

## Forecasts and Trends

### **Recession Not Likely During 2007 (What to Expect)**

by Gary D. Halbert

In late 2005, The Bank Credit Analyst, (BCA), predicted that the US economy would experience a "mid-course correction" in the last half of 2006 and extend into the first half of 2007. The first half of that forecast has come true. GDP was 2.0% (annual rate) in the third quarter, down from 2.6% in the second quarter and 5.6% in the first quarter. BCA expects the fourth quarter GDP number to be below 3% as well, and looks for similarly soft figures for the first quarter of 2007, with a recovery emerging by mid-next year. BCA has been very consistent in their view that the most likely scenario is that this mid-course economic correction will not devolve into a recession, barring any major negative surprises. So far, there is no reason to believe they are wrong, or that we will have another mild recession this year. Beyond the first half of 2007, BCA sees another economic rebound - they don't speculate how strong, other than a return to GDP growth of 3% or above.

BCA believes that inflation will continue to trend lower in 2007, and that should give the Fed the flexibility to halt its interest rate hiking cycle, if it hasn't already. Furthermore, the editors believe that inflation will tame to the point that the Fed will be able to lower short-term interest rates a couple of times in the first half of 2007.

As for stocks, BCA believes that the bull market will continue in 2007. Their most likely scenario is that stocks will have another year like 2006 in 2007, with decent gains on the upside, but with continued high volatility on the upside and downside. BCA also believes there is a potential *WILD CARD* looming in the equity markets this year, which I will discuss below.

As for interest rates, BCA believes that rates - both long and short - will be in a trading range in 2007. This is not particularly good news for bond investors, but it is what it is - more of the same. Likewise, BCA expects the US dollar to remain in a trading range for 2007. As for markets such as oil and energy, precious and base metals, and other resource commodities, BCA continues to believe that we are in a long-term, demand-driven bull market that will see these commodity prices move higher than the highs seen in 2006. However, in the short-term, BCA warns that precious and base metals and certain other resource commodities could get hit more on the downside - thus providing some good buying opportunities sometime this year.

#### **BCA's Potential Wild Card for Equities**

In the world we live in today, almost any forecast has to include some potential wildcards, caveats and risk factors. Typically such wildcards and caveats are on the negative side: terror attacks, new wars, major government defaults, currency crises, financial/banking breakdowns, hedge fund debacles, market meltdowns, etc., etc. All of these risk factors are a part of our world every day. For most of these risks, the odds are fairly low of them happening, or at least it would seem. Yet each of these risks is factored into market prices and investment valuations on a continual basis, at least as best as possible.

In all of BCA's forecasts, they also include all of the caveats noted above, as they cannot be ruled out. But BCA has always been good about suggesting what they consider to be

the "**most likely scenario**" in case no major negative surprises occur. BCA's most likely scenario is what I have summarized above for 2007 and beyond. However, BCA subtly makes a point regarding yet another Wild Card that could rear its head in 2007, and this is a point I have seen no other market research group make, at least among those I follow. There is currently a flood of global liquidity. Space does not allow me to elaborate at length, but suffice it to say that a combination of windfall oil profits and the excess personal savings rates in Asia and elsewhere has created a monumental level of global cash looking for a place to invest. **BCA believes there is the potential for a huge influx of this global cash to the US this year, when it is clear we have avoided a recession, and thus there is the real possibility that this potential tidal wave of cash could drive US equity prices into yet another bubble on the upside.**

This may or may not happen. BCA is just warning us not to be surprised if it does. If it does, it could mean another potentially huge leg up in the ongoing bull market in US equities.

### **To Ride, Or Not To Ride the Equity Bubble**

Many analysts, and most investors I talk to, were surprised by the strength in the equity markets in 2006 - even though BCA predicted that stocks would rise all year. What with oil prices soaring and the Fed raising interest rates in the first half of the year, and with the economy slowing down in the second half of the year, most people did not expect the market indexes to take off on an upward rampage in the last half of 2006 that sent the Dow Jones to a new all-time high. The 2006 bull market in equities also occurred at a time when the war in Iraq turned deadlier and public opinion on the war turned negative, so much so that the Democrats swept both houses of Congress in the mid-term elections. Even that didn't phase the equity markets.

So, despite a lot of real and perceived negatives, stocks moved higher than most anyone expected in 2006. The Dow Jones Industrial Average gained over 16%, and the S&P 500 climbed over 15% in 2006. While some analysts argue that US stocks are overdue for a downward correction, BCA believes that such a correction would likely be limited, in large part due to the continued influx of global capital to these same markets. And as discussed just above, BCA also believes that we could see the influx of global capital accelerate this year, especially if it becomes clear the US will avoid a recession.

Most of the investors I talk to are under-weighted in stocks and equity mutual funds. Most have been in this position for the last several years, in many cases having never gotten fully back into stocks and equity mutual funds since the bear market of 2000-2002. Investors in this position have left a great deal of money on the table since the current bull market began in 2003.

This brings up a difficult decision for many investors, especially in light of BCA's forecast for another positive year in equities, and the possibility that we could see another equity bubble in 2007. Yet despite that forecast and BCA's long and enviable history, many investors are likely to conclude that it's just too late and too risky to move back to a fully-invested position in equities. A major reason for this hesitance, I believe, is the memory of how many nest eggs were wiped out in the tech bubble that burst as we entered the new millennium. I think investors do see the potential for participating in up markets, but fear that they may not get out in time if the markets start to decline. Thus, some will decide to just stay on the sidelines and continue to watch.

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