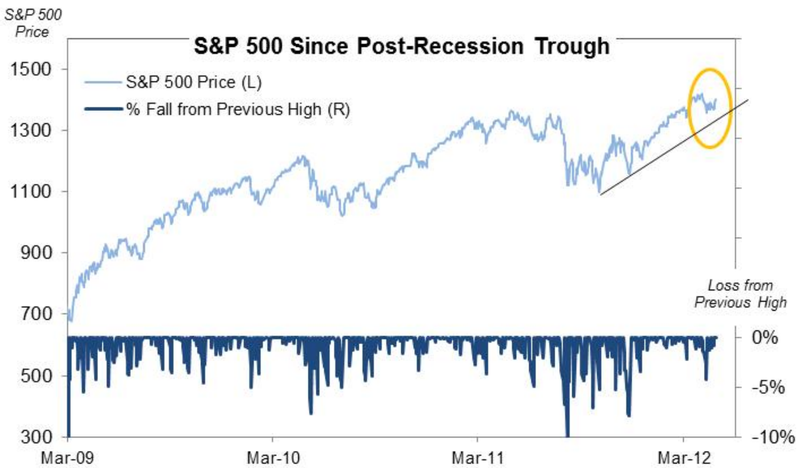
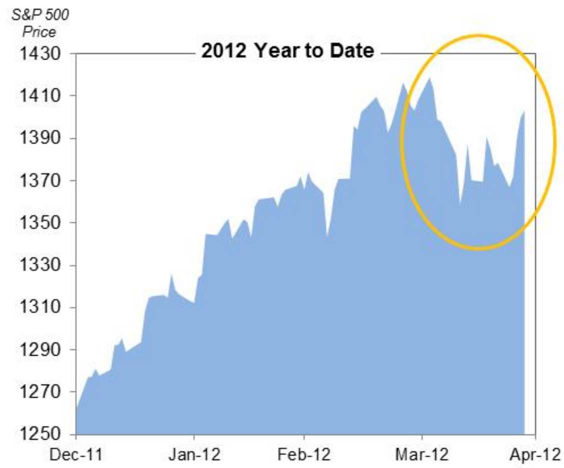
April 2012

Miracle Mile Advisors Research Spotlight: Spring Jitters

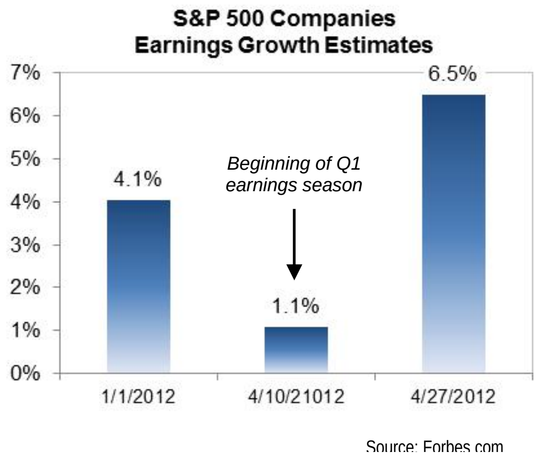
The turn of the calendar to April is greatly anticipated by most people after the dark days of winter, but investors have not been among that group for the past several years. In fact, the old adage "sell in May and go away" would have been a profitable investment strategy in both 2010 and 2011 as spring and summer were far less sunny seasons for the equity market than fall and winter. The S&P 500 index fell nearly 12 percent from the end of March 2010 through the end of June 2010, while March 31, 2011 through September 2011 saw a decline of nearly 15 percent. Twice bitten and thrice shy, investors grew increasingly nervous as the first quarter drew to a close this year. Right on cue, the U.S. equity market began to fall from its recent peak on April 2nd.

The rush to call the end of the equity rally has been remarkable. After just a few days of the market selling off – which at its trough (to date) was a loss of 4.3% – the predictable doomsday forecasts appeared. Throughout the winter investors who were on the sidelines clamored for a short-term pullback so that they could find an entry point into the equity market. However, once that pullback arrived, opportunity quickly turned to pessimism. Investors do love identifying patterns, so perhaps it is no surprise that market pundits have almost willed a spring slowdown into existence. This year, however, the economic environment is more supportive than the previous two years, and the market's behavior in April has been far from severe.





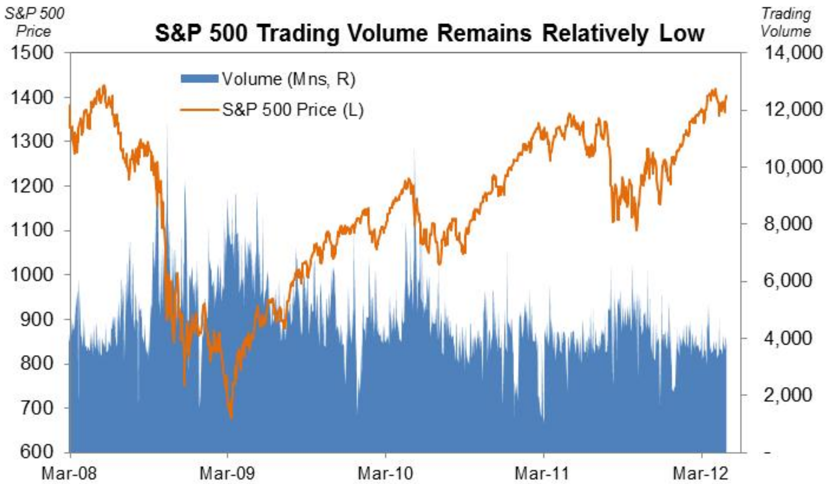
The chart above left shows the path of the S&P 500 index since its post-recession trough in March 2009. There have been several cyclical pullbacks during the past three years but the current uptrend still appears to be firmly in place. The bottom half of the chart illustrates the cumulative daily declines from the previous high point the index has experienced over the same time period. Putting this month's reversal into historical context, a roughly 4% drop is in line with many other short-term losses – even when the market is in an upward trend. The chart at right shows that year to date the index is still near its high point. There certainly is no guarantee that the recent market weakness is completely behind us, but from a contrarian perspective, the speed and severity with which the bears emerged from hibernation was confirmation that sentiment had not become overly optimistic.



Our focus on the improving macro backdrop directed us to turn positive on U.S. equities toward the end of 2011. However, many bottom-up stock pickers were unconvinced by macro arguments. Even as the equity market rose steadily earlier this year, stock pickers remained concerned that the rally could not last for long. They reasoned that as earnings season began and companies reported profits for the first quarter, surely the jig would be up. Wall Street estimates of earnings growth for S&P 500 companies stood at just over 4% in January but fell to 1% by the time earnings season kicked off on April 10. Now, with well over half of companies already reported, growth estimates have risen to 6.5% and this quarter is on track to post one of the highest percentages of companies beating consensus forecasts since the late 1990's. As we had speculated would happen in our February report *"The Macro Perspective: Ahead of the Pack"*, the "earnings" denominator of the Price/Earnings ratio indeed has caught up to the "price" numerator. We wrote:

"The market also is signaling that earnings improvement could be near. We have seen an expansion of the price-to-earnings multiple (P/E) as the market rallied over the last several months. Historically a higher P/E ratio is followed by an improvement in earnings per share growth over the next six months. If this relationship holds, we can expect better earnings seasons in the next few quarters and a higher likelihood of bottom-up stock pickers shifting toward a more bullish stance. More cash entering the equity market could mean more gains in the months ahead. "

We do not actively consider the earnings outlook for individual companies when making our investment decisions at Miracle Mile Advisors, and we are also highly aware of how easily company management can manipulate this information. It is important, however, to gauge the sentiment of the large segment of bottom-up investors in the market. In today's volatile and relatively low-volume environment, a more constructive corporate outlook could positively impact bottom-up sentiment and prod these investors to move cash from the sidelines into the equity market.



As Wall Street looks backward to the previous quarter's earnings, it is important for us to look forward. Macro data reported recently has moderated, but indicators such as GDP and employment also look in the rearview mirror. In our view, data indicative of the path *ahead* such as the inflation backdrop (both here and in Asia) and equity market leadership remain supportive for at least the next several months. We remain cautiously optimistic.

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