The 6 big market events of 2011

Here's a look at some possibilities that could shape the market this year, from the first true market highs in years to a Facebook buyout.

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The past few years in the market have been full of surprises -- most of them bad. This year, we should get some better news. The **Standard & Poor's 500 Index** (**$INX**) has new highs in sight, as the U.S. economy and corporate earnings break records. Gold could hit new highs, too. And hey, you might be buying a new car, finally.

But there will be plenty of bad along the way -- as the **European debt crisis** boils over and inflation returns. On a small scale, **Facebook** could wind up in unexpected hands instead of going public.

Here's a look at some potentially market-moving possibilities for 2011, and how to play them as an investor.

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How high will stocks go in 2011?

The S&P 500 closes in on all-time highs

Still shellshocked by the **Great Recession**, many Americans probably haven't realized that the U.S. economy seems set to break several important records this year because growth is back. Both corporate earnings and U.S. **gross domestic product** will reach their highest levels ever.

Michael Brush

This will push stocks to new highs for the recovery -- and the **Dow Jones Industrial Average** (**$INDU**) and Standard & Poor's 500 Index to their first new all-time highs since 2007.

Hard to believe? Consider that we're in the third year of the presidential election cycle -- a year in which the party holding the White House typically moves back to the political center and stokes the economy. Historically, this year of the cycle brings improved business confidence and economic growth, and stocks move higher.

Over the past 80 years, during the third year of the presidential cycle, the S&P 500 has gone up every time except one, according to market analysts at Deutsche Bank. The average return is 17%. That alone would take the S&P 500 to 1,470.

But the gains could be bigger this year. Deutsche Bank analysts expect the economic rebound to push earnings at the S&P 500 companies as a group to $96, surpassing the prior peak of $91.47 in 2007. Put a reasonable market valuation of 16.5 times earnings on that, and you get an S&P 500 that hits 1,584 during the year -- above the October 2007 closing high of 1,565. Those analysts predict the S&P 500 will close the year at 1,550.

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How to play it: Defensive stocks in areas like health care, consumer staples and utilities lag during an economic rebound, so avoid them, says Goldman strategist David Kostin. Instead, go with cyclical stocks, which do the best in a rebounding economy. Goldman suggests owning cyclicals in information technology, financials and energy -- like **Qualcom** (**QCOM**, **news**), **Bank of America** (**BAC**, **news**), **JPMorgan Chase** (**JPM**, **news**), **Schlumberger** (**SLB**,

news) and **Occidental Petroleum** (**OXY**, **news**). (For quality companies and banks to own in a rebound, see "**5 great companies to own now**" and "**5 reasons to love big banks again**."

2. Gold hits $1,800 an ounce

Gold has retreated in 2011 to around $1,360 an ounce from above $1,400. Is this a signal that gold's day is done? Now that the economy seems to be on the mend, will that take much of the fear premium out of the yellow metal?

No, says **Midas Fund** (**MIDSX**) manager Tom Winmill, for a simple reason: Inflation is on the way.

Winmill thinks concerns about inflation could easily push gold above $1,600. Then it could go to $1,800 on scary headlines -- say, defaults among U.S. municipalities or the perception that some states are approaching insolvency because their budgets are overloaded with pension and health-care obligations. He puts New York, Illinois, California, Wisconsin and Florida high on the list of states to watch. "A lot of these states have economies bigger than Greece or Portugal, and they have murkier financials," says Winmill.

Winmill's outlook on inflation, a key scenario for the gold bugs, is certainly not the consensus view. Goldman Sachs, for example, believes core inflation, which excludes food and energy prices, will remain "extremely low" at just 0.5% during the next two years. The reasoning is that capacity utilization is around 75%, well below the long-term average of 81%, and unemployment is high. So both goods and labor inflation seem improbable.

But Winmill says it's unlikely prices will remain tame, given the loose monetary policies put in place in the U.S. to spur growth. "Everyone is saying there will be no inflation. It's crazy, because you can't have all this money creation without inflation," he says.

The price of silver would also move much higher in an inflation scenario. Deutsche Bank analyst Jorge Beristain predicts silver will rise to $38 an ounce, from recent levels of around $28. In addition to lax monetary policy, demand from emerging markets and a scarcity of supply for these two metals will contribute to rising prices, say these analysts.

How to play it: Gold and silver mining stocks, of course. Winmill is bullish on **Barrick Gold** (**ABX**, **news**), **Freeport-McMoRan Copper & Gold** (**FCX**, **news**) and **Goldcorp** (**GG**, **news**). Beristain just upgraded **Coeur d'Alene Mines** (**CDE**, **news**) to "buy" from "hold," and more than doubled the price target to $54. The silver and gold producer's stock recently traded for $24.90 In this scenario, bonds will get hit, but stocks can still hold up if underlying fundamentals improve enough to support them. Howard Ruff of The Ruff Times, a top-ranked investment newsletter, is telling subscribers that the dollar will fall this year because of inflation.

3. Americans take to the roads in brand-new cars

After years of holding off, a lot of consumers are going to buy new cars this year. Buyers will unexpectedly push car sales back up to near pre-meltdown levels.

This may seem unlikely, given how many people are out of work. But the trend is already in place. Last year, car sales advanced 11% over the year before, as consumers warmed up to buying big-ticket items they'd been avoiding. The trend will continue this year, for the following reasons.

A lot of consumers have sharply cut back on debt. And the labor market will continue to improve, given that the economy is expected to grow 3.8% in 2011, according to Moody's Analytics. It suggests unemployment will fall below 9% by the end of the year. This will make consumers more confident and increase their spending power.

Meanwhile, finance companies are increasingly willing to lend to riskier borrowers, and there's plenty of pent-up demand for new wheels. **Ford Motor** (**F**, **news**) CEO Alan Mulally says the average car on the road is more than 10 years old. That means there's a big pool of drivers ready to upgrade. Mulally predicts vehicle sales could return to 13 million this year.

That's still below the long-term average of 13.8 million a year in light vehicle sales, but it looks like a conservative estimate. Wells Capital Management market strategist James Paulsen points out that auto sales are recovering just as fast as they did coming out of recessions in the early 1980s and 1990. If the current recovery continues, auto sales could increase to 15 million or 16 million in 2011, he says.

How to play it: Buy Ford, **General Motors** (**GM**, **news**) and **Toyota Motor** (**TM**, **news**). The easy money has already been made in these stocks, but they can still go higher.

4. There will be a 10% correction

It's hard to imagine stocks selling off sharply right now, since everyone seems so bullish, from the parade of commentators on CNBC to the people you meet at neighborhood get-togethers. But this is exactly why we know a big sell-off is coming.

Whenever the crowd gets very bullish, investors pile too much money into stocks without really thinking about what they are doing. Then sobering news comes along -- say a revival of the European sovereign debt crisis -- and the money that was quick to go into the market is quick to leave. A little pullback thus turns into a 10% correction.

How do we really know investors are too bullish, as opposed to guessing based on what we hear on TV and at parties? A favorite gauge of mine is the **Investors Intelligence Bull/Bear Ratio** -- a survey of the opinions of market newsletter writers. Whenever this ratio rises to its current level of around three bulls for every bear, a correction is likely.

Behind the scenes, more-esoteric measures used by hedge fund analysts are also flashing red. The percentage of companies getting upward earnings estimate revisions is at or near highs. And the stocks of economically sensitive companies (which do the best in rebounds) are outperforming defensive stocks by a wide margin.

The tough part here is knowing exactly when the correction will happen. My guess is that it will happen sooner rather than later, meaning over the next one to three months. It's tough to be more specific. "It could happen at any time," says market strategist Ed Yardeni, of Yardeni Research.

How to play it: Take risk out of your portfolio by reducing trades and your use of margin -- meaning borrowed money used to buy stocks. Have some cash on hand for the pullback. And be patient when the negativity starts to develop. Don't buy on the second day of any weakness, since a typical midcycle correction takes stocks down by about 10%.

5. The European debt crisis boils over again

Portugal's debt auction earlier this month went reasonably well, but don't take that as a sign the European debt crisis is over. European banks and governments must refinance more than $700 billion in debt in the first half of this year, according to estimates published by The Telegraph.

Given all the doubts about whether Europe's "periphery" countries -- Greece, Italy, Spain, Portugal and Ireland -- can impose strict-enough austerity to bring their budgets in line over the long term, refinancing on that massive a scale will be no easy task. This is why the **Centre for Economics and Business Research** in London cites "yet another Euro zone crisis in the spring if not before" as its top prediction for 2011.

So far, Greece and Ireland have borrowed from a $1 trillion bailout fund established by the **European Union** and **International Monetary Fund**. If other countries, particularly Spain, need to be rescued, that would likely exhaust the bailout fund. "A bailout fund closer to $1.5 trillion is necessary to convince investors they will get all the money back that they have invested in European sovereign debt," says Mark Zandi of Moody's Analytics.

But German and French politicians may have trouble upping the ante because of domestic political resistance among voters unwilling to bail out "Club Med countries" to the south. This view doesn't really make sense, because banks in the core European countries own a lot of the debt of these peripheral countries. But it is what it is.

How to play it: Keep some powder dry so you can buy stocks in the sell-off that will happen as the euro debt crisis boils over again.

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6. Apple buys Facebook

No list of predicted market events would be complete without at least one outlier, a **"black swan" event** that almost no one sees coming. So while most people are looking for a Facebook initial public offering next year, I'll go with a forecast by market strategists at Saxo Bank in Denmark who predict the giant social networking site gets bought by **Apple** (**AAPL**, **news**) this year.

It's not so farfetched. Apple has no substantial "social network" presence like Facebook, but it clearly has an interest, as evidenced by its fruitless attempt to partner with the website. Apple has cash, and buying Facebook could pay off. "The gigantic, 500 million-plus Facebook user base could be integrated across Apple's consumer products and services," says Saxo Bank. Among other benefits, every Facebook user would automatically have an iTunes account, and FaceTime chat could be integrated with Facebook chat.

Yes, it's wild. But stranger things have happened.

How to play it: Buy Apple stock, especially in the weakness this week on concerns about **Steve Jobs'** health.

At the time of publication, Michael Brush did not own or control any securities mentioned in this column.

*Michael Brush is the editor of **Brush Up on Stocks**, an investment newsletter. **Click here to find Brush's most recent articles and blog posts**.*

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