Mr. Market, wont to wearing his heart on his sleeve, reacts, reflects — and anticipates. Marching always to its own drummer, the market in 2007 should, likewise, behave true to character. And indeed, nothing is expected to kill the bull, forecasts our Research Roundtable panel of Wall Street experts.  
• Most markets climb a wall of worry. So too, the 2006 market. In ’07, look for the same phenomenon — what with inflationary pressures, a deflating housing bubble and uncertainty over short-term interest rates.  
• The new year is likely to see growth stocks and large-cap firmly take the lead — finally — over small-cap and, in a turnabout, U.S. stocks outperforming international equities.  
• The nation may see a short-term economic slowdown and with it, increased market volatility. But without a doubt, next year’s market is one in which to participate. Remember: It’s the third year of George W. Bush’s second term, and not since 1939 has there been a negative presidential Year Three.

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How would you describe the state of the stock market now?

BUCKINGHAM: A teeter-totter market: One sector or segment rallies while another descends. Then it goes back the other way. Large-cap stocks have awakened. That’s why the Dow Jones Industrial Average has finally got back to an all-time high. But it’s bifurcated: a market of stocks, not a stock market; a rising tide that has not lifted all boats.

JOHN BUCKINGHAM
(Laguna Beach, Calif.) CEO, Chief Portfolio Manager and Director of Research, Al Frank Asset Management, managing $800 million in assets. Editor, The Prudent Speculator newsletter; co-editor, The Prudent Speculator Tech Value Report. Manager, the $290 million Al Frank Fund, with an annualized five-year return of 16.73 percent through October 5, 2006.

Professionals are skeptical about this rally. That makes me feel there’s a lot of money on the sidelines that may eventually come in.

FISHER: We’re part-way through a longer, more extended bull market. It’s been four years in a row of Up, Up, Up.

DREMAN: An upward-trending market — not a roaring bull market but stocks are moving up at a reasonable clip. However, investors are worried about housing, adjustable mortgage rates. It’s a mixed picture.

TREVISANI: The best word to describe it is “resilient.”

What’s your general outlook for the market next year?

FISHER: As the market gets higher and higher, fear of heights makes the likelihood of increased volatility greater and corrections potentially bigger. Next year will be a strong one for the stock market with, somewhere in the middle, a bigger — though short, sharp — correction than we had this year. It’ll be caused by some irrational concern that comes out of no place and will freak people out.

TREVISANI: We think valuation and growth potential remain attractive. Globally you’ve got some recovery going on in Europe and Japan. The dollar weakness has moderated somewhat, which bodes well for foreign exporters. And the continued moderation in the price of oil and other commodities will be a relief to consumers and many corporations.

BUCKINGHAM: Equities are poised to move higher, since [even] with this year’s bad news — like the Israel-Hezbollah conflict and the collapse of a major hedge fund [Amaranth] — they really didn’t decline.

DREMAN: I’m optimistic. Stocks are much more conservatively priced than they’ve been in well over a decade. There’s very little chance of a major fall from here. The market will do reasonably well, or better, trending up to 15 percent, even higher. Earnings are supposed to be up 10 percent, but that might be a little high. You’ll have more upside than downside — a good place to invest your capital.

With International’s outperforming the U.S. market over the past few years, how is foreign investing shaping up now?

TREVISANI: Japan and Europe are in the early stages of a recovery. The growth in developing markets, like China and Asia ex-Japan, continues. Overall, valuation remains low. You have the opportunity to buy less expensive global companies with high dividend yields, and that will continue. Rarely is the U.S. the best global market performer, so to be invested internationally makes a lot of sense.

What are the risks?

TREVISANI: A severe slowdown in the U.S. would have a tentacle effect and impact export economies around the globe. We don’t expect that to happen, though. [But] money into International is slowing, increasingly; and a risk could be an asset reversal. However, that’s more supply-demand than structural. We think economies around the globe are healthy.

What’s your outlook for the U.S. economy?

BUCKINGHAM: Corporate profit growth, in all likelihood, isn’t going to be as strong, though we think it will be above-trend. I don’t see a recession on the horizon: a growth rate of 2 1/2 percent to 3 percent is reasonable. The economy will be all right; and “all right” is good enough to have at least a 10 percent to 12 percent return on equities, if not a little more.

FISHER: It’s largely barreling along. Next year will be a good one for corporate earnings; there are lots of ways for them to go up. The consumer is in a very healthy condition. The economy is just fine and will be next year.

TREVISANI: A modest global interest rate environment will allow corporations to keep investing at healthy levels and continue to grow their businesses.

DREMAN: We could have a slow-down, but it won’t last a long time.

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DAVID N. DREMAN
(Aspen, Colo.) Chairman and CIO, Dreman Value Management, LLC. Forbes columnist (“The Contrarian”). Managing editor, The Journal of Behavioral Finance. Manages $18 billion in assets, including the $8.3 billion DWS Dreman High Return Equity Fund, with an annualized five-year return, for Class A shares, of 8.79 percent, through September 30, 2006. Dreman sub-advises five DWS funds; one SunAmerica fund; and the new Dreman/Claymore Dividend & Income closed-end fund, as well as VA and separate accounts.
We’ll probably see higher prices continue to work through the economy — moderate inflation.

What about interest rates?
BUCKINGHAM: I don’t see rates going much higher than they are today, and we may even see them come down a little as economic growth starts to slow and inflation remains contained.

DREMAN: Interest rates are near the bottom of the scale. I’m not so sure the Fed will cut rates because there’s still a lot of inflation in the system. We’re starting to see some higher acceleration in the rate of wage increases. That, obviously, isn’t a good sign. Lowering interest rates in the face of potential inflationary forces doesn’t make a lot of sense. It would be a blunder to cut rates. The Fed would look foolish.

What’s in store, then, for the bond market?
FISHER: It will have a low, single-digit positive return.
BUCKINGHAM: I don’t see rates moving dramatically.
DREMAN: All in all, I’d much rather be in stocks now than long-term bonds!

What’s the biggest threat to the stock market in ’07?
TREVISANI: Inflation. And if we have a continued slump in housing prices, there’s the risk that consumers will start reacting. But I don’t foresee that as being much greater than in the recent past.
DREMAN: A recession that’s induced by housing; manufacturing and other industries fall off. There’s also the geopolitical threat — more so an exogenous event that could come out of the blue and affect markets.
FISHER: There’s not much of a threat. If there is one, it’s probably something geopolitical outside of America that we don’t anticipate. There are a lot of tinderboxes that could blow at any point. We’re not really in a great position to do another warfront, and that could freak out the market.

BUCKINGHAM: It ultimately comes down to economic growth and inflation. If something geopolitical comes from left field, it would be very short-term, but nothing that would impact the market.

What about the threat of terrorism?
DREMAN: We’re going to have a number of [potential] eyeball-to-eyeball confrontations with Iran, possibly North Korea. That won’t be good for stocks. But the [effects] will be short-term.
TREVISANI: The threat is always there. But 9/11 provided an opportunity to invest in certain solid companies.

Will large-cap be outdistancing small-cap stocks this coming year?
BUCKINGHAM: Yes. Large-caps are finally going to match small-cap stocks — at least. When one sector has performed well for so long, like small-cap stocks, eventually the money starts to move toward the area that hasn’t performed as well.
FISHER: Since World War II, it’s been true that before a bull market is over, small-cap leadership has rolled over into big-cap leadership. I don’t believe the bull market dies until that happens. We’re close to the trade-off where big-cap takes leadership away from small-cap in a demonstrable way.

But it usually doesn’t happen until people stop calling for it!

DREMAN: If the economy starts to go down, we might see a move toward larger-cap stocks. Mid-cap stocks have actually doubled in price, and small-cap has almost doubled. Next year it will probably be more and more toward the large indices.

What sectors do you like for ’07?
FISHER: We’ll have a resurgence in energy stocks. Financial stocks will be fine, but they’ll be largely market-like, [though] the capital markets world will probably respond to a rising stock market and do well. I think we’ll get a resurgence in materials, in industrials. Regardless of industry, if companies that have high earnings yield relative to bond yield and strong strategic attributes don’t get their stock up, somebody else will do it for them [in takeovers].

Technology will be largely a market-like performer, or it might do a little better than that if we move into the period where big stocks do better than small stocks.
DREMAN: I still like oil. It’s been battered lately, but it’s got a lot of po-

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ETFs are great. Maybe they’re emerging in investing in our [industry] because the average Joe says, “Why do I need a mutual fund? I really like homebuilders [for example], so I’m going to buy homebuilder ETFs.” You get increased volatility: ETFs make it easier to pile into one sector.

What about investing in Latin America?
TREVISANI: They’re a big producer and exporter of oil and copper, so that bodes very well for their economies. Also, we own stock in American Movil, a Mexican cellular phone provider, and in Wal-Mart de Mexico. They’re entering rural areas, which are very profitable for them and have unmet demand. We also like the Brazilian regional jet manufacturer Embraer.

And in Europe?
TREVISANI: Consumers are starting to come back in places like the U.K., which has been good for retailers such as Next [clothers] and Tesco, which has a hyper-market [supermarket] format. We also like pharmaceuticals in Europe, such as Roche. In International, you can really find unique companies like Louis Vuitton, in the luxury goods space; and we also own the Frankfurt Airport.

In addition, we have auto companies Toyota and Hyundai, and the U.K. bank, Lloyds. Telecommunications is intriguing: We like Vodafone and France Telecom. These stocks are down, but we believe their valuations are extremely compelling.

ETFs are smoking. Are they on track to revolutionize the market?
FISHER: ETFs are great. Maybe they’re eating into the mutual fund business a little, but that business is huge. I don’t think ETFs accomplish one bad thing for the market.
BUCKINGHAM: ETFs have a big impact on our [industry] because the average Joe says, “Why do I need a mutual fund? I really like homebuilders [for example], so I’m going to buy homebuilder ETFs.” You get increased volatility: ETFs make it easier to pile into one sector.

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