followed long trading ranges in the 1920s and 1990s – and such a continued bubble would suggest a minimum of 32,000 on the Dow or 40,000 at the highest by mid to late 2010. The Nasdaq should advance to around 13,000 at its peak, likely earlier in late 2009.

From a level of 15,000 by the summer of 2006, a Dow of 40,000 would not look so unattainable when compared to past bubbles that developed. Given that Dent was so right against the grain in the 1990s, why could he not be right again given how closely he has called this next bull market in its early stages?

Major Technical and Cyclical Indicators Strongly Suggest a Major Advance

But let's also look at a few key technical indicators that would also suggest major gains ahead. Chart 5 shows the valuation of stock earnings yields vs. 10-year Treasury yields since the late 1970s. Stocks got more overvalued than any time in history in early 2000 and then got more undervalued similarly in late 2002. Given falling bond yields since the recovery, stocks are still undervalued 34% as of October 2005. This alone would suggest that stocks at fair value should be at 14,000 to 15,000 on the Dow – Dent's targets for the summer of 2006. What would the valuations be if there is a continued strong boom and extreme overvaluation in another bubble again by 2010 – as high as 40,000!

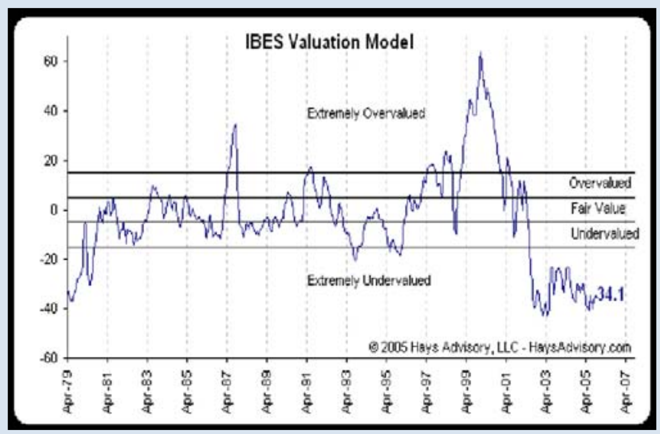
Chart 6 shows the bearish sentiment of everyday investors, and how it along with many other technical indicators has called the major bottoms of the past. Investors are approximately as bearish as they were at the end of the trading range in late 1994 and at the major bottoms in July 2002, October 2002, March 2002 and April 2005. Hence, the markets are due for a major rally ahead even if Dent's forecasts are too bullish.

In addition, the Decennial Cycle in Chart 7 documented by Ned Davis over the last century strongly suggests that the greatest stock and economic gains come in the last

Dow Channel
1974-2010

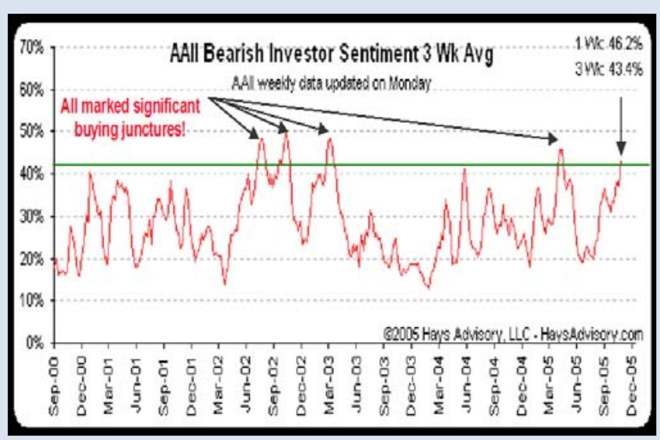
Source: www.globalfindata.com; Yahoo Finance
Chart 4

IBES Valuation Model



Source: Hays Advisory, Inc., www.haysmarketfocus.com
Chart 5

AAII Bearish Sentiment



Source: Hays Advisory, Inc., www.haysmarketfocus.com
Chart 6

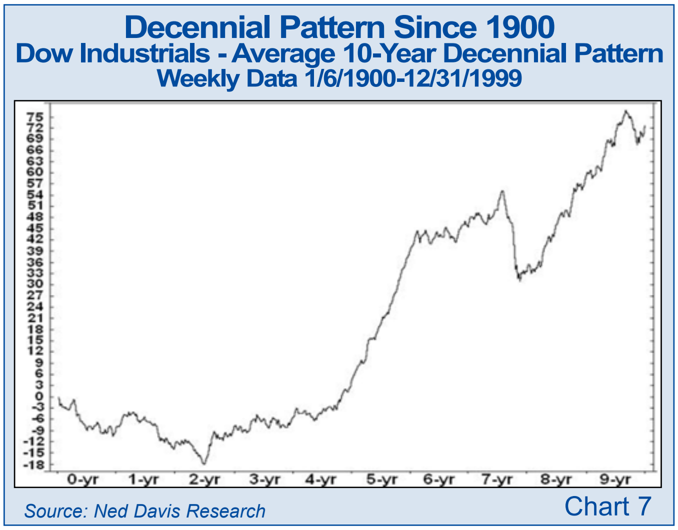


Chart 7

half of each decade, even in weaker economic trends like the 1930s and 1970s. But such gains should be much stronger there is see a continued economic boom in the second half of this decade similar to the 1920s, 1950s, 1960s, 1980s and 1990s as the demographic and technology cycles strongly suggest.

Summary: Dent is extremely bullish, especially as of mid-October of 2005 with his last great buy signal ahead of the “Next Great Bubble Boom” into 2010. He understands that most investors can’t see how the Dow could go to as high as 40,000 or the Nasdaq to 13,000. But despite his compelling demographic and technology cycle logic for the boom in the 1990s, most investors could not see the possibility of a Dow of 10,000. Thus far the stock market and economy are following very similar trends to the mid 1990s and mid 1920s before great bubbles suddenly emerged.

Dent will be the first to lower his forecasts and update his newsletter subscribers if we don’t continue to follow such bubble cycles.

If we don’t see a major advance in the stock markets between November 2005 and April 2006, then Dent will lower his forecasts.

Thus far, this evolving bull market is very closely paralleling the greatest bull market in history from late 1924 into late 1929 on a near 81-year lag and the five bubble markets in the last century. Dent will continue to monitor the progress of this bull market in the years ahead. A new high in the Dow by early to mid 2006 will only confirm a new bull market as new highs since 2000 in leading indices in the small and mid cap stocks have already strongly suggested. In a bubble boom, each new bull market phase tends to be even stronger than the last bubble – as occurred in 1985 to 1987, 1995 to 1999, and likely ahead from late 2005 into mid to late 2010. So, don’t be surprised to see the Dow as high as 15,000 in 2006, 20,000 in 2008 and 40,000 in 2010!

This great bubble boom will finally end by late 2010 when the baby boom generation slows its spending and new technologies fully penetrate our economy. The crash that follows will be similar to the long-term bear market in Japan from 1990 to 2003 (that Dent also forecast based on demographic trends there) and the Great Depression from 1930 to 1942. So, as bullish as Dent has been in recent decades, his fundamental indicators suggest an extended slowdown in the U.S. and most Western economies into 2022 or so. The opportunities after that crash into late 2012 or early 2013 will come in the growing demographics of many Asian economies and the health care sectors of the U.S. economy as baby boomers age. Investors should be in high quality bonds and fixed income investments during the crash, before reinvesting in the most opportune sectors after the markets have fallen.

APPENDIX: H.S. DENT FORECASTS AND WHAT ACTUALLY HAPPENED

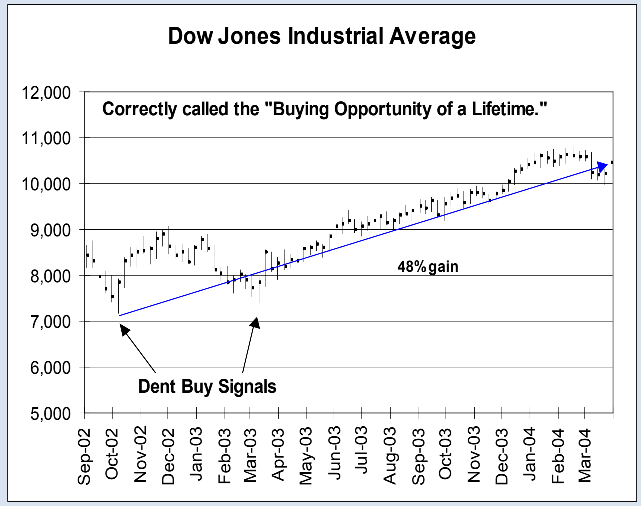
As written in the HS Dent Forecast, October 2002 through October 2005

Headline: H.S. Dent Forecast, October 2002
"Strong Recurring Cycles in the Stock Market That All Say the Time to Buy Is Now"

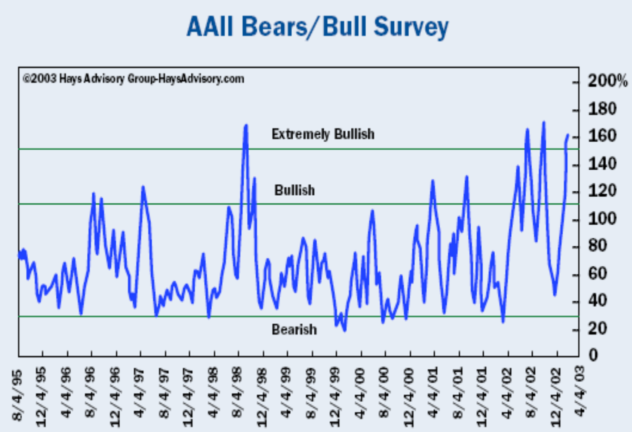
At the point of maximum pessimism as the third quarter of 2002 came to a close, we correctly saw the buying opportunity of a lifetime in which powerful technical cycles - the annual/seasonal cycle, the four year presidential cycle, and the regular ten-year cycle - coincided with the even more powerful technology and demographic longer-term cycles. All pointed to sharply higher stock prices in the immediate future:

*"Despite the very difficult and enduring crash of 2000 – 2002 we are **more bullish than at any time in the last two decades of our forecasting work**. All of our fundamental and cycle work suggests that investors are likely to see the highest average annual compound returns in history from late 2002 into 2008 or 2009, both in broader indices like the Dow and in the strongest sectors like technology, biotech, financial services, health care and Asia ex-Japan."*

*"As we said in late 1992 in **The Great Boom Ahead,** "Get Ready" for the next great bull market and economic expansion. But in this case we will see the last great bull market for decades to come. This is your last chance to make extraordinary gains in your wealth... But you have to have the guts and insights to buy here when no one else wants to."*



Source: Yahoo Finance
Chart A



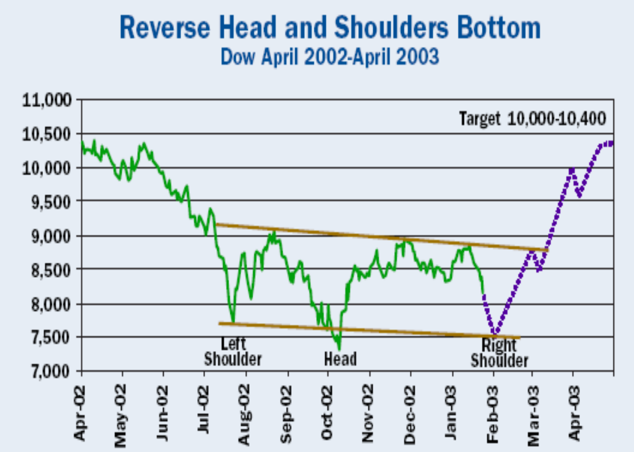
Source: March 2003 H.S. Dent Forecast, Page 2
Chart B

We called the bottom of the bear market and accordingly recommended the "*Buy Opportunity of a Lifetime.*" (Chart A)

Headline: H.S. Dent Forecast, March 2003
"Resolution to Iraq Crisis and Sharp Upturn Look Imminent"

In early 2003, it appeared that the rally that had begun just months before was in danger of faltering. With the economy still somewhat shaky and the U.S. on the verge of a controversial war, the market stumbled. In late February, investor sentiment was reaching almost record bearishness, as the AAII Bears/Bulls survey made abundantly clear (Chart B). A strongly bearish survey reading is a powerful contrarian bullish signal.

In retrospect, with sentiment reaching such extremes, a reverse was inevitable, yet few investors saw this at the time. Without a crystal ball to peer into the future, fear ruled the day. Remembering the example of the previous Iraq War – and keeping in mind the strong secular trends in place during both wars - we correctly forecast a strong move forward.



Source: February 2003 H.S. Dent Forecast, Page 2 Chart C

As for the timing and strength of the move, we based our forecast on the correct identification of a reverse head and shoulders formation in our February newsletter (Chart C), providing an excellent buying opportunity for the greatest part of the 50% advance from October 2002 into January 2004: *"The Dow now appears to be forming a classic reverse head and shoulders bottom pattern as we noted in our January 27 update. This pattern is likely to see more weakness near-term, but then a very strong rally to follow. The July panic lows formed the left shoulder. The ultimate lows in early October formed the head. Now we are putting in the right shoulder. This pattern would suggest the Dow could go down as low as 7500 to 7700, but not to new lows. But the good news is that this pattern would project a strong, sharp rally to follow into March and April."*

Headline: H.S. Dent Forecast, April 2003
"The Wicked Witch is Dead!!!"

*"We finally rallied strongly out of the right shoulder of the head and shoulders pattern right in our recent target ranges of 7500 and 7400 on the Dow. As we warned, the market would rise quickly leaving everyone who sold out behind with little opportunity to get back in. It still looks likely that we will see Dow 10,000 – 10,650 as early as late April/early May and 10,650 to11,200 by late summer or early fall. Such a move would represent an approximate **50% rally from the lows of last year** that we would typically expect on the 4-Year Presidential Cycle. The targets on the Nasdaq would be around 1900 to 2100 by early May and 2100 to 2300 by fall."*

Two months before, we had correctly seen the reverse head-and-shoulders pattern forming. In the ensuing rally, the Dow hit 10,748 by January 2004, representing a 50% jump from the 2002 lows. The time frame was slightly longer than we originally forecast in April, but the price was spot on.

Of course, no market goes straight up forever. Though still extremely bullish about the remainder of the decade, we correctly interpreted that the market would cool down for a while before resuming its rise.

Headline: H.S. Dent Forecast, July 2004
New Highs Likely Ahead, But Continued Narrow Trading Range for Months to Come

"The market is finally heading up again after getting very oversold into mid-May. But the markets are getting quickly overbought on the upside suggesting that we don't have a lot of upside ahead, nor conversely much downside. Hence, the story is just as we have been expecting: a narrow trading range for the entire year of 2004 with the upper end at 10,800 to 11,300 and the lower end at 9,600 to 10,000."

The Great Bull Market of the 2000s hits some snags that caused the trading range to last a little longer then initially predicted. Still, trading ranges do not last forever:

Headline: H.S. Dent Forecast, April 2005
"More Bubbles in the Bubble Boom — Major Reversal in Trends Ahead: Why the Next Stock Bubble Will Begin in Late 2005 vs. Early 2005 Due to the Great Oil Bubble"

As our technical indicators revealed, a surge in commodity prices interrupted the bull market in stocks. Still, the fundamental forces that dominate the economy – demographics and technological cycles – will prove the dominant force as the decade progresses.

In the early May edition released April 18, we noted:

"Bearishness among every day investors is at extreme readings comparable to October 2002 and March 2003. This extreme bearishness has always accompanied major bottoms. We see this as the second greatest buy opportunity after October of 2002"

Interpreting the extreme bearishness of the American Association of Individual Investors survey as a contrarian bullish signal, we correctly called a bottom for the remainder of 2005, at time of writing.

Major Reversal in Oil

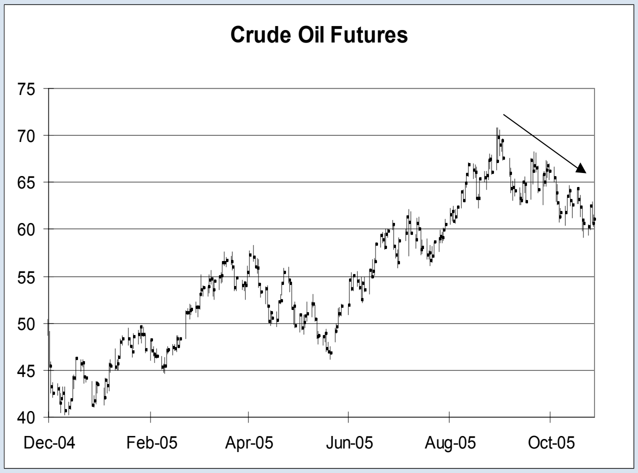
For most of 2005, the price of crude oil was the single biggest factor on the movement of the stock market. As far back as April 2005, we noted in the Forecast that oil was looking toppy and was due for a reversal within months and suggested two scenarios:

"In the first scenario we could see a final peak just ahead, around July, and then we go into a correction back to around $40 for 1 to 2 years and then see a final surge to $80 to $100 into around 2010. That would be followed by a long-term collapse to $10 to $40 in the downturn to follow from 2010 to 2022. The argument for this scenario would be that oil is overvalued now and needs a correction, but stronger U.S.-led growth for the world in the next bubble from 2006 into 2010, and continued extreme growth in China and Asia, would lead to strong pressures on supply again - and another bubble would form....

"The second scenario, and we think more likely, would be that we see a pullback in oil in the next several weeks. Then we see a brief and sharp surge to $60 or higher into around July when the U.S. stops buying extra oil for its strategic reserve and/or even sells a bit short term to cool the irrational bubble. In this case, oil could drop to $25 to $40 a barrel over the next few years...."

The oil bubble persisted slightly longer than we anticipated, due in no small part to infamous hurricanes Katrina and Rita. Still, in October 2005 we reiterated our forecast for a significant drop in the price of crude going forward:

"Now or in the coming weeks, oil is going to finally have to either break up to new highs (less likely) or break down (more likely) — first below $61.50 to $62.00, and then below $57.50 to $58.00 to confirm a top."



Source: Bloomberg Chart D

Will our oil forecast prove to be correct? Only time will tell, but at time of writing oil appeared to be in a pronounced retreat (Chart D).

Most investors saw no benefit to the oil bubble of 2005. In fact, most actually suffered, as record oil prices caused their fuel and electricity bills to soar. There was, however, a second bubble on which many investors made handsome profits – real estate.

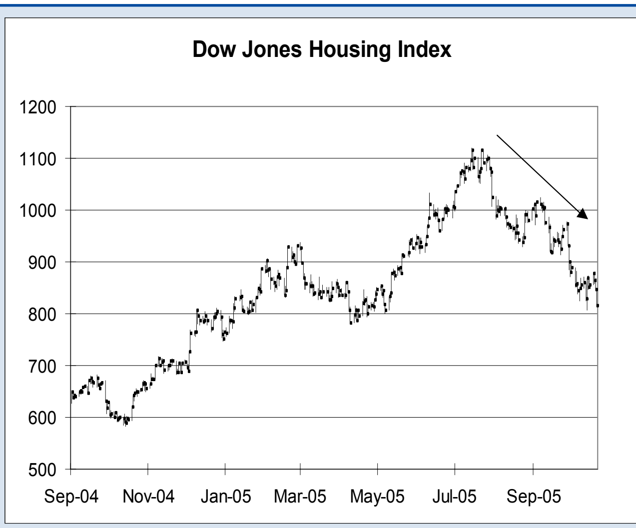
As we commented extensively in past reports, demographic trends favored a strong real estate market in the early 2000s. But, as we found in our research, those demographic trends peaked in 2003 – while house prices continued to soar for nearly two more years. We followed the housing bubble very closely in 2005, becoming more and more convinced that a top was near:

Headline: H.S. Dent Forecast, April 2005
"Home Prices: The Next Bubble to Burst – but not as Dramatic"

"…the real secret to the continued strength in housing despite warning demographic trends is the same factor as in oil or stocks. And that is of course – speculation!"

We examined numerous statistics - price-to-income, payment-to-income, price momentum of home sales and the price action of housing stocks, among other factors – and came to the conclusion that the bubble was peaking but that the fallout wouldn't be too damaging to most investors:

"Another bubble is about to end in real estate, while the bubble boom moves on…. The economy and interest rates will still generally be favorable for housing, so we won't see a broad crash. … The real crash in housing – and the final burst of the greatest bubble in history – will come in the downturn we project for 2010 to 2022."



Source: Bloomberg Chart E

There would, however, be some pain in the short term:

"Prices could begin to fall more substantially over the next year or so in the most overvalued areas like California, the Northeast and South Florida. Homebuilding stocks, which have been leaders, will turn to laggards, and likely suffer as much as a 40% correction in the next year or so."

As in oil, it appears that the tide has turned for housing stocks and that we correctly called the top (Chart E):

Headline: H.S. Dent Forecast, April 2005
"Big Reversals Ahead for...the Dollar"

In early 2005, there was a third major change in trend that we called - the reversal of the Dollar's decline (Chart F).

"The decline in recent years has simply brought the Dollar down from very high levels at the beginning of this decade. Our forecast is for the Dollar to sink a little lower near-term and then rebound strongly from 2005 to 2010 or so."

We elaborated our views in April:

"We said recently it looked like the Dollar was making a major low, but that it might take one more move to new lows. [The] Elliott Wave count...would suggest that the long wave down since late 2000 would be putting in a major bottom if we made a slight new low around .68 to .73. That would set off a major 5-year bull market into 2010 that we would expect to occur in line with the next great bubble in the stock market."

Euro/Dollar

Source: April 2005 H.S. Dent Forecast, Page 22 Chart F

At time of writing, the Dollar had rallied to 0.85 €, and with the Federal Reserve likely to keeps rates higher than their European equivalents, this trend is likely to continue.

By our analysis, the Bubble Boom is in the process of shifting back into stocks, and October 2005 provided one last excellent buying opportunity:

Headline: H.S. Dent Forecast, October 2005
"Get Ready for the Next Great Bubble Boom – Major Buy Signal Imminent!"

"Stocks are poised to break up strongly just ahead. It is merely a matter of whether this rally begins by early October with weakening oil prices, or after another spike in oil prices and likely sharper weakness to follow. This minor correction should end between 10,200 and 10,280 on the Dow near term; or at similar targets weeks from now after another failed rally – perhaps just after the November 1 meeting when the Fed raises rates one more time. Our buy targets for the Nasdaq are 2,050 to 2,080, and the S&P 500 1,180 to 1,200... Stay tuned for our updates!"

Our signal came just days later:

October 6, 2005 Update: "We are issuing a *major buy signal* here.... We advise buying this afternoon, or tomorrow at the morning at the latest. ***Our targets for the Dow are 14,000 to 15,000 by August of next year....***"

The HS Dent Forecast Monthly Newsletter.

Visit www.hsdent.com for a free sample of our October newsletter where we make our forecast for the subsequent November rally. Subscribe today so that you will be better informed about tomorrow!