

Market Update • May 4, 2012

## Late Bull Stampede Plays April Fools on the Bears



**Douglas Coté, CFA**  
Chief Market  
Strategist

The bears grew hopeful early in the month, as global markets were spooked by events in the euro zone: Spain briefly brought back fears of bailout Armageddon, the Dutch government collapsed, and PMI numbers for the region came in weaker than expected. April Fools! The bull market remains intact and offers compelling value for those looking to build wealth.

At its April trough, the S&P 500 was down 3.5% for the month. However, the bull awoke mid-April, prodded by relentless corporate strength that continues to confound Wall Street. Blockbuster corporate profits were led by financials, followed by industrials and put over the top by technology. With a meager 0.89% consensus expectation for first quarter earnings growth, Wall Street got it

wrong; in fact, considering that first quarter earnings growth, at press time, stands at an explosive 8.8%, “got it wrong” is a serious understatement. The S&P 500 surged into the end of the month, making up nearly all its lost ground.

This performance is no joke for those who are missing out on an extraordinary bull market that has just entered its fourth year. It is not too late for savers to turn into investors, but this market’s persistent and determined march forward will not wait for the hesitant. Investors must resist the all-or-nothing approach to risk; a moderate risk posture has been handsomely rewarded over the past three years despite pockets of extreme volatility.

The questions for investors to ask are how and when to invest. We get into the “how” below. The answer to “when” is more straightforward — immediately! Don’t delay, because every day is a good day to invest during a bull market.

### Executive Summary

- Relentless corporate strength squelched an early-April market skid.
- U.S. manufacturing is undergoing a renaissance driven in part by cheap natural gas.
- Global risks remain but have eased over the course of 2012.
- Every day is a good day to invest in a bull market.

### Global REITs led the way within equities during April and year to date

Index	Wgt	Apr-12	YTD	2011	2010	2009	2008	2007	1 Year	3 Years	5 Years	10 Years
<b>Equity</b>												
S&P 500	10%	(0.6)	11.9	2.1	15.1	26.5	(37.0)	5.5	4.8	19.5	1.0	4.7
S&P MidCap 400	10%	(0.2)	13.2	(1.7)	26.6	37.4	(36.2)	8.0	(0.9)	22.7	4.1	7.7
S&P SmallCap 600	10%	(1.3)	10.6	1.0	26.3	25.6	(31.1)	(0.3)	1.1	22.0	2.9	7.1
Global REITs	10%	2.8	13.4	7.3	27.6	27.8	(37.8)	(17.8)	8.5	30.2	(0.2)	10.2
EAFE	10%	(1.8)	8.9	(11.7)	8.2	32.5	(43.1)	11.6	(12.4)	12.3	(4.3)	5.9
Emerging Markets	10%	(1.7)	11.8	(22.7)	9.8	93.5	(59.3)	59.1	(16.5)	14.5	2.8	17.3
Average		(0.5)	11.6	(4.3)	18.9	40.5	(40.8)	11.0	(2.6)	20.2	1.1	8.8
<b>Fixed Income</b>												
Corporate	10%	1.4	3.5	8.1	9.0	18.7	(4.9)	4.6	9.1	12.6	7.1	6.6
U.S. Treasury 20+	10%	4.7	(2.4)	33.8	9.4	(21.4)	33.7	10.2	30.2	10.6	10.3	8.7
Global Aggregate	10%	1.2	2.1	5.6	5.5	6.9	4.8	9.5	3.3	7.6	6.4	7.1
High Yield	10%	1.0	6.4	5.0	15.1	58.2	(26.2)	1.9	5.9	19.7	8.0	9.2
Average		2.1	2.4	13.2	9.8	15.6	1.9	6.5	12.1	12.6	7.9	7.9
<b>60/40 Portfolio</b>		<b>0.5</b>	<b>7.9</b>	<b>2.7</b>	<b>15.3</b>	<b>30.6</b>	<b>(23.7)</b>	<b>9.2</b>	<b>3.3</b>	<b>17.2</b>	<b>3.8</b>	<b>8.5</b>

Source: FactSet

## Gaming Diversification Is Unwinnable

As discussed in these pages previously, “gaming diversification” is trying to outsmart the markets or to outrun risk. Many investors have turned into savers, squandering one of their most important assets by investing in cash or near-cash (i.e., short-duration) instruments in an effort to protect against some perceived risk such as another euro zone crisis or spiking inflation. By doing so, they have traded the *possibility* of a loss for the *guarantee* of a loss in terms of real return (i.e., a 0.5% cash return minus 2% inflation).

Diversification is not something to be trifled with but, rather, is the key to investing success. Effective diversification lowers risk and increases return, providing us with that elusive free lunch. Compare a globally diversified portfolio to the S&P 500 in terms of both risk and reward; not only has the former delivered superior annualized ten-year performance, the one-, three-, five- and ten-year standard deviation of returns for the globally diversified portfolio is on average one-third less than that of the S&P 500. Bon appétit!

## Fundamentals Dominate Global Risks, for Good Reasons

Our “ABCDs” of fundamentals have continued to positively impact the market.

**Advancing corporate profits.** Wall Street continues to be behind the earnings curve, having vastly underestimated corporate profits each quarter since the market turned three years ago. But the sheer magnitude of this quarter’s miss on earnings growth has been astounding. Many of the early bellwethers crushed expectations, and the beats have been broad-based; with 300 of the S&P 500 companies having reported results, 79% of have surprised on the upside. And let’s not forget that we are comparing this quarter’s earnings to those of first quarter 2011, a period during which earnings hit an all-time high by posting 19.4% growth against the year-ago quarter. Earnings growth stands at 8.9%, and sales growth is not far behind, at 5.7%. We estimate earnings per share for the S&P 500 Index will reach an all-time high of \$105 for 2012.

**Broadening manufacturing.** Last month we told you that if the U.S. manufacturing sector were a country it would be the ninth-largest

economy in the world — so you know it is an important driver of the economy. But are you familiar with the manufacturing renaissance occurring in the United States? If you aren’t yet, you soon will be. Manufacturing in the U.S. has expanded for 32 consecutive months, and in 2010 the sector began adding jobs for the first time in 14 years. The Institute for Supply Management gauge currently stands at 53.4%, firmly in expansionary territory.

The rock-bottom price of natural gas has undoubtedly fueled this rebirth in manufacturing, which uses the fuel in 27% of its processes. Natural gas prices have dropped 35% in the last year, giving U.S. manufacturers a distinct competitive advantage — natural gas costs about \$2/btu in the U.S. compared to \$16/btu in Japan and more than \$11/btu in Europe.

States focused on manufacturing have already felt an employment boost. Michigan, for example, has seen its unemployment rate fall from a peak of 14.2% to 8.5% currently. Increased employment is being seen not only in the energy sector, but also in transportation and trucking. The shale-gas expansion helped support 600,000 jobs in the transportation and trucking industry in 2010, and this figure is expected to rise to 1.6 million by 2035.

The U.S. already has surpassed Russia in natural gas reserves and has enough supply to meet demand for 90 years. While not as dramatic, similar strides have been made in oil production — domestic oil output is at its highest level in eight years. Instead of constantly being barraged with the terms like “peak oil” and “depletion”, we are now hearing the rumblings of “energy independence”.

## A globally diversified portfolio reduces risk

Global Model Portfolio	Standard Deviation of Returns			
	1 year	3 years	5 years	10 years
S&P 500 Index	19.51	17.00	19.63	16.27
60% Equity/ 40% Fixed Income	14.53	12.85	15.98	12.66

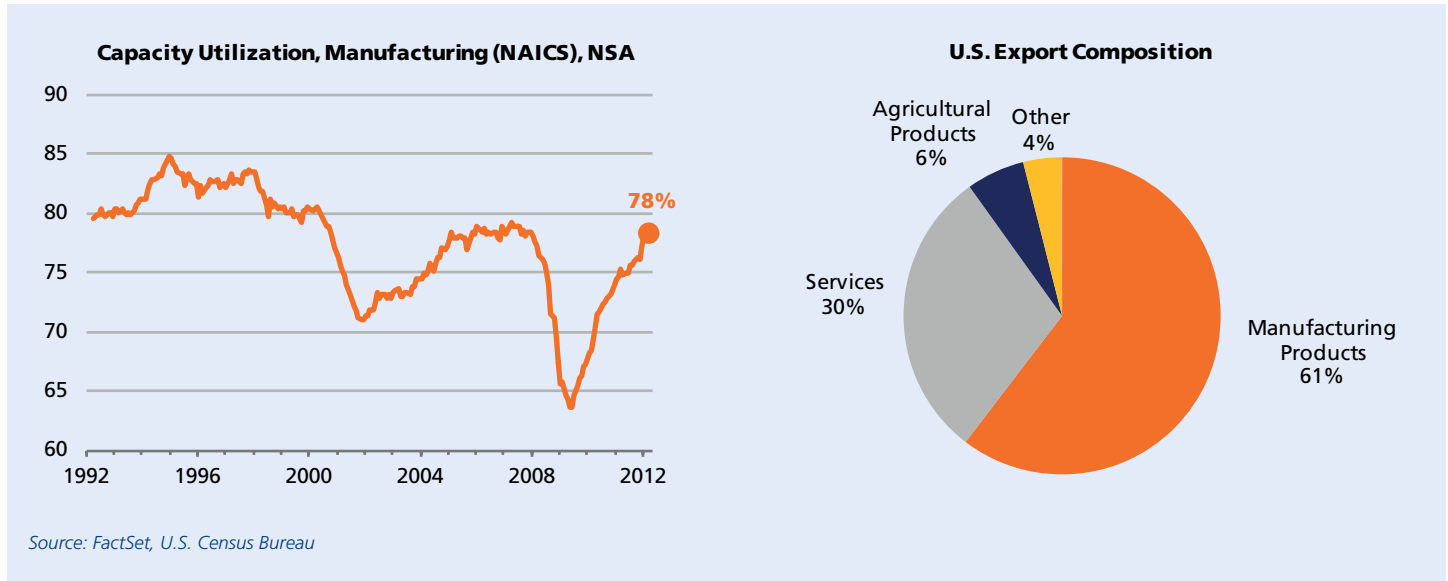
Source: FactSet

## Many S&P 500 sectors are enjoying double-digit returns year to date

Index	Apr-12	YTD	2011	2010	2009	2008	2007	2006	2005	1 Year	3 Years	5 Years	10 Years
Information Technology	-1.9	19.2	2.4	10.2	61.7	-43.1	16.3	8.4	1.0	14.6	23.0	6.6	6.3
Financials	-2.4	19.2	-17.1	12.1	17.2	-55.3	-18.6	19.2	6.4	-4.1	14.3	-14.1	-3.0
Consumer Discretionary	1.3	17.5	6.1	27.7	41.3	-33.5	-13.2	18.6	-6.4	14.5	27.3	5.0	5.7
Materials	-0.9	10.2	-9.8	22.2	48.6	-45.7	22.5	18.6	4.4	-6.9	17.0	1.6	7.6
Industrials	-1.1	10.1	-0.6	26.7	20.9	-39.9	12.0	13.3	2.3	-2.0	21.6	1.3	5.3
Health Care	-0.2	8.8	12.7	2.9	19.7	-22.8	7.1	7.5	6.5	9.0	18.3	2.9	3.8
Telecommunication	5.4	7.6	6.3	19.0	8.9	-30.5	11.9	36.8	-5.6	7.2	15.5	1.3	5.9
Consumer Staples	0.3	5.9	14.0	14.1	14.9	-15.4	14.2	14.4	3.6	11.8	19.6	7.7	6.5
Energy	-1.0	2.9	4.7	20.5	13.8	-34.9	34.4	24.2	31.4	-9.1	16.8	3.8	11.6
Utilities	1.8	0.2	20.0	5.5	11.9	-29.0	19.4	21.0	16.8	12.4	16.5	1.1	6.3
S&P 500	-0.6	11.9	2.1	15.1	26.5	-37.0	5.5	15.8	4.9	4.8	19.5	1.0	4.7

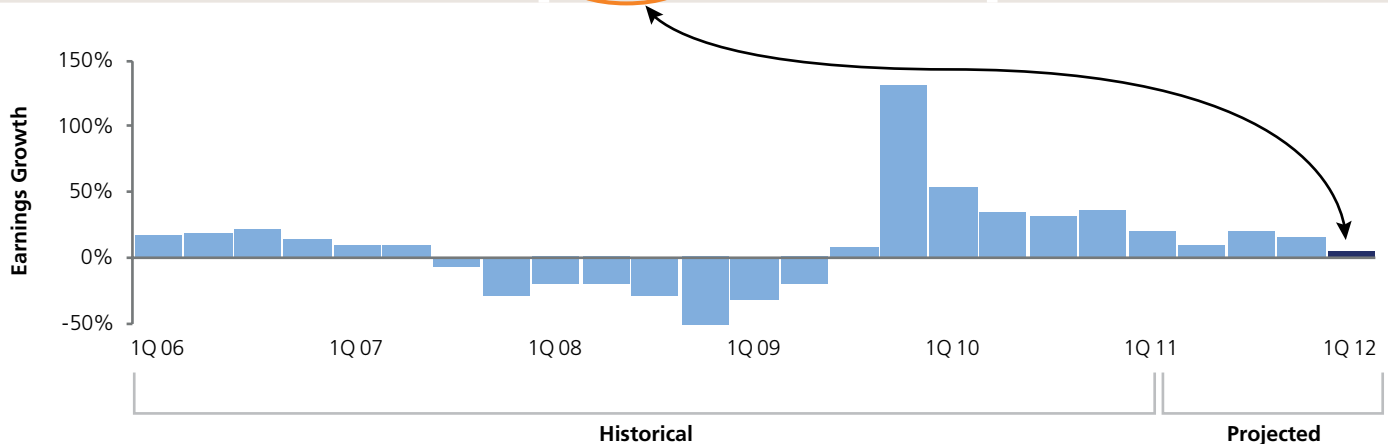
Source: Standard & Poor’s, FactSet

U.S. manufacturing is undergoing a renaissance



First quarter results have defied expectations for minimal earnings growth

Sector	Reported		Earnings Growth			Earnings Surprise		
	Actual	Total	Percent	Positive	Negative	Percent	Positive	Negative
Financials	56	80	25%	40	14	19%	39	12
Information Technology	43	71	20%	22	21	11%	31	6
Industrials	44	61	14%	35	9	8%	35	8
Consumer Staples	22	42	2%	10	12	2%	14	3
Health Care	35	52	1%	23	12	4%	24	6
Telecommunication	5	8	-1%	3	1	15%	3	2
Energy	24	42	-1%	13	11	-1%	15	9
Consumer Discretionary	45	80	-7%	27	16	7%	36	6
Materials	23	31	-10%	10	11	7%	20	3
Utilities	8	33	-13%	1	7	0%	3	5
S&P 500	305	500	9%	184	114	8%	220	60



Source: Bloomberg, FactSet, Standard & Poor's

**Consumer strength underestimated.** A variety of data points suggest the consumer continues to emerge as a game-changer. In fact, consumer spending accounted for two percentage points out of our most recent — and decidedly pale — 2.2% GDP growth report. Retail sales surprised again in March, increasing by a robust 0.8% over a very strong February and reaching another new all-time high in excess of \$411 billion. Personal incomes and personal consumption also pushed higher. The saving rate dropped to 3.9%, as consumers had to dig deeper into their wallets to pay for gas. But the good news was there are more consumers with paychecks. However, the initial unemployment claims number has unfortunately trended higher of late after months of much better-than-expected readings, suggesting that the warm winter weather may have temporarily pulled hiring forward; time will tell if this was the case.

**Developing economies are driving global growth.** Emerging markets continue to be a key catalyst for U.S. corporate revenue, as 50% of S&P 500 revenues come from outside the U.S. Most are familiar with the BRIC Nations — Brazil, Russia, India and China. A new term recently has been coined — MIST, representing the next tier of emerging economies: Mexico, Indonesia, South Korea and Turkey. All are large economies contributing more than 1% to global GDP and are members of the G-20. Mexico reported 3.9% GDP growth in 2011, and the cheap peso is making its exports attractive and its labor costs competitive with China. In fact, two major auto manufacturers have recently agreed to build new plants in Mexico.

### Global Risks Are Falling Short

Global risks will always compete with fundamentals for center stage. And while global risks cannot be dismissed — Spain, for example, has slipped into recession, and Italy may not be far behind — they have eased considerably throughout 2012. The slowdown in China is an ever-present risk looming on the economic horizon, although recent manufacturing numbers are hanging tough. While not without risks of its own, the economic picture in the U.S. is brighter and should help offset some localized European weakness. The Federal Reserve agrees, continuing to note the improving jobs landscape and the diminishing global risks.

### The Time for Hibernation Is Over

April should have derailed the market, but it didn't; a temporary pullback was the best the bears could muster. The bears normally make money by betting against the crowded trade; by being on the sidelines, the bears now are the crowded trade. The bulls, meanwhile, find themselves in the odd position of being seen as contrarians, even though fundamentals are setting records and equity market performance over the last two quarters has been spectacular. Let the stampede continue! ■

This commentary has been prepared by ING Investment Management for informational purposes. Nothing contained herein should be construed as (i) an offer to sell or solicitation of an offer to buy any security or (ii) a recommendation as to the advisability of investing in, purchasing or selling any security. Any opinions expressed herein reflect our judgment and are subject to change. Certain of the statements contained herein are statements of future expectations and other forward-looking statements that are based on management's current views and assumptions and involve known and unknown risks and uncertainties that could cause actual results, performance or events to differ materially from those expressed or implied in such statements. Actual results, performance or events may differ materially from those in such statements due to, without limitation, (1) general economic conditions, (2) performance of financial markets, (3) interest rate levels, (4) increasing levels of loan defaults (5) changes in laws and regulations and (6) changes in the policies of governments and/or regulatory authorities.

The opinions, views and information expressed in this commentary regarding holdings are subject to change without notice. The information provided regarding holdings is not a recommendation to buy or sell any security. Fund holdings are fluid and are subject to daily change based on market conditions and other factors.

Past performance is no guarantee of future results.

©2012 ING Investments Distributor, LLC • 230 Park Avenue, New York, NY 10169



[WWW.INGINVESTMENT.COM](http://WWW.INGINVESTMENT.COM)