

Richard  
Bernstein

# This is what bull markets are all about

**This is what bull markets are all about**

**August 9, 2012**

Investors have the impression that bull markets are days of wine and roses. However, nothing could be farther from the truth. Bull markets are periods of fear. This becomes quite obvious when one examines the valuation and sentiment data associated with the 1982, 1990, 1995, and 2003 bull markets.

The current bull market, which began in March 2009, seems to be fitting the historical precedent. The S&P 500 has appreciated nearly 100%, yet most observers are hesitant to concede that the US stock market is in a bull phase. Individual investors are still searching for protection, and ignoring the fact that equities have appreciated significantly more than the fixed-income yields for which they search. Institutional investors are still looking for “absolute returns” and paying high fees to alternatives managers instead of simply buying old-fashioned stocks.

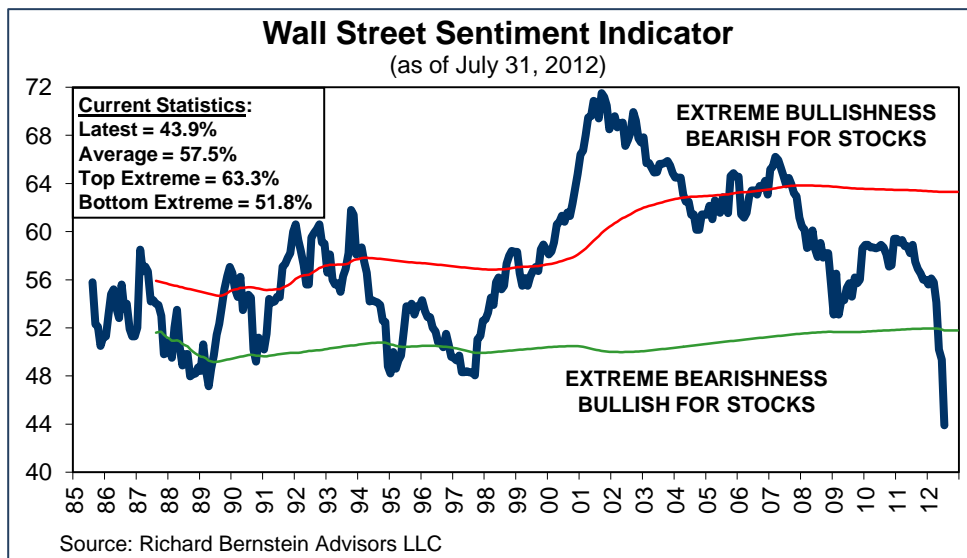
This pervasive hesitancy to invest in US equities despite the asset class’s significant performance further cements our bullishness regarding the asset class. Bull markets typically end with over-enthusiasm, and not the fear that is so prevalent today.

## Sentiment

Our Wall Street Sentiment Indicator clearly shows the extreme level of investors’ fear. The survey, originally crafted in 1986, is a survey of Wall Street strategists’ recommended equity allocation for a balanced fund. Extreme readings (i.e., one standard deviation above or below the long-term norm) have historically been reliable sell and buy signals.

Chart 1 shows the Wall Street Sentiment Indicator with “buy” and “sell” signals. The current reading, the lowest suggested equity allocation in the indicator’s history, certainly meets the requirements of a “buy” signal. Investors appear historically scared of equities.

**Chart 1:**

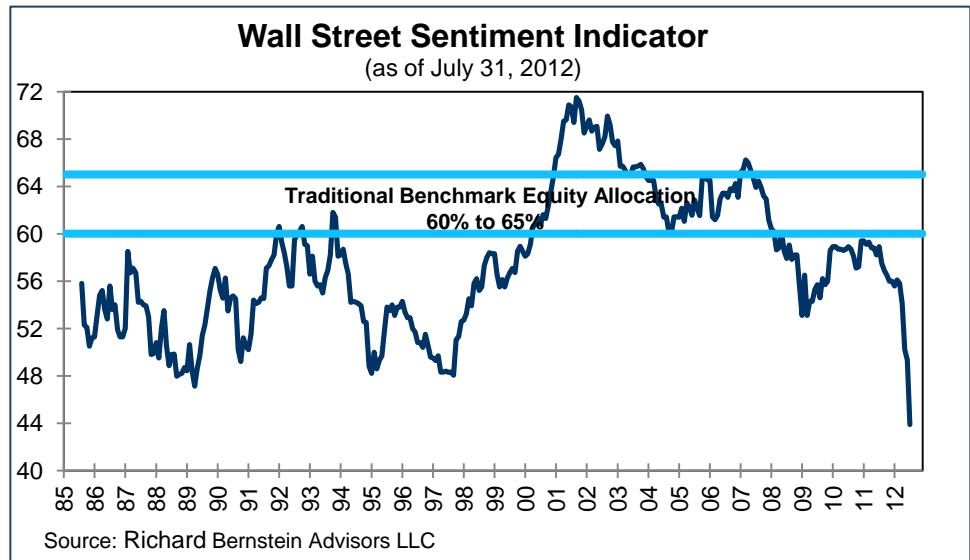




A second version of the Wall Street Sentiment Indicator shows the survey data relative to the traditional 60-65% “normal” equity weighting used by most investors. This chart highlights that Wall Street never suggested overweighting equities during the entire bull market of the 1980s and 1990s. In other words, equities were never the asset class of choice throughout the entire bull market. They become the asset class of choice, i.e., Wall Street suggested overweighting equities, in the early-2000s, which was just in time for the so-called “lost decade in stocks”.

Equities are certainly not the asset class of choice today, which is a typical sentiment during bull markets.

**Chart 2:**



### Valuation

It is hard to make the argument that equities are overvalued when the 10-year t-note is approximately 1.50%. After all, if one didn't like equities when the 10-year was at 3%, then one would have to be roughly twice as bearish to not like equities with a 10-year at 1.5%.

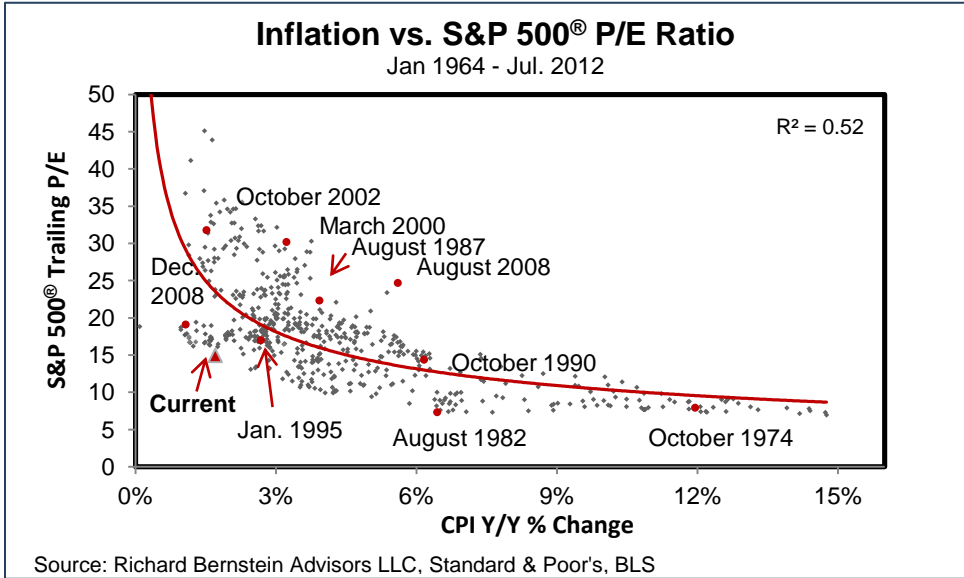
Chart 3 is one of our standard valuation models, and compares the S&P 500 price/earnings ratio to the inflation rate. Historically, there has been an inverse relationship so that higher rates of inflation suggest lower P/E ratios. For the past several years, this model has consistently suggested that the equity market was undervalued given the rate of inflation.

The US stock market continues to look attractive within this model even when compared to periods during which bull markets began. One might expect equity market valuations to have materially expanded because the stock market has nearly doubled. However, that is not the case because inflation rates have been much lower than investors previously expected.

In addition, the strength in corporate earnings over the past several years far surpassed the growth in the overall economy. Corporate profits as a percent of GDP rose to record highs despite the tepid pace of overall economic growth. Thus, the S&P 500 has a lower P/E ratio than it had several years ago despite a higher level of absolute earnings largely because of investors' fears.



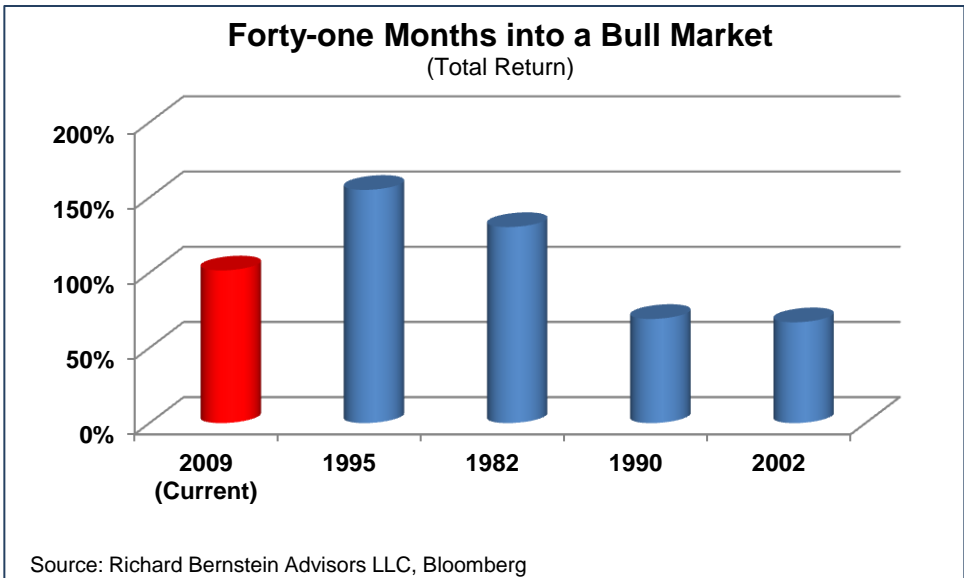
Chart 3:



**Comparing this bull market to prior cycles**

The bull market in US equities is now forty-one months old (March 2009 through July 2012), and Chart 4 compares the performance so far during the current bull market with the performance during previous bull markets' first forty-one months. The current cycle's performance fits well with history, and is in the middle of past cycles' performances.

Chart 4:





Richard  
Bernstein  
Advisors

### **When do bull markets end?**

Bull markets typically end when valuations are extreme, the Fed is tightening monetary policy, and investors are over-enthusiastic about potential equity returns. Valuations are quite attractive given that the 10-year t-note yields roughly 1.5%. Investors are very leery of equities, and equities are no longer the asset class of choice. The Fed is considering easing further, and a tightening of monetary policy seems far into the future.

The opportunity cost of fear has been very high. Both institutional and individual investors have largely missed out on a doubling of the US equity market. If this cycle continues to follow historical precedent, as it has done so far, then investors will eventually try to play catch-up, and fund flows will likely turn decidedly positive.

The bull market seems to be a very typical one and, like past cycles, is based on fear. This bull run may still be in its early stages despite being forty-one months old.

Richard Bernstein  
Advisors LLC  
520 Madison Avenue  
28<sup>th</sup> Floor  
New York, NY 10022  
212-692-4000

[www.rbadvisors.com](http://www.rbadvisors.com)



Richard  
Bernstein  
Advisors

## INDEX DESCRIPTIONS:

*The following descriptions, while believed to be accurate, are in some cases abbreviated versions of more detailed or comprehensive definitions available from the sponsors or originators of the respective indices. Anyone interested in such further details is free to consult each such sponsor's or originator's website.*

The past performance of an index is not a guarantee of future results.

Each index reflects an unmanaged universe of securities without any deduction for advisory fees or other expenses that would reduce actual returns, as well as the reinvestment of all income and dividends. An actual investment in the securities included in the index would require an investor to incur transaction costs, which would lower the performance results. **Indices are not actively managed and investors cannot invest directly in the indices.**

**US Equities: Standard & Poor's (S&P) 500<sup>®</sup> Index.** The S&P 500<sup>®</sup> Index is an unmanaged, capitalization-weighted index designed to measure the performance of the broad US economy through changes in the aggregate market value of 500 stocks representing all major industries.

© Copyright 2012 Richard Bernstein Advisors LLC. All rights reserved.

**Nothing contained herein constitutes tax, legal, insurance or investment advice, or the recommendation of or an offer to sell, or the solicitation of an offer to buy or invest in, any investment product, vehicle, service or instrument. Such an offer or solicitation may only be made by delivery to a prospective investor of formal offering materials, including subscription or account documents or forms, which include detailed discussions of the terms of the respective product, vehicle, service or instrument, including the principal risk factors that might impact such a purchase or investment, and which should be reviewed carefully by any such investor before making the decision to invest. Specifically, and without limiting the generality of the foregoing, before acquiring the shares of any mutual fund, it is your responsibility to read the fund's prospectus. Links to appearances and articles by Richard Bernstein, whether in the press, on television or otherwise, are provided for informational purposes only and in no way should be considered a recommendation of any particular investment product, vehicle, service or instrument or the rendering of investment advice, which must always be evaluated by a prospective investor in consultation with his or her own financial adviser and in light of his or her own circumstances, including the investor's investment horizon, appetite for risk, and ability to withstand a potential loss of some or all of an investment's value. Investing is an inherently risky activity, and investors must always be prepared to potentially lose some or all of an investment's value. Past performance is, of course, no guarantee of future results.**

Richard Bernstein  
Advisors LLC  
520 Madison Avenue  
28<sup>th</sup> Floor  
New York, NY 10022  
212-692-4000

www.rbadvisors.com

**PAST PERFORMANCE IS NO GUARANTEE OF FUTURE RESULTS**