First Trust
Monday Morning OUTLOOK
December 30th, 2013
630-517-7756 • www.ftportfolios.com

Plow Horse, Trotting

Brian S. Wesbury – *Chief Economist*
Robert Stein, CFA – Dep. Chief *Economist*
Strider Elass – *Economist*

What a year 2013 has been. Remember how it started, with the media hyperventilating over the "fiscal cliff" deal and spending sequester? The vast majority of economists, pundits and politicians believe in Keynesian economics. So, it's not surprising that higher tax rates and spending cuts sent them into an intellectual and theoretical funk.

Add to that the partial government shutdown, "debt ceiling" debate, tapering, and Obamacare! This created a whole new set of worries and if you got your economic news from TV, you expected Armageddon. But, in the end, all of this was over-hyped nonsense.

Cutting government spending actually helps the economy, the tax hikes were relatively minor and tapering has zero impact on real economic activity. "Real" (inflation-adjusted) consumer spending rose at a 5.7% annual rate in October and November, the fastest pace for any two months since 2006 (excluding "cash-for clunkers" in 2009).

Instead of falling over dead, the Plow Horse economy gained strength in the second half. Real GDP grew 4.1% at an annual rate in the third quarter and stock market indices rose to all-time record highs. We weren't surprised. Back in January, with the Dow at 13,104, the S&P 500 at 1,426, and the 10-year Treasury yield at 1.78%, we projected a 15,500 Dow at year-end 2013, a 1,700 S&P 500, and 2.85% 10-year T-note yield.

We were more bullish on stocks than the consensus and much more bearish on bonds, even though the conventional wisdom believed that higher interest rates would hurt stocks.

By mid-May, with stocks already at our year-end targets, we lifted the forecast to 16,250 for the Dow and 1,775 for the S&P 500. Last Friday, the Dow was 16,478, the S&P 1,841 and 10-year yield closed at 3.00%.

Right now, we're projecting further gains for stocks and more losses for Treasury securities in 2014. Our year-end 2014 forecast for the Dow is 18,500 and for the S&P 500, 2,075. Including dividends, that's a total return of about 15%. The 10-year Treasury yield should keep trending up and hit 3.65% by year end.

For the economy, the year began with the unemployment rate at 7.8%. The consensus expected a decline to 7.4%, while we forecast 7.0%, which is the exact rate for November. (December employment data arrives January 10th.) For 2014, the consensus projects a 6.5% unemployment rate at the end of 2014. We think we'll finish the year closer to 6%.

We were a little too optimistic on GDP for 2013. We predicted an acceleration of real GDP growth to 2.7% this year. The acceleration happened, but growth when all is said and done will come in at around 2.4%. For 2014, with housing and jobs accelerating, we expect growth very close to 3%.

Our biggest mistake was on inflation. We were bearish on gold, but bullish on the CPI. Gold fell alright (by 28%, so far), but the CPI, which rose 1.8% in 2012, will likely rise by just 1.3% for all of 2013. We still expect inflation to accelerate, but are holding our forecast at 2% for next year, with further increases in the years beyond. The link between monetary policy and inflation is often long and variable. We still believe higher inflation is just a matter of time.

Other themes for 2014 include a continuation of the housing recovery, although with more construction leading to somewhat slower gains in home prices. Meanwhile, the media will talk eventually about the "re-leveraging" of the American consumer. It's about time, with financial obligations such a small share of income. But expect the media to make this a negative story rather than a positive one.

In the end, the most important theme of all for 2013 is that the entrepreneur came through with productivity enhancing innovation in spite of having a bloated government on its back. The result was a Plow Horse economy – one that ain't gonna win the Kentucky Derby, but ain't heading toward the glue factory, either.

In 2014, the Plow Horse is likely to trot a little. Yes, without Obamacare and a spendaholic Congress, things *could* be even better. But, like 2013, we think those who spend all their time worried about politics will miss another year of growth and rising equity values. Stay bullish and stay invested.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
12-31 / 8:45 am	Chicago PMI – Dec	60.5	**64.0**		63.0
9:00 am	Consumer Confidence – Dec	76.3	**80.0**		70.4
1-2 / 7:30 am	Initial Claims – Dec 28	345K	**342K**		338K
9:00 am	ISM Index – Dec	56.9	**58.0**		57.3
9:00 am	Construction Spending – Nov	0.6%	**+1.0%**		+0.8%
1-3 / *afternoon*	Total Car/Truck Sales – Dec	16.0 Mil	**15.8 Mil**		16.3 Mil
afternoon	Domestic Car/Truck Sales – Dec	12.5 Mil	**12.3 Mil**		12.6 Mil