

REASONS FOR OPTIMISM

Stocks are fizzling ... but things could change this summer.

Presented by Craig S. Darnell, CFP®

When was the last time the Dow took a six-week tumble? On June 10, the Dow dipped below 12,000 and posted its sixth straight weekly decline. You have to go back to October 2002 to find a Dow losing streak that long. If you're hearing bearish groans in the distance, you're not alone: the bears are making their voices heard as the Dow is down almost 7% from where it was at the end of April.¹

June certainly has been tough on Wall Street, with the bulk of economic indicators flashing a slowdown. However, there is reason to think the third and fourth quarters of 2011 may be better for stocks - in fact, that's what many analysts believe.

Second quarter earnings projections are quite good. Investment research firm *FactSet* finds that despite the losing streak, aggregate 2nd quarter S&P 500 earnings estimates are basically unchanged from late May. The collective forecast projects a 14.6% growth in earnings for the quarter and a 10.4% jump in revenues. (That double-digit revenue growth would be the best since Q1 2010.) As earnings are truly the mother's milk of stocks, the market could heat up this summer if these collective predictions come true.²

Stocks are still relatively cheap. On June 3, the S&P 500's P/E (price-to-earnings) ratio was 16.4 compared to 18.3 a year earlier.³ The P/E ratio provides insight into whether or not a company's stock is worth owning. An environment of low P/E ratios provides great opportunities for long-term value oriented investors.

The economy is still growing. The Federal Reserve's latest Beige Book and the twin PMI indices from the Institute for Supply Management both signal this. In fact, the ISM service sector index showed the growth of that sector accelerating in May.⁴

Homebuying could be poised to pick up. Sustained high unemployment isn't going away this year, but some silver linings are emerging that bode well for the housing market. Moody's Analytics says that the ratio of home prices to income is now 20.9% below the average ratio from 1985-2010. Mortgage interest rates are at levels unseen since the early 1960s. There are also indications that prices may be approaching a bottom in metro areas not rampant with short sales and foreclosures. Real estate analytics company CoreLogic found that home prices were down 7.5% year-over-year in April, but only down 0.5% when distressed sales were factored out.⁵

Hang in there. The bull market is maturing; QE2 is ending. We haven't yet seen a correction, just a pullback. Mays and Junes have brought more than a few of those. Last year, the Dow fell nearly 14% from late April through early July on fears associated with the European debt crisis and more specifically defaults by Greece.⁶

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Citations.

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