THE OMNIVEST MARKET VIEW

Investments

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Was it a One-day only Euphoric Rally?

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Too many market participants are discounting the strong equity market rally yesterday in response to the apparent resolve of the European sovereign credit crisis. While it is clear that all issues have not been resolved, it is equally clear that we are now moving in the right direction.

At the same time, corporate earnings are coming in stronger than expected and this includes money center banks. Demand for high-yield debt has swelled to $7.16 billion in the past 3 weeks. For the week ending this past Wednesday, junk bond mutual funds recorded a record in-flow of $4.25 billion - all of this prior to the tentative Greek settlement.

Skeptics were quite quick to point out that there was little follow-through in the sovereign bond market performance yesterday to confirm the sharp rise in equities. And while this may be true for the debt of Italy and Spain, it is not true for the debt of Portugal, Ireland and Greece. In addition, it is also true that European bank shares have risen 29.9% since September 22nd and 9.4% on the week.

The chatter this morning about the euro was that it was not holding its gains and was beginning to roll over. Last Friday, the euro climbed from a low of 1.370 to an intra-day high of 1.425 against the US dollar and appears that it will settle at 1.418 on the week. Not too shabby for a currency that has been largely declared dead since birth.

The risk to skeptics is that they miss (for the 3rd year in a row) a strong 4th quarter rally for stocks. In 2009, the S&P 500 Index rallied 6% and that was surpassed by the 10.75% rally in last year's 4th quarter. In the current quarter, the S&P has already gained 13.8%. To put this in perspective, 20.86% was the strongest return for any 4th quarter since 1970 and that was recorded in the 4th quarter of 1998.

Whether yesterday was a one-day wonder or not is not really the question. The true question that needs to be asked is whether the earnings environment and the economic fundamentals have improved in recent months and the answer has to be "yes". It wasn't too long ago that certain prominent economists were describing the risk to the US falling back into recession as almost a guarantee by the end of this year. The 2.5% GDP report for the 3rd quarter released this week clearly pushes, into distant quarters, any risk of a recession.

While the relief rally may have lasted only one day, we do need to reconcile the fact that the equity rally has now completed its 4th consecutive week and that alone does not constitute a one-day wonder of any kind. The appetite for risk assets is slowly returning and so too are the returns from risk assets.

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