

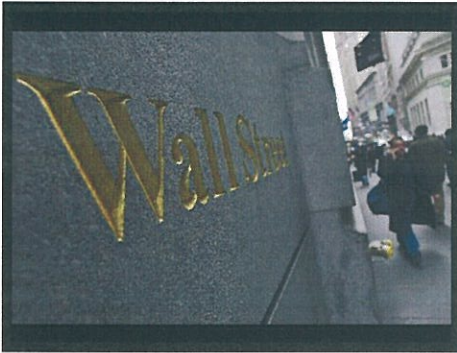
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Bullish Estimates Fail to Keep Up With S&P 500 Gain (Update2)

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By Lynn Thomasson and Michael Tsang



Sept. 23 (Bloomberg) -- Strategists at Wall Street's biggest securities firms can't keep up with the **Standard & Poor's 500 Index** after the steepest surge since the 1930s.

The benchmark gauge for U.S. equities has climbed 57 percent since March 9 to 1,060.87, leaving it above all but one of the 10 projections by forecasters in a Bloomberg survey this month, the first time that's happened in data going back to 1999. The average forecast for the S&P 500 from the strategists is 1,022, about 4 percent below the index's current level.

While the strategists raised estimates by an average of 5.8 percent from March this year, they're divided on whether the U.S. economy will be strong enough to justify further revisions. The last time the S&P 500 rose above the consensus was in 2006, when Wall Street responded by increasing projections, helping spur an 11 percent **advance** that ended when the index hit a record high in October 2007.

"There's a little bit of a wall of worry right now, but the market just feels like it wants to go up," said **Michael Mullaney**, a Boston-based fund manager at Fiduciary Trust Co., which oversees \$9 billion. "There's going to be a very strong near-term economic rebound greater than expectations. I think we'll end the year higher."

Economy, Fed

Bulls say the 17 percent advance this year can continue because the U.S. economy will emerge from the worst recession since the 1930s and grow 2.9 percent in the third quarter, according to the median of 61 economists in a Bloomberg survey.

The S&P 500 slipped 1 percent today amid concern the Federal Reserve is nearing the end of its efforts to lift the economy out of recession.

Credit markets are healing from the collapse of subprime mortgages in 2007 and the bankruptcy of Lehman Brothers Holdings Inc. a year ago. Investment-grade companies sold a record \$836.9 billion of corporate bonds in the U.S. this year through Sept. 18 as the relative cost of borrowing narrowed, according to data compiled by Bloomberg.

The decline in credit costs will improve **profitability**, according to JPMorgan Chase & Co.'s **Thomas Lee**, the only strategist whose year-end forecast of 1,100 is above the S&P 500's level. The index's valuation doesn't yet reflect prospects for a "strong" economic recovery, he said.

Bears say the highest U.S. **unemployment rate** since 1983 and concern the housing market will continue to deteriorate means the best is over for the rally. Frankfurt-based Deutsche Bank AG said last month that almost half of U.S. homeowners may owe more on mortgages than the properties are worth by 2011.

Share Valuations

Forecasters at Barclays Plc and Goldman Sachs Group Inc. say the gains may falter because stocks are no longer bargains. Since March, the S&P 500's valuation doubled to 20 times the reported profit from continuing operations of its companies.

"When you start looking at valuations relative to other asset classes and relative to history, the equity market is not looking cheap any longer," **Barry Knapp**, Barclays' New York-based head of U.S. equity strategy, said in a Bloomberg Television interview. "The market looks somewhat extended."

About \$4.9 trillion has been restored to U.S. equity markets on signs that the more than \$12 trillion spent, lent or committed by the U.S. government and the Fed has ended the credit crisis and revived the economy. Bond sales by investment-grade companies are 10 percent more than the record pace of 2007, Bloomberg data shows. Borrowing costs fell to the lowest in four years.

Money Flow

Investment-grade bond yields slipped to 5.04 percent on Sept. 22 from 9.3 percent in October 2008, the highest level since 1991, according to Merrill Lynch & Co. index data. Companies pay 230 basis points more to borrow on average than the government, the narrowest gap since February 2008. A basis point is 0.01 percentage point.

U.S. companies are piling up cash at the fastest rate ever compared with interest costs, setting the stage for a surge in mergers and acquisitions.

Cash relative to share prices will climb to the highest level in at least two decades next year compared with yields on corporate bonds, according to data compiled by Bloomberg and Zurich-based Credit Suisse Group AG. The previous high in 2005 preceded the two busiest years ever for takeovers.

The S&P 500 has added 3.9 percent this month as Northfield, Illinois-based **Kraft Foods Inc.'s** \$16 billion bid for Cadbury Plc in London and Burbank, California-based Walt Disney Co.'s \$4 billion purchase of Marvel Entertainment Inc. in New York signaled increasing confidence among executives.

Rally Conditions

Improving credit markets and more mergers aren't enough to extend the gain in stocks, said **Quincy Krosby**, a market strategist for Newark, New Jersey-based Prudential Financial Inc., which oversees \$580 billion. The economy must create jobs and companies earn more before that happens, she said.

"What the markets want to see, what investors want to see, is demand is picking up," Krosby said. "We should see a pullback and the market just waiting for the data to come in. Much will depend on the earnings and guidance."

The third-quarter earnings season starts in two weeks, when New York-based **Alcoa Inc.**, the largest U.S. aluminum producer, reports results. Profits will have to be "dramatically" above analysts' estimates to justify higher stock prices, according to **Tobias Levkovich**, Citigroup Inc.'s chief U.S. equity strategist in New York.

Increasing estimates now would be "just chasing the tape," Levkovich said in a telephone interview. "I could make an argument that momentum carries the market because people just want to throw money at it, but that's not a really good reason to buy stocks."

Gun Shy

The U.S. unemployment rate climbed to 9.7 percent last month, bringing the number of Americans thrown out of work since the recession began in December 2007 to 6.9 million, the most in any post-World War II contraction, Bloomberg data show.

The S&P 500's 38 percent loss **last year**, the biggest since 1937, has kept some investors from pouring more money back into stocks. Individuals **withdrew** a total of \$7.5 billion from U.S. equity mutual funds on a net basis in the four weeks ended Sept. 9, even as the index rose to an 11-month high, according to Washington-based Investment Company Institute. That's the longest stretch of selling in

more than a year.

"It's hard for people to let go that the crisis is over," New York-based JPMorgan's Lee said in a telephone interview. "In a lot of people's minds, not enough has changed since March to declare things are better."

Bouncing Back

The S&P 500 fell as much as **57 percent** from Oct. 9, 2007, through March 9. Stocks plunged as the credit-market freeze spurred \$1.6 trillion in losses and writedowns at the world's biggest financial firms, data compiled by Bloomberg.

This year's rebound was underpinned by signs the economy is bouncing back from the longest contraction since the Great Depression. Fed Chairman **Ben S. Bernanke** said last week in Washington that "the recession is very likely over," while reports on industrial production and consumer prices showed the U.S. economy is emerging from the economic slump without spurring inflation.

"We're in the part of the business cycle where you do want exposure to equity risk," **Michael Aronstein**, president of Marketfield Asset Management in New York, said on Bloomberg Television. His **mutual fund** has gained 14 percent since the S&P 500 peaked, compared with a 32 percent drop in the index. "For people who expect the market to make a new low, which means that sentiment would be worse, the wealth destruction would be worse, the fundamental environment would be worse -- you shouldn't be in the business if that's your expectation."

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