

Appendix 1.2

Who's the Bull Here?

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If anyone got the bull market of the mid-1990s right, it was Edward E. Yardeni. In 1988, he predicted that the Dow Jones industrial average would hit 5000 by 1993. He reiterated his bet in 1994 and again, most courageously, just eight months ago — when the Dow was still only 4200.

But the great bull market is just beginning, according to Yardeni, chief economist at Deutsche Morgan Grenfell/C.J. Lawrence. His latest report boldly predicts the next Dow milestone, in five years: "10,000."

Why not? When Yardeni ventured in 1988 that the Dow was headed to the stratosphere, the reaction was a mixture of ridicule and suspicion. "They said I was nuts," he recalled. There also was the snide assumption that as chief economist for Prudential Securities Inc., he was just another cheerleader drumming up customers.

But the reasons he gave at the time seem positively clairvoyant today. Forbes writer Ruth Simon explained his views in an Oct. 31, 1988, article: "Yardeni's theory is that the clump of workers born between 1946 and 1964 will soon pass from spendthrift youth to (comparatively) frugal middle age. That change will create a bull market in financial assets as these converts to saving look for places to put their money."

"That is a classic example of his thinking," said Yardeni's friend Alan Blake, co-chief investment officer at Smith Barney Investment Advisors. "Now you can't read about the market anywhere without someone talking about the great underlying demand for financial assets from baby boomers."

Blake, 46, and Yardeni, 45, are both part of that generation, and they typify the Frugal Boomer trend. They are careful with their money, preferring hamburgers at the Tribeca Grill across from Blake's office to more expensive fare. Their talk about business is punctuated by discussions about the peewee soccer and football games that fill their weekends in the suburbs.

Yardeni was born in Haifa, Israel, and moved to the Cleveland area with his father, an engineer, and his mother, a teacher, when he was 7. He attended junior high school in Campbell, Calif., and senior high in New Rochelle, N.Y. His academic talents took him to Cornell University and then to Yale University, where he earned a PhD in economics and studied under future Nobel laureate James Tobin.

Yardeni at first thought he might teach or join the State Department. But he became addicted to financial markets after stints with the Federal Reserve Bank of New York and E.F. Hutton & Co. "I still haven't lost my sense of excitement about business," he said. "It's never boring."

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Predicting the Markets

Ed Yardeni

That exhilaration was particularly strong if you had the nerve, as Yardeni did, to be a contrarian. The urge to be different hit him with particular force after the 1987 stock market crash, when Wall Street and Washington were full of Jeremiahs predicting the end, not only of the stock boom, but of U.S. economic might.

"I did an analysis of the crash and concluded that little of it had anything to do with economic fundamentals," he said. "It was a failure caused by technical things, largely the use of portfolio insurance."

He suggested that the Dow industrial average would reach 5000 by 1993. In January 1994, with the market barometer still at 3780, he admitted in a report that "our timing was a bit off, but the basic bullish story has been working very well indeed." People who were predicting a great crash in the 1990s were correct, he said, but they had the country wrong: It was happening in Japan, not America.

The market remained sluggish in 1994, and Yardeni was not immune to doubts. "I flinched plenty of times about the short-term prognostications," he said.

But he continued to focus on the positives: low inflation, the growth of high-tech industries and the prospects for lower interest rates. So in an April 10, 1995, report — at a time when most other Wall Street economists remained cautious — Yardeni took another analytical leap off a cliff:

"The Dow is currently around 4200. I first started to hallucinate about Dow 5000 in 1988. Last year was a setback, but obviously not a serious one. As more investors come around to my Best-Of-All-Worlds, New-Wave-View of our economy, I expect a moonshot move that will hurl the Dow to 5000 either by year-end or early next year. It's only a 20 percent move from here."

This, in the view of many admirers, was the most foolhardy prediction Yardeni ever made. Seven-year-old forecasts are usually forgotten (unless the forecaster mentions them himself), but many people would remember eight months later if the Dow machine did not ring up three zeros for the guy at C.J. Lawrence.

Yardeni's latest report — predicting Dow 10,000 in five years — will be read by some as a victory whoop and by others as a celebratory trip into insanity. Yet the bull continues to roar:

"I predict that U.S. inflation will be near zero within the next 12 months," Yardeni said in his Nov. 6 study. "In the short term, this would be bad for profits and stock prices. I even see a 25 percent chance of a mild recession during the first half of 1996. But, I also predict that inflation will remain near zero through the end of the decade, and the long-term consequences of this scenario are extraordinarily bullish for financial assets, i.e., both stocks and bonds. The long-term government bond yield should fall to 5 percent by the end of 1996 and perhaps as low as 4 percent by 1998. The Dow should soar to 10,000 by the year 2000."

Yardeni acknowledged that such colossal optimism has never hurt him with his superiors, who embrace anything that brings stock buyers in the door. But no one would take such risks with his reputation just to make the boss happy. "It's just something inside of me that I can't stop," he said.