

# S&P 500 APPROACHES 1,500... AGAIN

September 2012

Jack D. Brown, CFA



Aviance Capital Partners  
Focused Asset Management

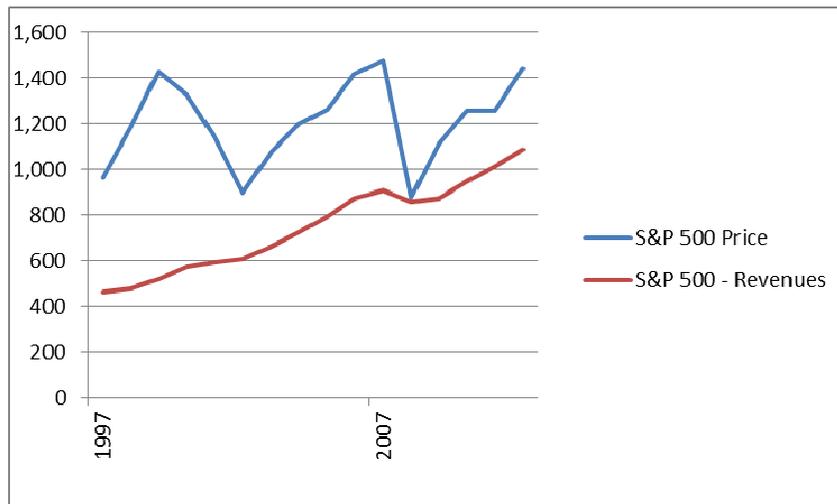
The broad stock market, as measured by the S&P 500, is up over +15% this year. Since investor sentiment has been rather ho-hum throughout 2012, this rather strong performance surprises many investors. It might also surprise investors that 48 of the past 100-years have generated stock market returns of at least +15%.

Why is this significant? The stock market likes to surprise us on a regular basis. When everyone is looking up, it likes to go down. This year, however, a lot of people have been looking down, and it has floated up. The sentiment indicators today seem to be mixed, or tilted to the negative. This alone doesn't make a good stock market prediction, however, it reinforces the notion that it is wise to be skeptical of the crowd.

The price of the S&P is a reflection of its total market capitalization. Today, the S&P stands at 1,440 (10/11/12). This translates into a market capitalization of \$13.7 trillion. That's big, and we've been here at least twice before – in the late 1990's and in the 2007 timeframe. As we get close to 1,500, a historical price chart makes one think there is a proverbial glass ceiling that we are all subjected to.

The key difference between the previous two periods and today is that the businesses that make up the market are bigger; a lot bigger. S&P 500 member companies are generating about twice as much in terms of sales (revenues) versus 1999 (and 20% more versus 2007). Yet, the price tag is the same. A similar story can be told about corporate earnings.

**S&P 500 – Price and Revenues (Year-end Values)**



(continued on back)

Though better, the truth is that valuations today are approximate to historically normal (comparing S&P 500 price to earnings, cash flows, or sales). This means that at 1,500, the stock market's valuation wouldn't be excessively out-of-line. In fact, chances are that we soon will be experiencing all-time records highs on the S&P 500, the Dow Industrials, etc. The bears and the bulls will both be ever so emboldened; continuing their eternal battle. It will continue to pay to look up when the bears are growling, and down when the bulls are charging. It will also continue to pay to be objective about the size of business revenues, earnings, and cash flows ~ relative to the price tag.

This does not mean to diminish the double threat of Europe and the Fiscal Cliff. However, the market has built itself a rather long runway to adjust to these risks that may deal a blow to the economy (or more importantly, corporate earnings). The smart play, we believe, is to accept these realities, and build a cash-position to take advantage of the inevitable risk-flare-ups.

### **Record Low Yields**

Another interesting topic relates to bond yields. From a business's standpoint record low yields means that the cost of capital is unusually low. Imagine for a moment that you're running a publically-traded company. It doesn't take long to figure out that borrowing money at 4% (and not having to pay back principal for 30-years) is a great deal ~ especially if you can invest that borrowed money into projects that earn 8-10%. This has led to the issuance of over \$90 billion in 30-year corporate bonds in 2012; a record. Over the long run, this of course is a double-edged sword. On the one hand, companies (and their investors) benefit by being able to grow earnings faster than normal by taking advantage of a good spread between the return-on-invested-capital and the cost-of-capital. On the other hand, overindulgence (i.e. too much borrowing) becomes a risk to keep an eye on.

For investors, record low yields push many out of treasuries and into other instruments. As we've made the case for some time, record low bond yields make a rather compelling argument for stocks on a long run basis. For investors who require the principal protection of bonds, treasuries feel foolish. In fact, buying-and-holding a treasury bond to maturity offers a yield lower than inflation; it is borderline sadistic – especially for longer maturity bonds. Fortunately, there remain plenty of options to place one's capital that offer above inflation yields. This line of thinking is reasonably common, and will continue to stimulate and shift demand towards higher quality income products as long as the treasury rates provide negative yields (adjusted for inflation) and credit quality remains in check.

### **In Summary**

In summary, now is a good time to hold tight to your customized and strategic asset allocation with a slight tact towards cash.

---

Past performance may not be indicative of future results. Different types of investments involve varying degrees of risk and there can be no assurance that future performance of any specific investment, investment strategy, or product (including the investments and/or investment strategies recommended or undertaken by Aviance Capital Partners, LLC), or any non-investment related content, made reference to directly or indirectly in this newsletter will be profitable, equal any corresponding indicated historical performance level(s), be suitable for your portfolio or individual situation, or prove successful. Due to various factors, including changing market conditions and/or applicable laws, the content may no longer be reflective of current opinions or positions. Moreover, you should not assume any discussion or information contained in this newsletter serves as the receipt of, or as a substitute for, personalized investment advice from Aviance Capital Partners, LLC. Any questions regarding the applicability of any specific issue discussed above to an individual's situation should be directed to the professional adviser of his/her choosing. Aviance Capital Partners, LLC is neither a law firm nor a certified public accounting firm and no portion of the newsletter content should be construed as legal or accounting advice. A copy of the Aviance Capital Partners, LLC's current written disclosure statement discussing our advisory services and fees is available for review upon request.