

WHAT YEAR IS IT?

A THIRD YEAR OF A BULL
MARKET – OR THE FIRST YEAR
OF SOMETHING ELSE?

WHERE IS THE MARKET?

- UP A TON, DOWN A LOT, OR ABOUT FLAT?
- ANSWER: YES!
- FROM THE BOTTOM: UP ~100%%
- FROM THE '07 HIGH: DOWN 25%
- YTD/PAST12 YRS: FLATTISH/UP A BIT
- FILLED “LEHMAN/BEAR GAP”

CURRENT MARKET TAKE

- Is the Bull Market in “Unprecedentedness” rolling over?
- Sentiment is fickle, shallow, short-term frothy, broadly skeptical.
- Watching the “likely voters.”
- The risk of “overthinking it” will wane, maybe soon
- Will age catch up with the bull?

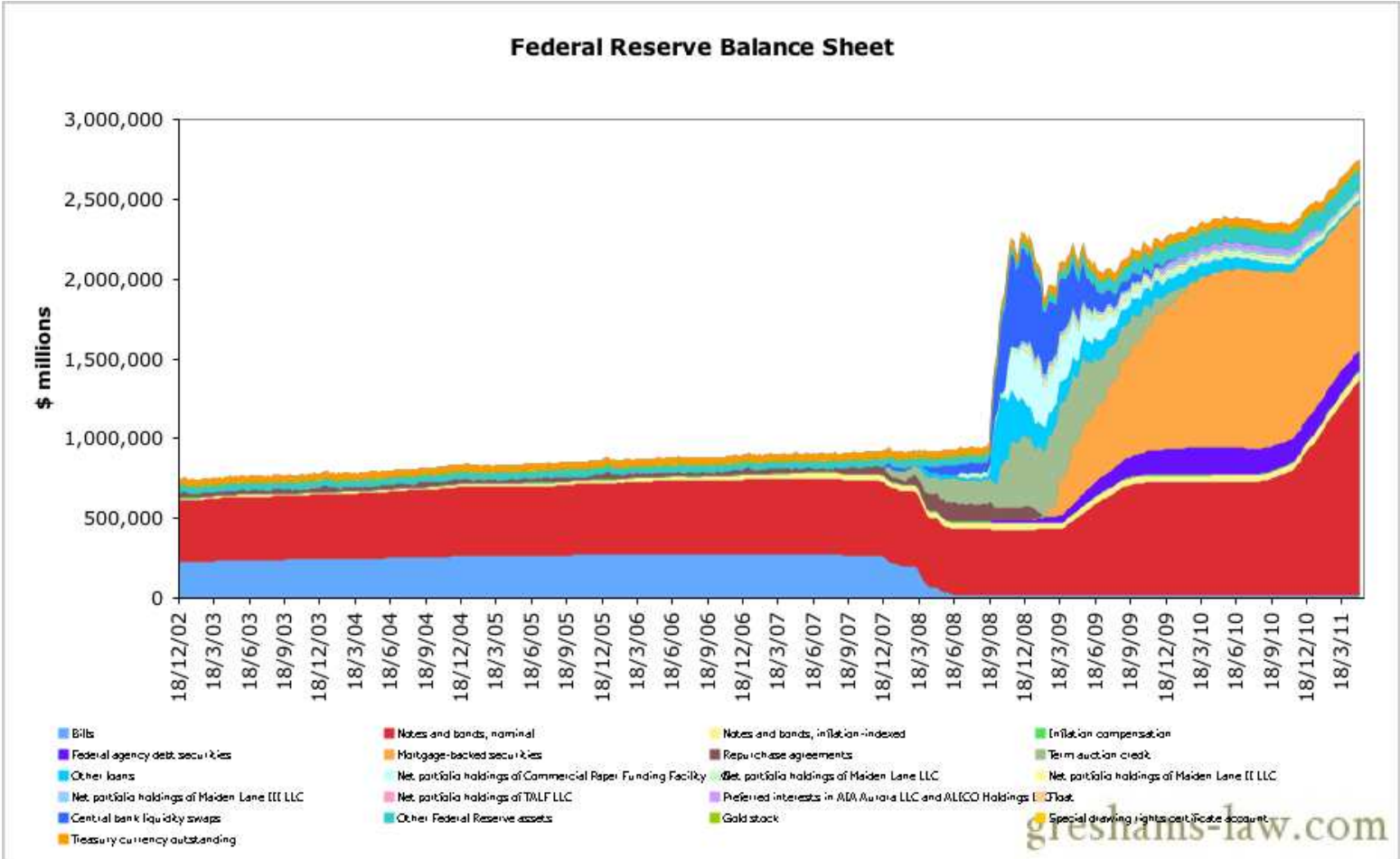
IS THE MARKET EXPENSIVE, FAIRLY VALUED, OR CHEAP?

- ANSWER: YES!
- Median P/E, 10-year trailing P/E >18x
- Trailing/forward S&P P/E ~13x
- Financials, oil, mega-caps weigh on P/E
- S&P cash/assets near record; 10-year trailing returns negative = positive forward implications; at same S&P level in '06, earnings were lower – stocks rose 20%

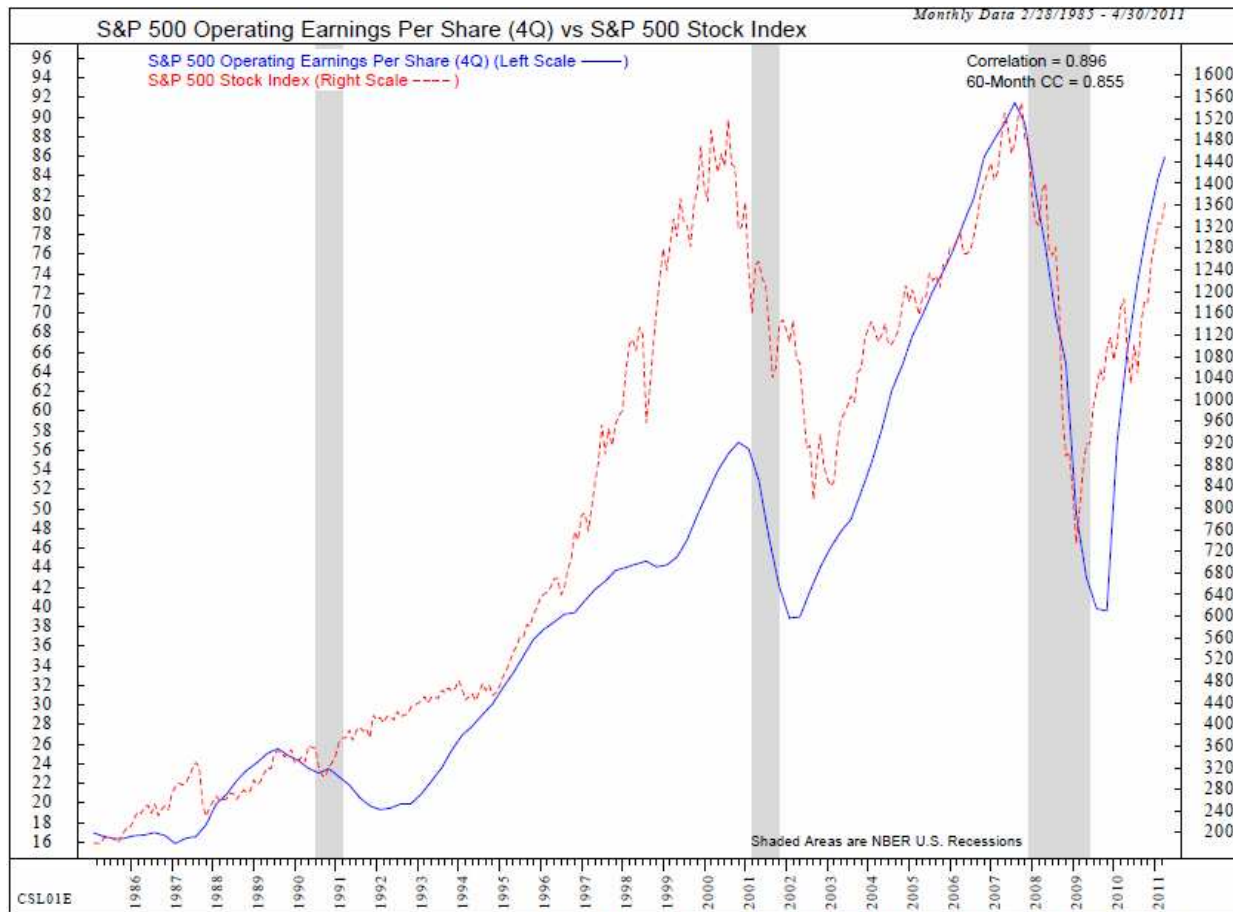
BIGGEST '12 SURPRISES?

- HINTS OF LESS EASY FED?
- EUROPE OUTPERFORMS?
- INFLATION: THAT DOG WON'T BARK
- HOUSING HAS BOTTOMED
- POLITICS ISN'T THE KEY

HAS IT ALL BEEN THE FED?



OR CORPORATE EARNINGS?



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WHAT'S BACK TO PRE-LEHMAN LEVELS?

- NOMINAL GDP
- RETAIL SALES
- THE S&P 500
- CONSUMER DEBT-SERVICE COSTS

WHAT'S NOT?

- EMPLOYMENT
- HOUSING (DON'T HOLD YOUR BREATH)
- RISK APPETITES (CORPORATE, INVESTOR AND CONSUMER)
- LIQUIDITY

WHAT YEAR IS IT?

- 2008
- 1939
- 1976
- 1995
- 2006
- 1946
- 1980

2008

- MORE BANK/CREDIT STRESS
- WORKING FOR THE WEEKENDS
- LIQUIDITY IS FIXABLE/SOLVENCY NOT
- STOCKS THE RESIDUAL ASSET CLASS
- S&P LOWER, PROFITS HIGHER
- CORRELATION IS A KILLER
- CYCLICAL BEAR VS. MELTDOWN

1939

- POLICY ERROR FUELS RELAPSE
- DRUMBEAT FOR FISCAL DISCIPLINE
- NEVER REVISITED POST-CRASH LOW
- GEOPOLITICAL NOISE

1976

- MALAISE/DISGUST WITH POLITICS
- SIMILAR MARKET RHYTHM
- CORRECTION, NO BEAR MARKET

1995

- REPRESENTATIVE HEADLINES
 - Private payroll job losses
 - Leading indicators soften
 - Real GDP below 1% one quarter
 - Europe in recession
 - Wages as % of GDP at an all time low
 - Slowing earnings growth
 - Parabolic move in tech leaders

2006

- ANGST OVER WEAK RECOVERY
- FOLLOWED RANGE-Y STOCK YEAR
- CHATTER OVER EXCESS DEBT
- CASH-RICH COMPANIES – DEALS
- BIG DIFFERENCE: HOUSING BUBBLE

1946

- FEAR OF RETURN TO DEEP RECESSION
-
- GOV'T FOCUSED ON SPENDING CUTS
-
- PRIVATE SECTOR SLOW TO SPEND
- MILD BEAR MARKET

1980

- PIVOTAL ELECTION YEAR
- ECONOMIC DISGUST/U.S. DECLINISM
- FATIGUE WITH “LOST DECADE”
- BIG MARKET RALLY, THEN ONE LAST DOWNTURN TO SECULAR LOW

WHAT TO DO WITH BONDS

- ZIRP FOR THE FORESEEABLE – CONSENSUS/PRICED IN
- HIGH-GRADE – ONLY THE COUPON
- “SPICIER” CREDIT SECTORS ENTICE
- INFLATION WOULD BE WELCOME

COMMODITIES

- ARE THEY EVEN AN ASSET CLASS?
- VOLATILE, MOVE WITH CHINA LIQUIDITY
- TOO INVESTABLE RIGHT NOW?
- IF A BUBBLE, PROBABLY NOT DONE

THE NEW CORPORATOCRACY

- DEVELOPED WORLD GOV'Ts BROKE
- CONSUMER HANGOVER
- MULTINATIONALS FLUSH WITH MONEY/POWER
- LIKE THE LATE 1800'S?

HEDGE FUNDS

- NO PAINFUL SHAKEOUT
- STRONG GET STRONGER, NEW GUYS TRY TO BOTTLE LIGHTNING
- OUTSOURCING OF PROP DESKS
- ENVIRONMENT TOUGH – CORRELATION – ALL MACRO – NO DUMB MONEY

WHAT ABOUT HIGH-FREQUENCY TRADING?

- CHANGED MARKET RHYTHMS
- NOT DIRECTIONALLY IMPORTANT
- LIKE MARKET MAKERS (SORT OF)
- STRUCTURAL FLAWS NEED FIXING