



January '06 Newsletter – 2005 Year End Update

If you would have told economists three years ago that in 2005 the U.S. economy would be engulfed with record high oil prices, a 13th straight interest rate hike, be in a global war on terror, have an expanding budget deficit, and be ravaged by the worst natural disaster in our great nations history, you might have been asked: “And what month did the recession begin?”

Quite the contrary. When the 4th quarter data is in, the U.S. economy is expected to grow 3.5% in 2005. A healthy level of growth by historical standards. Overall inflation was pumped up by oil prices but core inflation - minus volatile food and energy costs - remains below 2%. The economy added 1.89 million new jobs in 2005 and corporations have recorded double digit earnings growth for the second year in a row.

The major stock market indices for the year were as follows:

S&P 500 Index: +3.0% (The S&P 500 is made up of 500 common stocks representing major US industry sectors.)
NASDAQ Composite: +1.4% (The NASDAQ index is a measure of the combined value of roughly 5,000 stocks traded on the National Association of Securities Dealers Exchange.)

How can this be? How can the economy be doing so well with so much negative news? Maybe it has something to do with the Baby Boomers. The people in the biggest and richest generation in our nation’s history are in their peak spending years. Historically, when generations reach their peak spending years, the economy does well. Peak spending occurs, on average, at age 46 and stays high until people reach the early to mid 50’s.*

Weather the growth continues may depend on what the new Federal Reserve Chairman Ben Bernanke does with interest rates. If the 1st trading day of 2006 is any indication, we could be near the end of the rate hikes. On Jan. 3rd, the Fed’s summary of their December meeting suggested there may be only a few more rate increases. . The markets responded to the news and as of the close on 1/12/06 have went up: NASDAQ +5.1% and S&P500 Index +3.0% - since the 1st of the year.

Will the markets end 2006 positive or negative? This is a very difficult question to answer but the current market climate does suggest it will be a good year for the markets. One thing I do know, we must be vigilant in any market climate. Watching the daily price and volume action of the major market indices is the best indicator of future market direction.

Happy New Year,

Dave

* Source: H.S. Dent Foundation

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