First Trust
Monday Morning OUTLOOK
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Dow 19,500, S&P 2,150

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Last year was the best for equities since 1997. The Dow Jones Industrial Average rose 26.5%, the S&P 500 was up 29.6% and the Nasdaq was up 38.3%. Despite these outsized gains, and in spite of all the talk of a bubble, we still think stocks are cheap.

The one thing we know for sure is that stocks will not go up in a straight line; they never do, even during long powerful bull markets. We expect, at some point, to have a correction. It might be happening right now, but we won't spend a lot of time trying to figure it out. Attempting to time corrections, at least in our experience, is a fool's errand. We know no one who has done it consistently over the years.

Just think back over 2013 and those who sold because of the "budget crisis" or "tapering." The market fell, but then recovered before anyone who had sold over those fears could have reasonably been expected to get over them.

There will be plenty of news stories in 2014 to support bearishness no matter your political viewpoint, whether it's the continued rollout of Obamacare for conservatives or "austerity" and "inequality" for liberals. But, in the end, stocks are the best broad asset class for 2014.

We use a capitalized-profits model to find the fair-value of equities. We start by dividing corporate profits (excluding profits earned by the Federal Reserve) by the current 10-year Treasury yield (3%), and then compare the current level of the index this process generates to each quarter for the past 60 years. This method estimates a fair-value for the Dow at 30,000, almost twice the current level.

But that's largely the result of using today's interest rates, which, in our view, are still artificially low. So, we adjust the model and use a more cautious 10-year Treasury yield of 4.5%. This rate is very close to the Federal Reserve's estimate of long-term growth in nominal GDP (real GDP growth plus inflation). Using a 4.5% discount rate gives us a reduced "fair value" of 20,000 on the Dow and 2,240 for the S&P 500, about 22% above current levels.

To be clear, we are not counting on future growth in corporate profits to generate our fair value. We're saying that *current* profits *already* justify a higher price for stocks. In other words, equities are still cheap. If profits go up from here, and we leave our discount rate at 4.5%, that will push our fair value calculation higher as well.

Also, nothing in our analysis says the stock market has to rally today, or this week, or even over the next year. We think stocks will go up over the next year, but the model doesn't say they have to. However the upside risks for stocks are much greater than the downside risks. When stocks are cheap, it means investors are discounting too much negative news. For the past five years, this has been true and as profits have consistently exceeded expectations, stocks have continued to rise. With another 10 - 12% increase in profits on tap for 2014, stocks look solid.

And even though 2013 was so strong for equities, we expect more strong gains of roughly 20% for stock indices in 2014. Officially, we expect the Dow to hit 19,500 and the S&P 2,150 by the end of this year, with further gains ahead in 2015.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
1-6 / 9:00 am	Factory Orders – Nov	+1.7%	**+1.3%**	+1.8%	-0.9%
9:00 am	ISM Non Mfg Index – Dec	54.6	**55.1**	53.0	53.9
1-7 / 7:30 am	Int'l Trade Balance – Nov	-$40.0 Bil	**-$39.9 Bil**		-$40.6 Bil
1-8 / 2:00 pm	Consumer Credit– Nov	$13.8 Bil	**$15.1 Bil**		$18.2 Bil
1-9 / 7:30 am	Initial Claims – Jan 4	335K	**339K**		339K
1-10 / 7:30 am	Non-Farm Payrolls – Dec	195K	**120K**		203K
7:30 am	Private Payrolls – Dec	195K	**120K**		196K
7:30 am	Manufacturing Payrolls – Dec	15K	**13K**		27K
7:30 am	Unemployment Rate – Dec	7.0%	**7.0%**		7.0%
7:30 am	Average Hourly Earnings – Dec	+0.2%	**+0.2%**		+0.2%
7:30 am	Average Weekly Hours – Dec	34.5	**34.6**		34.5