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Tooth Fairy Show Yourself!

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This is a long issue as my annual forecast usually is. And that's after I cut out some content that will be used in my upcoming Shockers issue. Before getting into the "meat", I want to share a story from home. With three little kids, things like Santa Claus and the Tooth Fairy are still very real and believable people.

The other day, my 6 year old son lost his second tooth at school. He knows the routine and put it under his pillow. When we went to take it away, we found a little note that said, "I want to keep my tooth please!!!"

Last week, my 8 year old daughter lost yet another tooth after having one pulled right before that. She has become very sneaky with her teeth, trying to find out if the Tooth Fairy really exists. Under her pillow, she

wrapped the following note around her tooth.

"Hi.

I am guessing you are the tooth-fairy. I have to ask you a few questions.

1. Can I have my tooth back?
2. What is your name?
3. Where do you live?

KT

P.S. Please write back to me"

I hope you got a little chuckle from that. And now on with the Fearless Forecast issue...

## **Fearless Forecast 2011 Review**

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It's that time of year again, a phrase I use often in January and February with the various pieces I create. In this case, we are going to talk about the Fearless Forecast 2012. As I mention each year, one of the most worthless yet enjoyable topics of the year is the pundits annual forecast. An unusual amount of time is spent discussing this in the media, but after January, few ever review them again nor seem to care. I usually end December with an idea of what I see ahead and then adjust according to how many others agree with me. As longtime readers know, I don't like to be in the majority as consensus thinking hasn't fared well over the years.

Before I get to my forecast, which is **not** my annual [Shockers](#) list, let's do a quick review of what I envisioned for 2011. For the full forecast for 2011, you can click [Fearless Forecast 2011](#). My comments from last January (2011) are in italics with a few sentence update in normal font.

**Stock market** - *"For 2011, I think the stock market will end the year modestly in the black, but only in the mid single digits. I envision corrective behavior in the spring with a more significant correction in late summer to fall. I haven't done enough sector work yet, but given that almost everyone hates healthcare and utilities, I'll take those two sectors as winners in 2011."*



2011 chart of the S&P 500 is above. Forecast was spot on, which only means this year will be spot off! In hindsight, I would have loved to have used it in our strategies.

Both utilities and healthcare fared well in 2011 and were market leaders as you can see below.





**Long-term treasuries** - *"After attempting to rally in Q1, bonds resume their slide during the first quarter and into Q2, but firm up during the second half of 2011."*



Treasury bonds spent the first four months of 2011 in a trading range before taking off to the upside during the debt ceiling debate, S&P downgrade and Euro crisis. They ended up 2011 as the best performing asset in our system.

**Dollar** - *"I remain bullish on the greenback over the long-term, even if we see another selling wave back to the old lows. Ultimately, I think the dollar index will hit 100 and the Euro will slide back below 100 on its way to oblivion."*



After sliding back towards the lows during the first four months of the year, the US Dollar regains its safe haven status, closing the year near the highs.

**Gold** - *"Clearly, after back to back strong years, gold is due for some pause to digest, in the short, intermediate and long-term. That can take shape in many ways. I think 2011 will bring a significant increase in volatility and I would not be surprised to see a \$100 down day during the year. When all is said and done, I believe we will see at least \$1500 hit during the first half of the year, but not another vertical assault like we saw in 2009 and 2010. Based on history, the year should end up with modest single digit returns, best case scenario, but outperforming its cousin, silver. Should that roadmap unfold anywhere close, that could set the stage for a monster blow off to the upside in 2012. But that's getting laughably ahead of myself."*



The shiny metal certainly saw an increase in volatility in 2011 and right in the middle of the chart, you can see a \$200+ down week. It hit my \$1500 upside target early in the year, but also kept on going above \$1900 before settling back to close 2011 about 10% higher than where it started.

**Inflation** - *"Unlike the past few years, I see headline inflation percolating a bit, especially during the first half of the year, but the core (excluding food and energy) remaining tame."*

The inflation bulls remained out and about all year, but once the summer swoon began around the globe, it was deflation that became the big concern.

**Economy** - *"If this was a "normal" recovery, GDP should explode higher this year, but especially during the second and third quarters. I just can't subscribe to the "normal" recovery theme. The economy has been juiced with free and easy money for years and once that spigot is turned off, similar to what FDR did in 1937, I believe we are in for trouble."*

*Thankfully, Congress learned from their predecessors' mistakes in 1937 and did not allow taxes to increase in 2011. In fact, by cutting the payroll tax for 2011 and 2012 by two full percentage points, I have to upgrade my take on the economy to a better than just plodding along at 2%. Don't underestimate how much not raising income taxes and cutting payroll taxes will do for the economy and markets!"*

The economy plodded along as history indicates it should post a financial crisis and credit contraction. One thing we continue to learn is that our economy is a lot more resilient than most believe!

**Federal Reserve** - *"As the voting members of the FOMC turnover, expect the Fed to mirror Washington and get stuck in gridlock. Bernanke loses some internal power with Kevin Warsh sliding more towards the hawkish side and Plosser and Fischer coming back to dissent and push a more neutral stance once QE2 runs out by June. Keep a close eye on the two year note as the markets may force Bernanke's hand later in 2011 to take action he clearly won't want to take."*

Plosser, Fischer and Kocherlakota certainly added some spice to what used to be a more dovish and one sided Fed. While they may not behave like the republicans and democrats in Congress, there is a clear group of dissenters to more aggressive actions.

**Unemployment** - *"Sadly, the jobless recovery continues and unemployment stays stubbornly elevated above 8.75%. I think it's going to take a second recession to cleanse the system and get put unemployment on a path back to 6% or lower sometime later this decade."*

I wish my forecast ended up way too pessimistic, but the jobless rate finished up 2011 at 8.50%. Thankfully, it improved as the year went on and let's hope that trend continues into 2012!

**Natural Gas** - *"Surprise! Surprise! Finally, the bulls take control and natural gas ends up as one of the top performing assets of the 2011."*



Yikes! In an otherwise very accurate (and lucky) forecast, this one really laid an egg! Forget about natural gas rallying, it couldn't even put in a

simply poor year. It was a disaster!

## 2012 Fearless Forecast

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So now, let's get to my forecast for 2012. The sooner I get it out there, the sooner I can be proven wrong! As always, I had a lot of fun thinking about it and creating it, although it has no bearing on how we manage money for our clients.

**Stock Market** - It's no secret that 2012 is a presidential election year and the fourth year of Barack Obama's term. Historically, the stock market has delivered an 8% return on average during this period. Additionally, most years following flat market years have shown solidly positive returns. Wall Street strategists as a whole are forecasting their typically average upper single digit year.

Given how challenging 2011 was, my initial read is that 2012 possesses the potential for a big year in the stock market, well into double digit returns with the 2011 peak exceeded during the first quarter and possibly much higher after that. Europe will remain front and center and cause occasional "dislocations" in the markets but the central banks and governments will do their best to Band-Aid the situation and smooth out the rough edges. But as I have said for years, only T-I-M-E will cure these systemic problems.

And speaking of Europe, there aren't many (maybe any) investors who think their equity markets represent a good opportunity. Given how pervasive bearish sentiment is, I believe Europe can outperform other areas around the globe, at least earlier in the year. This call may be early (or wrong), but if everyone is so negative on Europe, who is left to really sell it?

In the U.S., I believe growth stocks will come back to life and reward investors better than value, including the popular dividend payers, which should be under pressure the closer we get to 2013 with tax hike on dividends. On the sector front, if the stock does well, the rising tide should lift most ships, but since healthcare and technology seem to have big support, I don't think they will be able to meet those lofty expectations. On the flip side, it's been five miserable years on balance for the financials and I am going to stick my neck out that they are ripe to reward contrarian investors in 2012, both on an absolute and relative (against an index)basis.

**Dollar** - In mid 2008, I opined that the U.S. dollar was embarking on a



long-term bull market. Nothing has changed to alter that view. When the Fed was printing money at the fastest pace in history, it spoke volumes that the dollar did not even make new lows below the March 2008 bottom. Now that Europe is no longer the western economic leader and longer-term devaluation is inevitable, the dollar should retain and increase its long-term value.

**Gold** - The metal's 10+ year secular bull market has been called into question following the \$400 decline from its all time high last summer. For now, that bull market still looks alive with \$2000 achieved in 2012. Gold has a habit of near vertical rises followed by multi month or quarter periods of digestion. Since last summer, it looks more like consolidation than the end of the bull market. The longer this period lasts without significant downside damage, the higher the metal is likely to shoot when the digestion ends.

**Residential Real Estate** - There are enough initial signs that at least stability is returning to this market after so many years of disaster and rubble. With Obama desperately needing an election year boost to housing, expect the government to unveil a slew of new mortgage alteration and principal forgiveness programs to goose the market. Home prices have historically gained roughly 4-5% per year and 2012 should get back to the norm.

**Inflation** - I continue to have the same view on inflation as I have had since 2008. Whatever price increases we see are likely to be temporary or as Ben Bernanke said, "transitory". I believe the headline number will outpace the core (ex food and energy) until the economy goes through another recession. Deflation is and has been a much bigger and more widespread problem to deal with. Housing, money velocity, capacity utilization, wage growth are just a few ingredients in the deflationary formula. Just ask Japan about it. They have been fighting it on and off since 1990!

**Economy** - The global economy continues to repair itself from the damage caused by the financial crisis. It took decades for the world to leverage up (borrow) and it should take at least a third as long to unwind that and deleverage. That cycle will be with us in 2012 as the economy plods along, tempting and teasing on the upside, while occasionally threatening on the downside.

**Federal Reserve** - It's not too difficult to make a forecast here since Ben Bernanke has already said that short-term interest rates aren't likely to move for at least another few years. I continue to see the Fed aggressively intervening in the global markets with coordinated efforts as well as efforts to keep mortgage rates low or stable at a minimum. We

are far from the time when the Fed's balance sheet and operations will return to historical norms.

**Natural Gas** - I am going to the well once again here! If and when it ever goes up, I can just play Wall Street and say that I wasn't wrong, I was just early!! Yes, I know that we have a 500+ year supply and a glut on the market. But this commodity is still way too cheap to be priced with a "2" as the first digit. I have heard people ask if natural gas will have a "1" handle in 2012. Not from my seat. Not only do I think it's going to rally and do well in 2012, but I also believe it outperforms its energy cousin, crude oil.

So that's it. Another fearless forecast in the books. Good, bad or otherwise, I am always eager to hear your comments. Please don't be shy about emailing me!

Coming soon... Top Shockers for 2012!

## Upcoming Appearances

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ET NOW's Trading Calls - January 29 at 9:30pm

WNPR's (90.5 FM) Real Life Survival Guide - February 12 at 4:30pm

CNBC's Worldwide Exchange - February 15 at 5:35am

You can view most of the past segments by clicking below.

## Media Appearances

(<http://www.investfortomorrow.com/InMedia.asp>)

## Investment Quotes/Adages To Live By

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"When in doubt, get out!"

"If it's obvious, it's obviously wrong."

-Joe Granville

"It's ok to be wrong, but it's not ok to stay wrong."

"This time is different."

"The markets require the patience of a dozen men."

-Robert Rhea

"Luck is the residue of effort."

"The most bullish thing a market can do is go up in the face of bad news."

"The most bearish thing a market can do is go down in the face of good news."

"The market can stay irrational longer than you can stay solvent."

-John Maynard Keynes

"Government is best which governs least" - Thomas Jefferson

Inflation is the one form of taxation that can be imposed without legislation.

-Milton Friedman

"You cannot legislate the poor into freedom by legislating the wealthy out of freedom. What one person receives without working for, another person must work for without receiving. The government cannot give to anybody anything that the government does not first take from somebody else. When half of the people get the idea that they do not have to work because the other half is going to take care of them, and when the other half gets the idea that it does no good to work because somebody else is going to get what they work for, that my dear friend, is about the end of any nation. You cannot multiply wealth by dividing it." - Dr. Adrian Rogers, 1931

"Bear markets seem to be divided into three phases: the first being the abandonment of hopes upon which the final uprush of the preceding bull market was predicted; the second, the reflection of decreased earnings power and reduction of dividends, and the third representing distressed liquidation of securities which must be sold to meet living expenses. Each of these phases seems to be divided by a secondary reaction which is often erroneously assumed to be the beginning of a bull market."

- Robert Rhea via Tim Woods

"Free enterprise is a rough and competitive game. Nobody too big to fail. Nobody too small to succeed. It is a hell of a lot better than government control." - Ronald Reagan via Dan Kennedy

"A government big enough to give you everything you want is big enough to take everything you have." - Gerald Ford via Dan Kennedy

"The problem with socialism is that, sooner or later, you run out of other people's money." - Margaret Thatcher

"Diversification alone is no longer sufficient to temper risk... You need something more to manage risk well."

- Mohamed El-Erian

## Friends And Family Plan

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Finally, as you know, our firm and this newsletter continues to grow mostly from your referrals. If you know anyone who is interested in securing their retirement, planning for it or just plain worried about it, please send them here. As always, thanks for thinking of us with your circle of family and friends.

Sign Up Here

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