Surging Stocks Put Bears on Heels

Investor Sentiment is Improving, Making it Harder for Wall Street's Pessimists to Hold Their Ground

By JONATHAN CHENG

Gina Martin Adams is spending a lot of time on defense these days. As the most pessimistic forecaster on Wall Street this year, the Wells Fargo Securities strategist is coming under increasing pressure from clients skeptical about her views as the major U.S. stock benchmarks run up toward record highs.

At client meetings across the country this month, "I'm getting a lot more pushback than I usually do," says Ms. Adams. She admits her stance, calling for the Standard & Poor's 500-stock index to drop 7.5% to 1390 by year's end, is looking increasingly out of step.

Across Wall Street, the bears are facing more pressure. Major stock indexes have marched steadily higher. The Dow Jones Industrial Average has gained 6%, closing last week within spitting distance of a record high. The S&P 500 closed Friday at 1502.96, its first close above 1500 in more than five years.

Investors are taking notice. Ms. Adams says her clients are becoming increasingly enthusiastic about stocks, after years of ambivalence. There are signs that mom-and-pop investors are starting to return to stocks. On Thursday, fund-flow tracker Lipper said investors had put money into equity mutual funds for a third straight week.

Many optimists point to the continued efforts of central banks around the world to help pump money into their national financial systems. They argue that stock prices will remain buoyant for as long as those efforts are in place. The economy is showing gradual signs of improving, U.S. company earnings haven't tapered as sharply as many feared, and anticipated turmoil from Washington and Europe hasn't come to pass. On top of that, stock prices are low relative to earnings, they say.

Overall, investor sentiment appears to be improving, some market observers note, making the bear case for stocks increasingly unfashionable.

Market strategists, generally a bullish bunch to begin with, tend to start the year in an especially positive frame of mind.

But this year, at least four prominent Wall Street strategists called for the S&P 500 to finish the year with a loss, or to end roughly flat.

Wall Street strategists aren't directly responsible for allocating...
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Investment dollars, but their predictions are disseminated widely and watched closely.

Taking a bold stance, particularly a bearish one, is a precarious position for a strategist to take, as Ms. Adams acknowledges. Strategists have the freedom to tweak their forecasts throughout the year, and some have made frequent adjustments amid the volatility in recent years.

Nicholas Bohnsack, strategist and partner at Strategas Research Partners, says he has seen a "noticeable pickup" in optimism among his clients in recent weeks, and a flurry of inquiries about whether the firm will change its year-end S&P 500 prediction of 1404. That forecast implies a 6.6% fall from current levels.

"Customers are saying, 'Gosh, I really want to be in this market,' 'I'm late in this market,' 'Do you think this rally can keep going?,' 'I think this rally can keep going,'" Mr. Bohnsack says.

So far, Mr. Bohnsack remains unconvinced. While stocks have jumped as lawmakers in Washington took steps to avert a fiscal crisis and Europe's debt turmoil calmed, Mr. Bohnsack says he doesn't see many further catalysts to send the market higher.

That doesn't mean the market's momentum won't allow it to reach new highs. "I don't think we're standing in the face of that possibility, but our question is, what is the sustainability of that?" he says.

Where others see a steadily improving U.S. economy, many bears see the hand of the Fed, which is currently buying $85 billion of bonds a month to boost the economy. Corporate earnings, many bears add, are at a peak at a time when many investors expect profits to climb. And with taxes and government regulation set to rise, the market bears see more headwinds.

They point to disproportionate pessimism from corporate executives this earnings season. Of the companies that have reported their results and offered guidance on future profits, forecasts by nearly nine in 10 have fallen short of Wall Street expectations, the most for any quarter since at least the beginning of 2008, according to FactSet.

Ron Sloan, who oversees $12 billion as a portfolio manager and chief investment officer of the core equity team at Invesco, says he is worried about when the Fed, which has pumped up its balance sheet by more than $2 trillion since 2008, will turn off the spigot.

"The real issue in my view is that this has been a recovery that's been almost 100% fueled by liquidity from the central banks," Mr. Sloan says.

Mr. Sloan says he expects corporate earnings to remain flat in 2013, with little hope for an expansion of profit margins. In the shorter term, Mr. Sloan says, the S&P 500 has risen too quickly, and could pull back to as far as 1350 by the end of the quarter, in March.

As indexes approach record levels, though, the question for some market watchers is whether to change their tune.

Ms. Adams is standing her ground. "Prices are moving against my recommendation, but I think we need to have a bit of respect for the fact that it's still quite early," she says. "It's only January, but some people are talking as if this is a done deal."
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