THE OMNIVEST MARKET VIEW

Investments

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The S&P has Not Finished its Upward Drive

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While it is unlikely that the S&P 500 Index will repeat its first quarter return of 10.60% in the second quarter, it also seems unlikely that a negative return will occur. Support from the Federal Reserve and its quantitative easing, stable economic environment and a general underweighting of equities may be the correct recipe for further equity market gains in the second quarter of 2013.

Fed Chairman Ben Bernanke stated that the equity market, in real terms, was still considerably less than at its peak in 2000. In percentage terms, the S&P 500 Index is approximately 20% off from its previous peak (in real terms). In other words, for the S&P 500 Index to reach its previous real term highs, the market would have to move to around 1875, up from 1563 currently.

There is virtually no chance that the Federal Reserve alters its current stance of monetary policy in the current quarter. However, the Bank of Japan (BoJ) is likely to announce, later in the week, an expanded asset purchase program that may include REITs and other lower quality assets. If so, then risk assets would find another reason to continue in rally mode.

We find that most investors are still anticipating a market correction in order to add to equity positions rather than actively selling into strength. This sentiment suggests that investors have simply missed a large portion of the rally that has now entered its fifth year.

Cyprus and North Korea, notwithstanding the markets, seem to be able to absorb and compartmentalize new risks as they occur. Gold, which should have spiked on the threat of war from North Korea, has barely even yawned. The US dollar, another barometer of risk sentiment, also remains subdued in its price action. Even though headwinds remain significant, they appear not to be insurmountable as long as Central Banks continue to provide liquidity.

This week, the BoJ, the European Central Bank (ECB) and the Bank of England (BoE) will meet to set their own policies. The BoE will likely extend its asset purchases, the ECB will undoubtedly address Cyprus and potential contagion and the BoJ will most likely broaden its asset purchase program. All said, more liquidity injection should be expected.

Another round of Japanese yen weakening at the start of a new fiscal year for Japanese financial companies will likely result in a controlled flight of capital out of Japan and into US financial markets. Single A or better credit would be a likely target as well as US equities. The combination will help to push spreads narrower and equities higher.

A target of 1875 on the S&P 500 Index should be viewed as the upper end of the range with 1650 at the lower bound of the range for the calendar year 2013. Sentiment, quantitative easing and a global economy that is on the mend should give way to higher valuations across most asset classes. Europe will continue to contract but at a slower pace. This should be offset by growth in China and the US.

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