

## **NOW THAT THE BULL MARKET IS TWO YEARS OLD, WHERE DO WE GO FROM HERE ?**

The stock market began its ascent off of the worst bear market since the Great Depression of the 1930's on March 9, 2009. The S&P climbed just over 100% from the low at that time to its recent high on February 18<sup>th</sup>, and this rise was the largest two-year increase off of a bear market low since the 1930's as well. For instance, after the 1973-4 bear market, the S&P rallied back by 75% in 1976. After the 2000-2 bear market, the S&P rose by 48% two years later. So the current move higher has certainly been one for the record books. Now that two years have passed, the question on investors' minds certainly is – "where do we go from here?"

One can certainly argue that there are still plenty of bullish arrows in the quiver. In addition to the rise in equities, we have also seen large gains in commodity prices and corporate debt as well, as central banks around the world have pumped in \$12 trillion in stimulus and corporate profits have been rising by more than expected as well. As long as this stimulus is still available, there is no reason to think that the bull run is going to end.

Here are a number of reasons presented by bullish prognosticators as to why stocks might be able to continue on their recent upward path:

- 1) Even after doubling in the past two years, the S&P's two-year return is 36% below the average bull market gain of 131% since 1962.
- 2) The 730 day rally without a decline of 20% compares with the average duration of 1,407 days.
- 3) The S&P has risen in 18 of the past 24 months.
- 4) Profits have grown for five consecutive quarters but the price/earnings ratio for the S&P is currently at 15.5, and this compares with the average p/e ratio of 19.7 at former bull market peaks, which means that stocks can still advance.
- 5) The S&P earnings yield (the inverse of the price/earnings ratio) is 3% higher than the yield on the 10-year Treasury Note, and this is the widest differential at the two-year point of any prior bull market since 1962.
- 6) The projection is for S&P companies to increase their earnings by 17% this year to a record high \$99 a share, which would be the largest amount ever.

On the other hand, there are reasons for caution going forward as well, and these are reflected in various bullish statistics, and here are a few of the many:

- 1) A gauge of how hedge funds are heavily invested in stocks rose to 33% in January and this compares to the average gauge of 29% since 2000.
- 2) Shares sold short have declined for four straight months to 3.3% of all stock at the end of January.
- 3) Individual investors have added \$24 billion to U.S. equity funds this year while pulling out \$60 billion from bond funds and \$16 billion from emerging market funds.

Most importantly, the ultimate determiner of stock prices, namely market action itself, has turned rather mixed the past three weeks since the various indexes reached their highs on February 18<sup>th</sup>. Since that time, there have been two declines of 3.7%, and these have matched the November decline of the same magnitude that marked a bottom in the ongoing up-move and allowed for its further resumption. If the current decline exceeds this amount, this could be evidence that the tide is turning. For instance, the S&P just closed below its 50-day moving average for the first time in 130 trading days, which was the longest streak since early 2007.

There is also the pernicious influence of higher energy and food prices, and economists believe that crude oil prices over \$120 a barrel will start to subtract from further economic growth.

This means that it is going to be extremely difficult for the major averages to break above their recent highs, which would be 1344 for the S&P and 12,400 on the Dow, as there are going to be investors who would most likely be willing to sell on rallies back to those levels considering that they might have bought at high prices.

Therefore, I am predicting that stocks are not going to be able to overcome those February 18<sup>th</sup> highs at least for the next month, or until the first-quarter earnings season gets under way, and let us also remember that the comparisons this year to 2010 will be more difficult than the 2010 earnings comparisons were to the depressed year of 2009.

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Disclosure:

*Don Selkin is the Chief Market Strategist at National Securities Corporation, member FINRA/SIPC, (NSC) and provides the Fair Value analysis for CNBC each morning. The commentary provided in this Market Letter is intended to provide our customers with timely market analysis and should not be considered a research report. This Market Letter may contain, and is limited to: Discussions of broad based indices; Commentaries on economic, political or market conditions; Technical analyses concerning the demand and supply for a sector, index or industry based in trading volume and price; Statistical summaries of multiple companies' financial data, including listings of current ratings; and, Recommendations regarding increasing or decreasing holdings in particular industries or securities. This Market Letter does not make a financial or investment recommendation or otherwise promotes a product or service of the firm. This Market Letter contains only news, facts, and commentary on information previously reported from a news source believed to be accurate and reliable by the author. These news sources include the following: {Bloomberg Financial, Reuters, Associated Press}. It is possible that at any given point in time, the author, NSC, or one or more of its employees or registered individuals associated with NSC, may hold a position, either long, or short, as well as options, bonds, or other instruments in the companies noted in this report. This Market Letter is intended strictly for current National Securities Corporation customers only.*