Buena Vista Investment Management, LLC

Creative Investment Solutions

ECONOMIC DATA IS IMPROVING - Can the US Markets Rebound In 2012?
By John Moffat, Partner

Political discourse and years of governmental fiscal mismanagement rocked the world's equity markets during the second half of 2011 and wiped out all of the gains posted in the first half of the year. Unfortunately, the budget deficits in the US and Europe overshadowed positive economic news.

As we look to the investment environment for 2012, a good place to start our discussion is with Europe. Europe is beginning to implement policies that should improve the financial environment in the future. Fiscally conservative governments have been elected in Spain and Italy and a healthy discussion on solving Europe's fiscal dilemma is occurring. Change may not be occurring as fast as many in the markets would like, but we expect the bond markets to force European leaders to make the necessary tough decisions.

If we looked at fundamentals alone, the U.S. equity markets would likely be higher than current levels. If and when the European fear is removed, or even significantly reduced, then that should pave the way for a nice rally in US stocks in 2012.

If Europe improves, investors are likely to bring their focus back to economic fundamentals and there are a number of positive trends developing in the US. First, the stage has been set for unemployment to come down in 2012, as unemployment claims have dropped to a 3 ½ year low. The nation added 100,000 or more new jobs every month since July and over 1.4 million jobs during the last year.

Additionally, housing starts are at their highest level since April 2010. Consumer confidence numbers from the Conference Board continued to improve in November and December. Retail sales are expected to be up over 8% compared to 2010 and we have the US Leading Economic Index moving to new highs in December. Finally, US corporations in the S&P 500 are on pace to post record profits this year and their balance sheets are as strong as they have been in many years.

We also have a stock market that is undervalued compared to historic norms. The forward price to earnings (P/E) ratio based on 2012 earnings estimates for the S&P 500 is 11.4. This is below the historic average of 15.6, which suggests the S&P 500 may be 27% undervalued. The same holds true for other fundamental indicators, such as Price to Book, Price to Cash Flow and Price to Sales; they are all pointing to an equity market selling below historic norms.

So as we look to 2012, it is important to look past the negativity often displayed in the media and remember that emotion can be the enemy of sound investing. In these uncertain times it is important to focus on the facts. The US economy is improving and the Asian and Latin American economies are growing. Europe is working to solve its problems.

Under these conditions our forecast for next year is that the S&P 500 should rise to a level between 1350 and 1450. However, don't expect a smooth ride as European and other headlines can cause world markets to move up and down on a short term basis. But ultimately, fundamentals will matter and things like corporate profits and valuations should be reflected in higher stocks prices during 2012.

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