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In 2011, it's all about stocks

5 top experts agree: New year's looking great for stocks, not so great for bonds

By Reporter Name
USA TODAY

NEW YORK — Five Wall Street heavyweights say it's time for individual investors to shun the perceived safety of bonds — and get over their fear of the U.S. stock market — so they can take advantage of what they predict will be a third straight year of solid gains for stocks in 2011.

The major theme from USA TODAY's 15th annual Investment Roundtable is that the bond market is looking riskier amid signs the economy is gaining traction. The five panelists say stocks, which get a boost from stronger growth, will post better returns than bonds in 2011. They are advising investors, many still leery two years after the financial crisis, to start shifting some investment dollars out of bonds and back into stocks.

"If you don't believe in a depression, and I don't," says BlackRock's chief equity strategist Bob Doll, "stocks will go up and bonds will go down in the next few years."

Adds David Bianco, chief U.S. equity strategist at Bank of America Merrill Lynch: "We're broadly bullish on U.S. equities. It's important for investors to get back into the asset class. Go buy mutual funds. Go buy index funds."

With the odds of a double-dip recession fading, assets perceived as safe, such as bonds, may be riskier than investors think. And "risk assets" like stocks may be better priced than they appear, says Abby Joseph Cohen, senior investment strategist for Goldman Sachs' Global Markets Institute.

Each panelist predicted double-digit gains in 2011. Dan Chung, CEO and chief investment officer at Alger Funds, was the most optimistic, saying stocks could rise more than 20% sometime in 2011. Earnings will surprise to the upside, he says.

By Robert Deutsch, USA TODAY

Met the investment pros: Our five panelists, from left: Richard Bernstein of Richard Bernstein Advisors; David Bianco of Bank of America Merrill Lynch; Bob Doll of BlackRock; Abby Joseph Cohen of Goldman Sachs; and Dan Chung of Alger Funds.

Richard Bernstein, CEO and chief investment officer of Richard Bernstein Advisors, says U.S. stocks "sort of have the wind at their back right now."

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Market outlook

Is it time for Main Street investors to sell bonds and buy U.S. stocks?

Since the start of 2009, individual investors spooked by the financial crisis have poured more than $664 billion into bond funds and fled stocks. They have yanked more money out of U.S. stock funds than they have put in for 32 straight weeks. Are they making a mistake by being too risk-averse at this time?

Abby Joseph Cohen, Goldman Sachs: The relevant part of your question is "at this time." My answer is yes, they are making a mistake. One can certainly understand why investors are so concerned. We have gone through an extraordinary experience between the credit crisis, very severe recession and extremely volatile markets.

But now that we're seeing that the U.S. economy has some traction, and the likelihood of a double-dip recession is remote, it's time to look again, not just at so-called risky securities like stocks, but to do the really hard work on valuation. Because a security that seems safe, if it is priced too high, is not safe.

I would put quite a few bonds in that category. To be buying a bond at record low yields makes one think that there is now risk there. Investors have to recognize that there may be risk in the so-called safe securities, but there's also the opportunity cost of not participating in some other securities.

When the economy does better, things like stocks and commodities tend to rise in price. U.S. equities are now trading between 13 and 14 times earnings, and that is significantly below the historical average. That suggests that there's good value there. Our 12-month market forecast for the S & P is 1450, (a 17% jump from Thursday's close of 1243).

Bob, what's your take on bonds vs. stocks?

Bob Doll, BlackRock: I echo everything Abby said. Let me add a couple of things. First, why are individuals shunning stocks? We cut them in half in 2000. We cut them in half again from 2007-2009. They're scared. That's to be expected. You have to ask, OK, what are the alternatives? And where have they been putting their money? We all know they've been selling stocks and buying bonds. You look at the big gap that's opened up in the valuation of stocks vs. bonds, and you've got to believe, unless the world is going to end and we are going to have a depression, that the gap is going to close.

If you don't believe in depression, and I don't, in the next few years stocks will go up and bonds down. And we all know that the public tends to buy after things are moving up. So maybe what we've seen in the last few weeks is the beginning of the reversal.

What kind of stock market returns do you expect next year?

Doll: Low double-digit returns, including dividends. The difference is, in 2010 the risks were more to the downside. In 2011, in my view, the risk is more to the upside. So if we're wrong, I think our forecast is too low.

Will higher stock prices boost confidence among consumers and investors?

Doll: We've been through a period of very low confidence: consumer confidence, CEO confidence. And there's nothing like a slightly better economy, a slightly better stock market to argue that confidence will beget more confidence. CEOs are never more confident than when their stock price is going up.

They will be more willing to do some positive things with the $2 trillion-plus in excess cash sitting on their balance sheets: raise their dividend; buy back their stock; engage in M & A; re-invest in their business; hire a worker or two; or maybe put up a new plant. I think that's what's in front of us.

David, do you agree that investors should consider taking more risk next year?

David Bianco, Bank of America Merrill Lynch: Yes. We have just a little bit more of an optimistic outlook, about 15%, in total returns. And from the perspective of someone whose firm is the world's largest wealth adviser, with 16,000 financial advisors, to Abby and Bob's point, the past two years have been about return of capital rather than return on capital.

But when we talk to clients and we look at portfolios that are largely cash, Treasuries, municipal bonds and gold, we point out that that's just not a balanced portfolio. It's a portfolio with its own kind of risks, and a portfolio that, over time, is not going to keep up with your wants and desires for funding your long-term financial needs.

So you're recommending investors ratchet up their stock exposure?

Bianco: We are broadly bullish on U.S. equities. It's important for investors to get back into the asset class. Go buy mutual funds. Go buy index funds. Within the S & P 500, our advice is to stick with strength in 2011. And strength in the world is the emerging economies. But we want to point out that there are lots of plays on emerging economy growth within the S & P 500, particularly the technology, energy, industrial and materials sectors.

Rich, should people still fear stocks?

Richard Bernstein, Richard Bernstein Advisors: With individual investors, it's understandable what their attitude is, and it's been accentuated by the amplitude of the

How high is high for the stock market in 2011?

Based on year-end 2011 pace targets for S&P 500, here are the price gains panelists predict:

13.2% 2011 S&P close: 1400

David Bianco

Bank of America Merrill Lynch
Chief U.S. equity strategist

IBM ($144.55, Thursday, ticker IBM). The computing giant fits the theme of big international growth stocks that can profit from growth in emerging economies around the world.

Google ($591.71, GOOG). The search giant is expanding its reach and will benefit from more corporate spending on mobile computing.

United Technologies ($79.02, UTX). Big, geographically diversified industrial company is a play on Asian urbanization, aircraft demand and energy efficiency process controls.

Occidental Petroleum ($94.84, OXY). Energy company is sensitive to oil prices, which will average $85 a barrel in 2011 but will top $100 during the year.

Walt Disney ($37.01, DIS). This consumer discretionary stock has a great brand and will profit from replicating its business model — media, films, theme parks and resorts — around the world.

21.3% 2011 S&P close: 1500

Dan Chung

Alger Funds
(Fred Alger Management)
CEO and chief investment officer

Lowe's ($25.45. Thursday, ticker LOW). Home improvement retailer could double depressed profit in 2011 thanks to an eventual housing recovery and more repairand maintenance related purchases by consumers if real estate market lags.

OpenTable ($70.87, OPEN). Free online restaurant reservation play is fast-growing small stock serving 15,000 clients with plans to feed growth in foreign eateries around the globe.

Apple ($321.25, AAPL). Fifty percent-plus 2010 gain for iPad and iPhone maker isn't a barrier to 2011 rally given high-teens profit growth estimate and reasonable valuation.

Qualcomm ($49.65, QCOM). High-quality maker of chips that power mobile phones will benefit from telecomtransformation to wireless, PC-like smartphones and 4G networks.

Cognizant ($70.41, CTSH). A tad expensive but best-of-class IT outsourcer will gain business from struggling European economies and costconscious U.S. cities and states.

cycle. We've had such a big downturn that they've been very scared. But the important thing that they've forgotten is that there is still a cycle! What they've done is, they've seen a big downdraft and they've just extrapolated a trend down and down and down. That's not atypical.

So it's not unusual?

Bernstein: Markets go through four phases. The first phase is a period of denial, where people say, it can't happen (stocks rising despite risks), it won't happen, and if it's happening it can't continue. That's where we are in the U.S. The second phase is acceptance, like OK, I should probably be (buying stocks). The third is what I call the brave new world, things are never going to change, everything is wonderful. The fourth phase is the bear market.

What phase of the cycle are we in now?

Bernstein: In the U.S. we're in phase one. The fact that the stock market is up more than 80% from its trough, and people refuse to believe that there's actually a bull market underway, reflects that we are in the denial phase.

Where I think there is more risk, and where we're closer to the brave new world and bear market scenario is in the emerging markets, where people do believe that there is something completely different going on, the world has changed and this is never-ending. There's clearly something going on there which is vastly different in terms of where we are in the stock market cycle in the U.S.

Investors are a little bit mispositioned in that they're probably in equity markets where they are taking more risk than they think they are. And they refuse to look at stock markets where the wind is at their back right now, and I would put the U.S. in that category. We've been telling clients to expect about a 15% rise on the S & P 500 in the next 12 months.

Dan, from a stock-picker's perspective, where are you on 2011?

Dan Chung, Alger Funds: In some ways I'm more bullish than anyone here. This year was characterized by three double-digit swings in the S & P 500. I think that volatility continues; it's a reflection of the uncertainty among investors. But I think the volatility continues on the upside, and we're going to hit 1500-plus at some point in the S & P 500 next year. We're going to see investors come back into U.S. equities next year, and we're going to see that U.S. returns are actually surprisingly good.

My only concern is I'm not so sure we hold it for very long, because the market is very volatile.

Why don't you think the gains will hold?

Chung: There are a lot of things that concern me about next year. In contrast to this year, where I was sort of cautious in the first half and bullish on the second, I'm a little bit on the reverse for next year.

Why is that?

Chung: China policy, which has been the topic of almost every conversation that affects macro issues, is going to be very tricky next year. The Chinese government is clearly not happy with their efforts to slow what they believe is a rising property bubble. We are going to see some more (policy tightening) action there. Finally, the rest of the world, including China, isn't that happy with what the U.S. Federal Reserve has been doing with (its easy-money policies). There are risks related to policy responses by emerging markets.

Everyone seems bullish. What are key tail winds?

Will the deal to extend the Bush-era tax cuts and reduce payroll taxes give stocks a lift?

Chung: It's a very positive tail wind for accelerating something that's been occurring, which is increasing capital expenditures by business. The payroll tax cut is not insignificant in terms of putting more money in the pockets of working Americans. So, both of those are very pro growth.

Is the government turning more investor-friendly?

Doll: We've been through a couple years where capital has been a bad thing, and people that had capital were bad people. This tax bill is saying returns on capital are good things.

Bianco: There's a positive signal that the Obama administration's No. 1 focus is now the economy and that they are treating investors a little more investor-friendly, at least for now.

Is the Federal Reserve, which announced plans to inject an additional $600 billion of stimulus into markets, going to be a positive or negative driver?

Bernstein: We can argue to great length as to whether all this monetary and fiscal policy is good for the long-term health of the U.S. economy. But it's hard to fight the fact that in the next 12 to 18 to 24 months, this is going to put the wind in the sails of the U.S. economy.

How can companies generate such big profits with so many people out of work?

Bianco: About 40% of the S & P 500's revenue comes from abroad, where many countries are growing at a faster clip than the U.S. The S & P has a lot of powerful indirect exposures to the world economy, via emerging market and commodity demand. Commodity prices are very important to the energy, industrial and material companies. Business spending also has a lot of connections to global growth. And that's what drives S & P earnings.

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Why so bullish on U.S.?

What else is driving corporate earnings?

Chung: Earnings are likely to be better than expectations for a while. Retail investors need to remind themselves that public companies represent some of the most dynamic innovation in our country. Netflix was recently added to the S & P 500. This is a company we invested in many years ago at $5 (Thursday's close: $181.65). Everyone knows it now. It's an example of zero international exposure, but pure innovation. Most of what it does is an old business of watching movies delivered by mail. Now they're moving to the Internet. This type of innovation is why U.S. stocks are very attractive now.

What are investors missing?

Doll: One of the big mistakes investors are making is using the U.S. economy and U.S. stock market in the same sentence, and they're increasingly unrelated. We've touched on companies getting 40% of revenue abroad. Our guess is over the next five years, 60% to 70% of incremental profits to the S & P 500 will come from outside the U.S. And while the consumer is not in as bad shape as a lot of people think, they're still two-thirds of the U.S. economy. But discretionary consumer earnings are only 15% of the S & P 500. They're very different numbers.

Cohen: Let me put some numbers on that. If you go back to the bottom of the bear market that ended in 2002, early 2003, S & P stock prices were up 35%, but S & P earnings were up 75%. And while that's sort of a gross measure, there are very few valuation approaches which suggest anything other than the U.S. stock market being inexpensive.

Companies have also piled up tons of cash on their balance sheets. Is that bullish?

Cohen: When publicly traded equities are inexpensively priced and corporations have cash sitting on the sidelines, they can do several things with that cash. They might pursue M & A activity. They may take a look at one of their competitors, or another company that they think might add to their business. They could return capital to shareholders in the form of a tax-advantaged share repurchase. They can also increase the dividend. We expect all of this to happen. All of this is positive for the stock market. The numbers involved are probably larger than that of individuals coming into the market.

Bianco: Good point. Even if the retail client base doesn't come back to the stock market, you'll see corporations buying their shares. We also think asset-allocation funds will be moving into equities.

How can stocks go up if the economy remains sluggish, compared to prior recoveries?

Bernstein: Individual investors are very scared of the equity market. Part of that is because they hear a lot of economists talk. There's a big difference in the way an economist looks at the world and the way an investor does. I don't think most people realize that the stock market does not move on good or bad economic numbers. It moves on better or worse.

If you're an individual investor, when you look at the data, most people would have to say there's a pretty good probability the U.S. economy will be better a year from now than it is today. Therefore, you should be at least reasonably bullish.

Shouldn't investors worry about interest rates soaring and hurting their bond holdings?

Bernstein: I don't even think you have to be really wigged out about inflation to say that there's a little more risk in bonds than people think. Not that we're going to have massive inflation from printing dollars and that we're going to turn into Argentina. But the economy is simply going to get better, and as the economy gets better, you're going to have normal upward pressure on long-term interest rates. I don't think individuals can conceive that we could actually have a normal increase in long-term interest rates. It's not on their radar screen. But, in my opinion, that's where the risk really lies right now.

Does anyone consider the third year of the presidential cycle, which has historically been bullish for stocks, as a tail wind?

Chung: I happen to think that the first half of 2011 will actually be somewhat positively biased, because I think that the new Congress is indicating that they want to get things done, as opposed to nothing. The risk is gridlock, and the market would be unhappy with gridlock. Both President Obama and Congress are well aware of that sentiment in the public. I think that's what the election results really mean, that we don't want to see gridlock, we want to see some compromises. And we're seeing that. It's very positive, in that sense. I don't think it's so much tied to the third-year cycle necessarily.

Isn't the typical reasoning that stocks do well in the third year of the cycle because the politicians are already worrying about re-election and, therefore, taking steps to prime the pump to get the economy firing on all cylinders?

17.2% 2011 S&P close: 1450

Abby Joseph Cohen

Goldman Sachs
Global Markets Institute
Senior investment strategist and president

Cash in on global economic rebound. Seek out stocks with the ability to post strong revenue and profit growth where all the good news has not already been priced in.

Favor developed markets. Emerging markets like China have been getting most of the attention, but stocks are less pricey and, thus, more attractive in the U.S., Europe and Japan.

Snap up sectors that thrive in recoveries. Information technology is good early cycle play; select financials offer value as markets improve; energy gets global demand boost.

Profit from stock market resurgence. Wall Street banks and asset managers are likely to rise along with stocks, as fee income rises and underinvested folks shift cash back to stocks.

Beware bond mutual funds. Bond funds are not as safe as they appear. If interest rates start going up and bond investors sell, individual investors will suffer losses.

9.1% 2011 S&P close: 1350

Bob Doll

BlackRock
Chief equity strategist

Marathon Oil ($35.17 Thursday, ticker MRO). If the global economy is going to grow, demand for energy will grow and drive prices up, fueling integrated oil plays such as Marathon Oil and **Conoco Phillips** ($65.67, COP).

Eli Lilly ($35.18, LLY). To get growth no matter how the economy fares, consider drugmakers Eli Lilly and **Bristol-Myers Squibb** ($26.72, BMY), which sport fat dividend yields, decent free cash flow and must-have pharmaceuticals.

Verizon ($34.76, VZ). Telecom giant is in a price-competitive space but sports a nearly 6% annual dividend yield; greater data use by mobile users and new smartphone products give it an edge.

General Electric ($17.77, GE). Global company is a low-expectation stock with rebounding industrial businesses and a financial lending arm that is getting healthy in the post-financial crisis.

Dell ($13.33, DELL). Onetime computer powerhouse's business strategy faces questions, but it's a cheap stock with strong cash flow and a good risk/reward profile.

15%

Richard Bernstein

Richard Bernstein Advisors
CEO and chief investment officer

Small-caps sized right. In a bet on a positive economic surprise in U.S., small-company stocks, which have posted bigger gains than China stocks for three years, are set up for more success.

Buy U.S. municipal bonds. The hot trade has been buying sovereign debt of emerging market countries, but risks are rising. A basket of U.S. "muni" bonds issued by municipalities, cities and states — which investors have been avoiding — is a good total-return play.

Profit from economic rebound. As the economy enters the midphase of its recovery cycle, the global reach of the energy and materials sectors should make them market leaders.

Go long on the U.S. dollar. Despite talk about the U.S. central bank debasing the dollar with its easy-money policy, the dollar, which troughed in 2008, is set to appreciate.

Long live the U.S. consumer. Money managers' love affair with stocks that benefit from spending by emerging market consumers is likely to fade as inflation crimps buying power abroad. With the U.S. jobs picture brightening, U.S. consumer stocks could be a positive surprise.

Doll: Well, look at the tax-cut package that's n the process of going through. We talked about why it's a positive for growth, and part of the reason is these guys are saying, if I want to get re-elected in 2012, I'd better do something good for the economy.

If the tax-cut deal is passed, how will it boost markets?

Doll: A lot of economists are using the potential passage to raise their economic growth expectations. In September, October, November, almost every statistic was a little better than the last one. I think they're realizing that their numbers weren't high enough. A lot of economists are boosting their GDP growth expectations from around 2% to 3%.

What about the impact of the U.S. dollar? It's showing strength after months of weakness.

Bernstein: Normally people say a weak dollar means your exports are going to go up, and there's something to that, although I don't think we're a big manufacturing economy. We export services and agricultural things, and that type of stuff.

But a stronger dollar will be a positive because it will reflect renewed confidence in the U.S. If there's one theme that transcends every bearish view — whether it's inflation, deflation, economic malaise — the general consensus is: You should not invest in the U.S.; there's no future in the U.S.; we're on our way down to some new low in global society. It's quite dramatic. My point is that in 2011 into 2012, people will be surprised by the growth in the U.S., and you will see investment flows come towards the U.S., and that will be a big support for the dollar.

Bianco: A stronger dollar will be a bit of a head wind to earnings growth, but there will still be strong earnings growth. The focus is going to shift to interest rates: How far can they go up? A stronger dollar is going to help keep interests rates from going up a whole lot. It's also going to attract foreign investors to things like the U.S. equity markets.

Will higher stock prices create a wealth effect and boost the economy and stocks?

Chung: Where the wealth effect tends to play out very directly is in upper-end consumers that have a lot of discretionary income. We're watching very carefully how the luxury goods manufacturers, or companies that service higher-end consumers, are doing. They've seen some of the strongest comebacks. It seems very unlikely that that gets derailed in 2011. I think sentiment improves, as does spending on higher-end luxury items, and more actual investing in U.S. stocks, something that even high-end consumers have been shy of in the last couple years.

Cohen: The wealth effect impact will be very different on middle-income investors than on others. For many middle-income families, their most significant asset is still their home. Middle-income families and lower are skewed much more towards fixed income. So even if we were to see a meaningful rally in stocks, the impact would be very uneven in terms of which families would benefit.