Best Stock Market Since 1997 Seen With S&P 500 Momentum

By Lu Wang and Whitney Kisling - Nov 4, 2013

The broadest equity rally on record will pick up speed through year end and lift the Standard & Poor’s 500 Index to the biggest annual increase in 16 years, if history is any guide.

Shares have climbed in the final two months 82 percent of the time since 1928 when the benchmark gauge advanced at least 10 percent through October, data compiled by S&P and Bloomberg show. The mean November and December increase of 6 percent would boost the index to 1,862.79, an all-time high that is about 20 percent above the record 1,565.65 set in 2007.

Instead of selling shares to lock in profits during rallies, investors almost always add them in the final quarter, convinced that gains built up over the first 10 months will expand. The S&P 500’s return has been positive over November and December every year since the bull market started in 2009. While earnings growth is slowing and the Federal Reserve is planning to curtail stimulus, Jeff Mortimer, director of investment strategy for BNY Mellon Wealth Management, says it usually doesn’t pay to fight the trend in stocks.

“You have to pay attention to momentum in markets and that’s what this calendar year is showing,” Mortimer, whose firm has about $180 billion in client assets, said in a phone interview on Oct. 30. “Clients asked me, ‘Why don’t I take profit now?’ My theory is you can sell a lot higher later.”

Weekly Advance

U.S. stocks have risen for four straight weeks. The S&P 500 increased 0.1 percent to 1,761.64 last week as earnings at companies from Pfizer (PFE) Inc. to General Motors Co. beat analyst estimates and the Fed said it needs more evidence of economic growth before reducing its stimulus program. Futures on the index gained 0.1 percent at 8:19 a.m. in London today.

The benchmark gauge for American equities gained 23 percent from January to October as companies such as Boston Scientific Corp. and Netflix Inc. advanced. A total of 447 stocks in the index are up this year, the most since at least 1990, and 80 percent (SPX) traded above their 50-day moving averages last week, data compiled by Bloomberg show. That compares with 58 percent over the past 20 years.

The last time the S&P 500 recorded bigger returns for the first 10 months was in 1997, when stocks were in the middle of a bull market in which the index quadrupled over eight years. The gauge advanced 6.1 percent in November and December of that year, pushing the annual rally to 31...
percent.

**Missing Out**

“People that are not in the market feel they’re missing out and therefore want to join everybody else,” Omar Aguilar, the San Francisco-based chief investment officer of equities at Charles Schwab Investment Management, said in an interview on Oct. 29. The firm had $229 billion in assets under management as of Sept. 30.

December has had the second-best returns of any month, with the S&P 500 climbing an average 1.5 percent since 1928, data compiled by Bloomberg show. For the final two months of the year, the index rose 68 percent of the time, more often than any two-month period except March to April. The mean 2.1 percent gain for the end of the year is almost double the 1.1 percent average for similar periods.

The S&P 500 is up more than 160 percent since 2009 after earnings expanded for four years and the Fed bought $2.3 trillion of bonds, keeping interest rates low to spur growth. Worse-than-estimated September payrolls and a government shutdown last month fueled speculation that the central bank will delay paring its monetary stimulus until March, according to a Bloomberg News survey of economists. Fed policy makers decided last week to maintain the $85 billion in monthly bond purchases.

**Bubble Market**

BlackRock Inc. Chief Executive Officer Laurence D. Fink, whose company is the world’s largest money manager with $4.1 trillion in assets, said Fed policy is contributing to “bubble-like markets,” such as the surge in stock prices.

“We’ve had a huge increase in the equity market,” Fink said on Oct. 29 at a panel discussion in Chicago. “We have issues of an overzealous market again.”

Equity valuations have increased 18 percent this year to 16.7, near the highest level in more than three years, even as U.S. gross domestic product is projected to expand 1.6 percent, almost half the rate of 2012, data and estimates compiled by Bloomberg show.

Economists this month cut their growth forecasts for the fourth quarter to 2 percent from an earlier projection of 2.5 percent. GDP hasn’t expanded faster than 3 percent a year since 2005 and won’t achieve that pace until 2015, they say.

**Embedded Gains**

“I just don’t see the market having a reason as a whole to really go up a lot,” David Pearl, co-chief investment officer at Epoch Investment Partners Inc. in New York, said in an Oct. 31 phone interview. His firm manages about $35 billion. “Generally if you’re looking at a year where markets are up that much, it’s usually a good economy. This year, it’s not that great of an economy.”
Even with this year’s rally and increase in valuations, the S&P 500’s price-earnings ratio is below the 15-year average of 19.3, data compiled by Bloomberg show. Profit growth will pick up this quarter, increasing to 6.8 percent or almost twice the 4.1 percent rate in the previous three months, according to more than 11,000 analyst estimates compiled by Bloomberg. It will rise more than 10 percent next year and in 2015.

“How can the market do so well? Because the market started the year inexpensive, the P/E ratios were too low,” Abby Joseph Cohen, a senior investment strategist at Goldman Sachs Group Inc., said in an Oct. 31 Bloomberg Radio interview. “We still think the market is underpriced on a 12- to 18-month period.”

**Shares Double**

Pfizer, the world’s biggest drugmaker, is up 24 percent so far this year after earnings beat analyst estimates the last two quarters. The New York-based company had gained 71 percent in the first 10 months of 1997, before advancing another 5 percent by the end of the year.

Home Depot rallied 67 percent up to this point in 1997, going on to rise 5.6 percent more in November and December. The Atlanta-based home-improvement retailer has gained 24 percent in 2013, as earnings beat estimates every quarter this year. Per-share profits will rise 19 percent this fiscal year, which ends in January, according to analyst projections compiled by Bloomberg.

MGIC Investment Corp. extended a 59 percent rally another 10 percent by the end of 1997, data compiled by Bloomberg show. The home-loan guarantor based in Milwaukee reported Oct. 16 its second straight quarter of profits. The shares have risen 203 percent in 2013.

“Once you have an uptrend market throughout the year, there is enthusiasm for running up the return even further,” Wayne Lin, a portfolio manager at Baltimore-based Legg Mason Inc., which oversees about $656 billion, said by phone on Oct. 31. “There is a momentum factor in markets, and right now the momentum factor is fairly strong.”

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