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Friday, Jul 13, 2012

Posted on Wed, Jul. 11, 2012

Money Matters | First half review, by the numbers

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After a strong start to 2012, the S&P 500 index slowed appreciably in May and June. The index was up 11.2% in the first four months of 2012 and down 2.6% in the last two months. The good news is the first half gain in the S&P 500 of 9.5% (including dividends) was better than the annual total return realized in five of the last ten years.*

The world stock markets enjoyed a strong rally at the end of June on news that European leaders came up with a new plan to rescue banks, relieve debt-burdened governments and restore investor confidence.

The first half of 2012 had most of the same concerns as last year. The European debt crisis continued to dominate investor's concerns. Greece, Italy, and Spain's debt issues remained the central reason for volatile economic, financial, and political conditions. There is a fear that their poor economy will spread to the United States and cause us to enter a new recession.

In late June, the U.S. government reported the 1st quarter 2012 Gross Domestic Product (GDP) grew at only a 1.9% annual rate. Last week the government reported that only about 80,000 new jobs were created in June. This was another disappointing jobs report and the U.S. stock market fell nearly one per cent.

With the U.S. presidential election approaching and the outcome now too close to call, investors seem to be on the sidelines until key issues are resolved. The expiration of the Bush-era tax cuts, the end of the 2% reduction in payroll taxes, and the automatic spending cuts are scheduled for 2013. Note that Congress doesn't have to do anything to raise taxes – this is current law. Congress must act to not raise taxes.

There has been some good news. The price of gasoline fell to a five month low to around $3.40 per gallon. Americans are now spending roughly $200 million per day** less on gasoline than in early April, when gas peaked at $3.94 per gallon. And many analysts are expecting further declines through the remainder of this year.

We are currently entering into earnings season and the consensus forecast for S&P 500 operating earnings during Q2 fell to $25.45 per share during the week of June 14. That's down $0.70 from the end of the previous earnings season at the end of April. The estimates for Q3 and Q4 have also been revised down over this period by $0.51 and $0.40, respectively.

As a result, the estimate for all of 2012 is now down $1.24 since the end of April to a new estimate of $105.31. These estimates, if true, would still equate to the best corporate earnings since 2007 and would show that the economy is growing, but at a slow rate of 2%-3%.

What could go "right"? Congress could pass meaningful legislation. President Obama and the U.S. House of Representatives controlled by the Republicans could agree to extend the Bush Tax Cuts for yet another year. This would alleviate much of the fear of a rising tax environment that could send the economy back into a recession.

What else could go "right"? Europe could agree on a policy that strengthens the European Union and thus brings stability to an important region of the world. Each of these last two issues is keeping huge amounts of money in cash and bonds and out of the stock market.

So far this year the stock market has experienced the same roller coaster ride as it has the past several years. Should we expect the same type of ups and downs for the second half of this year?

I expect the same market volatility that occurred for the past two summers to continue. That said, recession fears, which caused those previous mid-year declines in equity prices, should give way to no recession and subsequently, no major decline in equity prices. Nevertheless, bearishness is in the "air" with participants in