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Strategists Sticking With 17% S&P 500 Gain on Higher Profit

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(Updates with today's closing prices in sixth paragraph.)

Aug. 5 (Bloomberg) -- Wall Street has never been more sure that the Standard & Poor's 500 Index will rally in 2011, even after speculation the U.S. economy is heading for a recession prompted the biggest plunge since the bull market began.

Chief strategists at 13 banks from Barclays Plc to UBS AG see the benchmark measure of American equity surging 17 percent through Dec. 31, the average estimate in a Bloomberg survey. Their projection that the index will reach 1,401 hasn't budged in four weeks, while mounting concern U.S. growth is slowing drove the S&P 500 down 11 percent since July 22, including yesterday's 4.8 percent tumble.

About \$1.8 trillion has been erased from American equities as reports on manufacturing and consumer spending showed the world's largest economy is slowing. Forecasters at UBS and Deutsche Bank AG say rising profits mean the S&P 500 deserves a higher price-earnings ratio than the 28-month low reached yesterday. A year ago, strategists also remained bullish after a 14 percent drop, and proved prescient as the S&P 500 rallied 20 percent from its August low.

"I'm reluctant to overreact to some shorter-term weakness, no matter how real it is, because the market has proven to be unbelievably resilient," Jonathan Golub, the chief U.S. market strategist at UBS in New York, said in an Aug. 3 phone interview. "If you would have been acting that way for the last two years, you would have gotten killed by this market. Companies have done an absurdly good job of managing through this environment."

Most Since 2009

Golub says the S&P 500 will end the year at 1,425. It fell yesterday to an eight-month low of 1,200.07 amid a global rout, extending a nine-day retreat to 11 percent. That was the biggest loss over the same amount of time since March 9, 2009, when the gauge ended a 17-month bear market. The MSCI All-Country World Index slid 4.1 percent yesterday, the most since March 2009. The Stoxx Europe 600 Index fell to the lowest level since July 2010, while Brazil's index sank the most since 2008, as commodities producers dropped.

The S&P 500 fell 0.1 percent to 1,199.38 at 4 p.m. in New York, bringing its weekly loss to 7.2 percent, the most since November 2008. Treasuries and the dollar fell today.

A year ago, stocks also fell as investors speculated the U.S. economy would contract. Equities plunged until Federal Reserve Chairman Ben S. Bernanke foreshadowed \$600 billion in bond purchases meant to prevent deflation and stimulate growth at a Aug. 27, 2010, meeting in Jackson Hole, Wyoming.

Pimco's Gross

Bill Gross, who runs the world's biggest bond fund at Pacific Investment Management Co., told Bloomberg Television on Aug. 2 that another asset-purchase program may be announced by the Fed, even after President Barack Obama signed a deficit reduction plan that demands less government spending.

Should a plan materialize, it won't have the same impact as last year, said Mark Luschni of Janney Montgomery Scott LLC, which manages about \$54 billion.

"The macroeconomic issues are trumping the good earnings picture," Luschni, the chief investment strategist at the Philadelphia-based firm, said in a phone interview on Aug. 3. For valuations to rise, "we'd have to have better economic conditions than we do at the moment, and that's not evident," he said.

Expecting Growth

Strategists say earnings growth will fuel gains. S&P 500 profit will rise 18 percent in 2011 and 14 percent in 2012, according to the average per-share analyst estimates in a Bloomberg survey. More than 75 percent of corporations in the index have exceeded earnings estimates for the second quarter, with total income topping projections by 5.2 percent.

Credit Suisse Group AG and HSBC Holdings Plc advised investors to buy equities today. Andrew Garthwaite, a London-based strategist at Credit Suisse, reiterated an "overweight" recommendation on stocks even as he cut his year-end forecast for the S&P 500 to 1,350.

"Our economists are not forecasting a recession and, indeed, are looking for U.S. growth to accelerate in the second half," Garry Evans, global head of equity strategy at HSBC in Hong Kong, wrote in a note today. "Investors should look to raise equity risk gradually over the summer."

Even as companies from Ford Motor Co. to Boeing Co. beat forecasts, the S&P 500 has plunged as investors turned their attention to reports showing slower economic growth. Consumer spending fell 0.2 percent in June, personal incomes grew at the slowest pace since November and an index of American manufacturing sank to a two-year low.

Not 'Well-Reasoned'

"It's unlikely I will change my view because we had a bad week or get really excited because we had a good week," Tobias Levkovich, Citigroup Inc.'s chief U.S. equity strategist in New York, said in an Aug. 3 phone interview. "That's not a well-reasoned market outlook," said Levkovich, who forecasts the S&P 500 will end the year at 1,400. "That's a reactive trader mindset, but that's not what I'm supposed to be doing."

The combination of falling prices and rising profits has driven the S&P 500's price-earnings ratio down 17 percent since Feb. 18, data compiled by Bloomberg show. At 13.2 times profit, the valuation is 20 percent below the average since 1954.

Following the drop in valuations, "our view is growth picks up, and like last summer/fall as the data turn up, they will take the equity market up with it," Binky Chadha, Deutsche Bank's chief U.S. equity strategist in New York, said in an Aug. 2 e-mail. He said the index will reach 1,550, the highest projection in the Bloomberg survey.

Last Year's Rebound

The S&P 500 bottomed in 2010 at 1,022.58 on July 2. Gross domestic product expanded at an annual rate of 2.5 percent and 2.3 percent in the third and fourth quarters. The stock index rallied 10 percent to 1,127.79 through Aug. 9, before slipping 7.1 percent to 1,047.22 by Aug. 26.

At the time, strategists said the index would rise to 1,234 through the end of 2010, according to the average estimate. Three days later, Bernanke said the central bank would "do all that it can" to sustain growth, foreshadowing the bond-purchase program revealed two months later. The August announcement helped catapult the S&P 500 to 1,257.64 as of Dec. 31 and 1,343.01 by Feb. 18, a 28 percent advance.

Laszlo Birinyi, one of the first investors to recommend buying stocks when the bull market began in March 2009, said this week that stocks shouldn't be abandoned.

More Scotch

"It's like all these times when you second-guess yourself, and you probably wake up a little earlier than you're used to, and maybe you put an extra finger of scotch in the glass," Birinyi said in an Aug. 2 telephone interview. "It's probably a good idea to have a gut check once in a while, because it makes you review and rethink your process. Our view is that this is still a market of some duration."

The S&P 500 had the second-best performance in 2011 among the world's 10 biggest stock markets through yesterday, even after the 12 percent slump since April 29 brought the year-to-date decline to 4.6 percent. China's Shanghai Stock Exchange Composite Index did best with a 4.4 percent drop. Japan's Topix lost 8.1 percent, while the FTSE 100 Index of U.K. stocks dropped 8.6 percent.

"Doing this 22 years, to me this has to be the type of bottoming that the U.S. needed to just clean the slate," Brian Belski, the New York-based chief investment strategist at Oppenheimer & Co., said in a telephone interview yesterday. "A year ago, we were only a couple quarters into the rebound, now we're further in. There was less belief a year ago because nobody really believed forward earnings growth. Now they've proven themselves." He estimates the S&P 500 will reach 1,325.

No Contraction

Barry Knapp, the New York-based chief U.S. equity strategist at Barclays, said that it's unlikely the economy will contract even though data show a slowdown. The Citigroup Economic Surprise Index has averaged negative 95.05 since sinking on June 3 to negative 117.20, meaning reports were missing the median estimate in Bloomberg surveys by the most since January 2009.

"If you sell stocks at 1,250, that's a bet we're going back to a recession, and we don't buy that," Knapp said in a telephone interview yesterday. His year-end projection is 1,450. "The probability of the U.S. going back into a recession is low. These things have a way of running their course."

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