FISHKIND
& ASSOCIATES

Market Strategy For 2005

December 21, 2004

As a New's Year gift to you, let me offer a quick economic forecast and investment strategy for 2005.

Next year will start off strongly, but rising rates of interest and higher inflation will produce much weaker conditions in the 2nd half. Growth will be running at the 4% rate in the 1st half, but only 2% for the 2nd half. Inflation will first taper off some, courtesy of falling oil prices, but will rebound by the spring. This is because of the falling value of the dollar, which makes imports more expensive, and because of the sharp rise in commodities prices that are only just now being translated into higher finished goods prices.

Many firms have announced big price increases in 2005. Furthermore, many of the forces that held inflation down during the 1990s are now reversing. For example, productivity growth has slowed sharply this year. Factories are much busier. Monetary policy remains overly simulative, despite recent increases in interest rates. And of course the dollar is weaker and even though oil prices are down, they are still 35% higher than they were last year.

Oil prices remain a real wild card in the outlook for 2005. If oil prices bounce back to \$50-\$55 per barrel this will subtract about 1% from GDP growth in 2005. But a geopolitical upheaval or supply disruptions (Yukos, Iraq, Saudi Arabia take your pick) could drive prices even higher. By contrast, there is a reasonable chance that prices could fall as well to say \$30 per barrel. This would stimulate U.S. growth and trigger a consumer boom. Corporate profits and stock prices would rise, but the Fed would be compelled to boost interest rates even faster to protect against overheating. But, I am most concerned about the falling value in a rerun of what happened in the 1980s. Then as now, we had the simulative impacts of large tax cuts along with huge budget and trade deficits. By 1985-87 the dollar plunged 40% Vs major currencies, treasury bonds jumped by 2 percentage points and stock prices plummeted 35% in October 1987. We are certainly very vulnerable to this scenario and already foreigners are limiting their purchases of U.S. securities.

So what's an investor to do? The watchword for 2005 is quality. Migrate your portfolio towards high quality stocks, those with consistent earnings growth and strong balance sheets with low debt and good cash flow. If they trade at a discount to there peers, that's even better. But few stocks are cheap, the S&P is trading at 17 times earnings. However, many quality stocks, especially utilities and consumer staples, are trading at lower multiples. I also like stocks that pay high dividends, and I particularly like stocks that invest in rapidly growing areas such as Florida. So, please have a safe, prosperous, and happy New Year.

This is Hank Fishkind for 90.7 FM, WMFE News.