

# THE WALL STREET JOURNAL.

## *Why the Dow 36000 Forecast Was Right*

Hassett and Glassman were mocked in 1998 but have been vindicated by rising stocks. The danger now? Rising interest rates.



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Journalist James Glassman and economist Kevin Hassett took to [these pages](#) in March 1998 to dismiss concerns of a stock market bubble and offer a rationale for why stocks could still go a lot higher. That was already sticking their necks out. But then they stuck them out further, arguing—with many qualifications—that over the long run the Dow Jones Industrial Average could go to 35000. Their simple policy advice: Buy a diversified portfolio of stocks, and don't put too much money in bonds. Over the long run, stocks offer a higher return without significantly greater risk. Their basic rationale, which depended on investors gradually coalescing around their view, was that stocks had to rise as the market risk premium came into line with empirical reality.

Later, in 1999, they stuck their necks out even further in a best-selling book titled “Dow 36,000.” In it, their very rough guess on timing was five years. The left hated them, in no small part because Mr. Hassett is a prominent conservative economist. The right liked them, partly for the same reason. On balance, it is probably fair to say that the book was viewed as somewhere between outrageous and absurd.

Well, this summer, 22 years later, the Dow closed above 35000 for the first time, and 36000 is within reach. Is it time to admit the book might also have been a wee bit prescient? In my view, it is.

Admittedly, making that judgment is a little like deciding how to grade a student who intuited a strong answer to a very difficult exam problem but whose proof had a significant logical flaw. At the time of the Journal piece, the Dow had hit a lofty 8800, a value that had unnerved many pundits, especially considering the Dow had been 3400 only five years earlier. Indeed, when the Dow hit 6400 in December 1996, Federal Reserve chairman Alan Greenspan, worried that the financial system might be reaching a vulnerable zone, gave his legendary “irrational exuberance” speech. Mr. Greenspan was hardly alone; a few days before his speech, Yale finance expert Robert J. Shiller (a Nobel laureate in 2013) had given a presentation to the Federal Reserve Board explaining his view that there was a high risk of a stock market crash.

For years, the Glassman-Hassett analysis was widely denigrated, particularly by left-leaning commentators, who delighted in equating conservative and stupid. Nobel Prize-winning economist Paul Krugman [called](#) the idea “silly,” albeit having once expounded their case for much higher stock prices quite eloquently. Berkeley economist Brad DeLong [echoed](#) a review castigating the book’s “incredibly money-losing advice.” And those were not the worst. I confess that I, too, [strongly questioned](#) Messrs. Glassman and Hassett’s zero long-run risk logic, although I did stress that there was academic gravitas to their core point that, historically, a diversified portfolio of U.S. stocks has typically outperformed safe bonds over very long periods—say, of 25 to 30 years—even if one can construct exceptions.

Truth be told, Messrs. Glassman and Hassett’s theory was “Stocks for the Long Run,” Jeremy Siegel’s 1994 best-seller, on steroids. Mr. Siegel in turn had extended and reinterpreted Rajnish Mehra and Edward C. Prescott’s seminal 1985 paper on the “equity premium puzzle.” Rather than view the consistent excess long-run real returns on stocks as a theoretical puzzle, as Messrs. Mehra and Prescott did, Mr. Siegel argued that the long-run excess return on stocks was a massive investment opportunity, offering to patient investors a much higher return on modestly higher risk. Messrs. Glassman and Hassett took the argument one step further still, basically guessing that stocks would keep rising and rising as the arguments of Messrs. Siegel, Mehra and Prescott became more widely accepted, leading investors to bid up stock prices.

So, what, if anything, did they get wrong? Well, for starters, stocks are certainly risky in the short to medium run, and for a lot of investors that is a big deal. If you have \$40 million and overnight it becomes \$20 million, you can probably afford to be patient, however long it takes for the market to come back. But if you are elderly with \$300,000 in retirement savings, seeing it collapse to \$150,000 is pretty painful, and the knowledge your investment will be worth much more if you can wait two decades won’t dull the pain.

Even a long-lived foundation or university faces constraints from trustees and regulators that can effectively force an uncomfortable spending adjustment if the market collapses. The pool of players who care about short and medium returns is very substantial. The Mehra-Prescott model does not allow for liquidity constraints, which are important for a sizable chunk of the market.

Now that the Dow is approaching 36000, is it actually because people are putting more and more of their investments into risky assets? In part, yes. But surely the biggest driver of prices for all long-lived assets—including equities, housing, art and even bitcoin—has been the extraordinarily low level of real interest rates. It's not so much that the equity premium has fallen as that the interest rate on bonds has collapsed.

Nevertheless, Messrs. Glassman and Hassett also got something very right. Their extreme take on the equity premium puzzle—the mystery of why the average return on stocks seems so high relative to safe bonds—hits an important point that has operational significance for many investors. Those with the wealth and liquidity to ride out short- and medium-run fluctuations have an enormous advantage. For those with little wealth, the advice to invest in stocks is not very helpful. Yet for the majority of middle-income Americans, who certainly understand long-term investing when it comes to housing, the equity premium is something they should know about and make their own decisions.

What's next? The two-plus decades of experience since “Dow 36,000” has changed my mind far more about the equilibrium real interest rate than it has about the riskiness of stocks, including in the medium and long run. Risk markets could wilt if and when global real interest rates start trending up, or if there were a real or cyber war. There is ample reason to be nervous. Nevertheless, if Messrs. Glassman and Hassett decide to publish a new edition called “Dow 72,000,” I will buy a copy.

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