

There the Bears Go Again

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The S&P 500 is up 6% since the start of the year and 12% from a year ago. On cue, the bears have started to claim this run-up in stocks is just plain crazy, based on unreasonable euphoria or “it’s just technical.” It can’t possibly last because “the fundamentals are bad.”

We would probably listen to these complaints if it were the first time we had ever heard them, but the same theme has persisted for a long time. Whenever something good has happened over the past few years (since the bottom in March 2009), the naysayers claim that it’s based on some sort of mental defect, but when something bad happens it’s a dose of reality. We remember Nouriel Roubini saying the stock rally in 2009 was a “dead cat bounce.”

And here they go again. The bears ignore the fact that earnings are good, stocks are cheap relative to those earnings, and the economy is growing.

Corporate profits were at a record high in the third quarter and, so far, reports from Q4 show 69.2% of S&P 500 companies beating estimates, with earnings-per-share at \$25.95 – a 13.6 price-to-earnings ratio. This is amazingly low, especially with 0% short rates and 10-yr yields near 2%.

Think about it this way: if long-term interest rates were 4.5%, the Price-to-Earnings ratio on a bond would be 22.2, with a fixed, not growing, yield.

Of course, the market could be pricing in another recession, but this is becoming much less probable every day. ISM reports are well above 50, unemployment claims are the lowest in almost five years, auto sales remain strong, durable goods orders are up, and the first estimate that real GDP contracted at a 0.1% annual rate in Q4 is suspect.

Both commercial construction and net exports came in much better than the government assumed. It now looks like

real GDP probably grew in Q4 (maybe by 0.4%) even if the government revises down its estimate of inventories.

We doubt any of the recent hand-wringing would be going on if stocks had fallen recently. The pouting pundits of pessimism would be praising investors for being so erudite and prescient.

Don’t get us wrong, bamboo doesn’t grow to the sky. At some point this year – with almost absolute certainty – stock prices will fall. Because of news out of Europe, or the Middle East, or maybe the political parties will be at loggerheads again over some federal budget issue.

But the issue for investors is whether any of these periods of negative returns are predictable or signal something unsustainable about equity performance.

Stocks have dropped in May in each of the past three years, lending credence to the old idea that investors should “sell in May and go away” for summer activities and vacations. But the time to buy back after these May dips has changed each year, with July in 2010, October in 2011, and June in 2012.

Even if you know when to sell, if you don’t know when to buy back in, then a strategy based on market timing is not going to work as well as buy and hold, which is what we continue to recommend, especially when the market is as undervalued as it is today.

Investors have to decide whether they want to go with the conventional bearish wisdom so they don’t feel out of step. No one is going to think you’re a genius if you tell them you’re aggressively invested in stocks; crazy is more like it. But, for the year ahead, like the past few, it’s the “crazy” ones who should come out ahead.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
2-13 / 7:30 am	Retail Sales – Jan	+0.1%	+0.0%		+0.5%
7:30 am	Retail Sales Ex-Auto – Jan	+0.1%	+0.5%		+0.3%
7:30 am	Import Prices – Jan	+0.8%	+0.9%		-0.1%
7:30 am	Export Prices - Jan	+0.3%	+0.4%		-0.1%
9:00 am	Business Inventories – Dec	+0.3%	+0.3%		+0.3%
2-14 / 7:30 am	Initial Claims – Feb 9	360K	360K		366K
2-15 / 7:30 am	Empire State Mfg Survey - Feb	-2.0	-2.5		-7.8
8:15 am	Industrial Production – Jan	+0.2%	+0.3%		+0.3%
8:15 am	Capacity Utilization – Jan	78.9%	78.9%		78.8%
8:55 am	U. Mich Consumer Sentiment- Feb	74.8	74.0		73.8