

We Were Too Optimistic

A year ago, we predicted [4% real GDP](#) growth in 2011 and a [14,500 Dow](#) by year-end. We were too optimistic.

Real GDP grew just 1.2% annualized during the first three quarters of 2011. This will climb to about 1.75% if the consensus forecast is right about Q4. The Dow finished the year at 12,218, well off its high for the year of 12,928.

This isn't the first time we have missed a forecast, and it won't be the last. And the good news is that our optimism actually paid off. Back in September, when the stock market had corrected by about 16% and conventional wisdom had completely bought into the idea of a double-dip recession, we held to our convictions. We begged investors to hold the line and maintain positions in stocks.

It worked. The economy avoided recession and accelerated, while the stock market had one of its best October's ever. Those who hung in there did no worse than money market funds. Yes, already over-valued gold was up 10% for the year, while municipal and Treasury bonds had nice returns, but holding a diversified stock portfolio, especially of dividend paying stocks, did not hurt anyone.

So here we go again. For 2012, we are forecasting 3% real GDP growth and an 18% rise in broad stock market prices. We expect the Dow Jones Industrial Average to rise to 14,500, with the S&P 500 targeted for 1475.

All the reasons for our optimism are still in place. The Fed is accommodative. Government spending has peaked

and is declining as a share of GDP. And the most important driver of growth – technology and productivity (Schumpeter's creative destruction) – is robust and relevant.

We do not believe deleveraging is holding back the economy. The private sector is still paying down debt, but doing so more slowly than before. As a result, purchasing power can grow faster than income, not slower.

We do not worry about consumer confidence. We do not subscribe to the view that the US is on the cusp of a collapse in the dollar and hyper-inflation. We don't believe that there is a fundamental weakness in the economy.

The story isn't complicated. When government tilts toward redistribution, the growth rate of potential GDP slows down. This hurts job creation. Big government always hurts economic performance. We should have more fully accounted for this in our forecast last year.

Some will ask: Then how can you forecast 3% growth in 2012? The answer is relatively simple. 1) The Fed is even more accommodative today than it was last year. 2) Government spending will be basically flat in 2012 for the third consecutive year. 3) Technology continues to advance. These developments mean the tailwinds are stronger at the same time the headwinds are diminishing.

That's enough reason for us to maintain our optimism for the year ahead. Let's try it again in 2012.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
1-3 / 9:00 am	ISM Man. - Dec	53.5	53.0	53.9	52.7
9:00 am	Construction Spending - Nov	+0.5%	+0.3%	1.2%	+0.8%
1-4 / 9:00 am	Factory Orders - Nov	+2.0%	+2.8%		-0.4%
<i>sometime</i>	Domestic Auto Sales - Dec	4.5 Mil	4.5 Mil		4.6 Mil
<i>during the day</i>	Domestic Truck Sales - Dec	5.9 Mil	6.0 Mil		6.0 Mil
1-5 / 7:30 am	Initial Claims – Dec 30	375K	377K		381K
9:00 am	ISM Non-Man. - Dec	53.0	53.0		52.0
1-6 / 7:30 am	Non-Farm Payrolls - Dec	150K	155K		120K
7:30 am	Private Payrolls - Dec	170K	175K		140K
7:30 am	Manufacturing Payrolls - Dec	5K	0K		2K
7:30 am	Unemployment Rate - Dec	8.7%	8.6%		8.6%
7:30 am	Average Hourly Earnings - Dec	+0.2%	+0.2%		-0.1%
7:30 am	Average Weekly Hours - Dec	34.3	34.3		34.3