

## "2012 - The Year of the Dragon"

Tonight when I chase the dragon  
The water will change to cherry wine  
And the silver will turn to gold  
Time out of mind

... Steely Dan, 1980

Year-end letters are always difficult to write because there is a tendency to either discuss the year gone by; or worse, try to precisely predict what is in store for the new year. Nevertheless, 2012 has arrived, and as the Year of the Dragon, I thought I would share these thoughts with you from *California Psychics*, written by Psychic Verbena (as paraphrased by me):

"The last Year of the Dragon, which occurred in 2000, was fraught with fear. There was a lot of hand wringing about the collapse of our technological world, the Y2K bug and other millennial prophecies that turned out to be more hype than bite. The Year of the Dragon is [here] and fear and trepidation are once more an issue. This time it's the Mayan Calendar and the alleged 2012 Armageddon prophecy. Is the Chinese Year of the Dragon, which comes around every 12 years, truly something to be feared?

Unlike the wicked, fire-breathing dragons of Western mythology, China's celestial dragon symbolizes potent and benevolent power. Dragons are ancient, majestic, wise, and intelligent, and Dragon years are considered particularly auspicious for new businesses, marriage and children. Dragon years also tend to boost individual fortunes and the world economy. It's also true, however, that all five of the Chinese Dragon years — Wood, Fire, Earth, Metal and Water — tend to magnify both success and failure.

What influence might the Water Dragon, which rules from January 23, 2012 to February 9, 2013, have on the powerful energies already anticipated at that time? Like all Dragons, the Water Dragon is an innovative, fearless leader. But the Water Dragon is also far more sensitive to others' needs, and is more likely to be progressive and diplomatic, as well as socially and environmentally conscious. Because Water bestows a more peaceful disposition, this Dragon will act wisely and intelligently, and unlike his fellow Dragons, is willing to set aside his ego for the good of all.

This Dragon is a successful negotiator, and while he is adept at marketing, he also knows how to apply force skillfully when necessary. ... If you subscribe to the dawn-of-a-new-era theory of 2012, then it's easy to see how the influence of the Water Dragon will increase the likelihood of success for progressive movements gaining momentum all across the globe. ... But of all the Dragon years, the 2012 Water Dragon is most likely to bestow the Chinese Five Blessings of harmony, virtue, riches, and fulfillment and longevity, adding even more weight to the growing belief that 2012 will be about breakthroughs, not disasters."

From Verbena's lips to God's ears because I am really pulling for a year steeped with "harmony, virtue, riches, fulfillment, longevity," and "adding even more weight to the growing belief that 2012 will be about breakthroughs, not disasters." As stated in last week's letter, I remain steadfast in the belief there will be no recession, nor will Euroquake pull us into one. I also embrace the theme that the nation is moving in the direction of energy self-sufficiency and that an American manufacturing renaissance is taking place. Moreover, there appears to be the hint of a housing recovery, as well as a technology revolution. Combine these beliefs with the demographics of a baby boom echo, which should foster a new cadre of investors, and I think the S&P 500 (SPX/1257.60) will have a mid- to high-single-digit return in 2012. If you layer in a 3-4% dividend yield on top of said return, the allure of equities becomes pretty compelling.

However, that is not true for *Barron's* requisite curmudgeon Alan Abelson, who writes in this week's edition, "It's so darn tough, try as we might, to dig up genuine cheerful news." Barron's Bellyacher goes on to lament, "Scouring the economic and financial landscape for bright spots can also be something of an exercise in futility." To which I reply, "How can we all eat at the same table and then disagree about what's been served?!" Indeed, of the 45 economic indicators I track only three are not showing stronger growth readings. Those three are Michigan Consumer Confidence, The Case Shiller Home Price Index, and The Average Work Week.

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More specifically, railcar loadings tagged new all-time highs recently, credit card delinquencies have plunged to a record low, regional PMIs (Purchasing Managers Index) are stronger, pending home sales are improving, job surveys are better, real retail sales are on track for a +7% rise quarter over quarter (annualized rate), and unemployment claims are falling. So I ask it again, "How can we all eat at the same table and then disagree about what's been served?!"

Continuing on the fundamental tack, it's worth noting there is a global interest rate easing cycle underway and that crude oil is back below \$100 per barrel. These are not unimportant observations because every stock market rally since last summer has been thwarted when oil traveled above \$100 per barrel. Moreover, with the extension of the existing tax and unemployment benefits, real GDP is more likely to approach 3% in 2012. Speaking to earnings, while fourth quarter earnings have yet to be reported, based on current estimates the SPX is on track to earn a record \$97. Surprisingly, for the past 11 months my estimate for the SPX has been \$96, yet many of Wall Street's finest scoffed at such an optimistic number. My estimate for 2012 has been \$106 for nearly a year, and I still feel comfortable with that estimate provided we don't talk ourselves into a recession.

As for the technicals, by my work we experienced another Dow Theory "buy signal" last week when both the DJIA (INDU/12217.56) and the DJTA (TRAN/5019.69) bettered their October 2011 closing reaction "highs." This week we may see another positive occurrence called a "golden cross," that is if the DJIA's 50-day moving average (@11934.29) crosses above its 200-DMA (@11946.57). That said, the NYSE McClellan Oscillator is short-term overbought and the stock market's internal energy has not yet been fully recharged. Accordingly, after the equity markets pop their collective "corks" with an early January upside blow off, it would not surprise me to see a pullback attempt. One thing is for sure, the volatility remains legion, for as the eagle-eyed folks at the Bespoke Investment Group write:

"Throughout 2011, we made numerous mentions of the record number of 'all or nothing' days in the stock market. We define an all or nothing day as one where the daily net Advance/Decline reading for the S&P 500 is greater than +/- 400. Up until recently, these types of days were relatively rare and there were some periods where more than a year went by without any all or nothing days. In the last few years, however, we have seen an explosion of occurrences, culminating with this year's record reading of 70 days! To put that number in perspective, from 1990 through 2004, there were only 67 all or nothing days!"

Such a volatile environment clearly calls for risk management and with these thoughts we wish you a healthy and prosperous new year.

**The call for this week:** Since the day after Thanksgiving I have stuck with the strategy that the Santa Claus rally had begun. On November 25th the SPX was changing hands around 1158. We are now 100 points higher. Consequently, I would not chase the dragon right here since I anticipate that an upside blow off is due . . .

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