

Market Update

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BullTick
Capital Markets

February 3, 2012

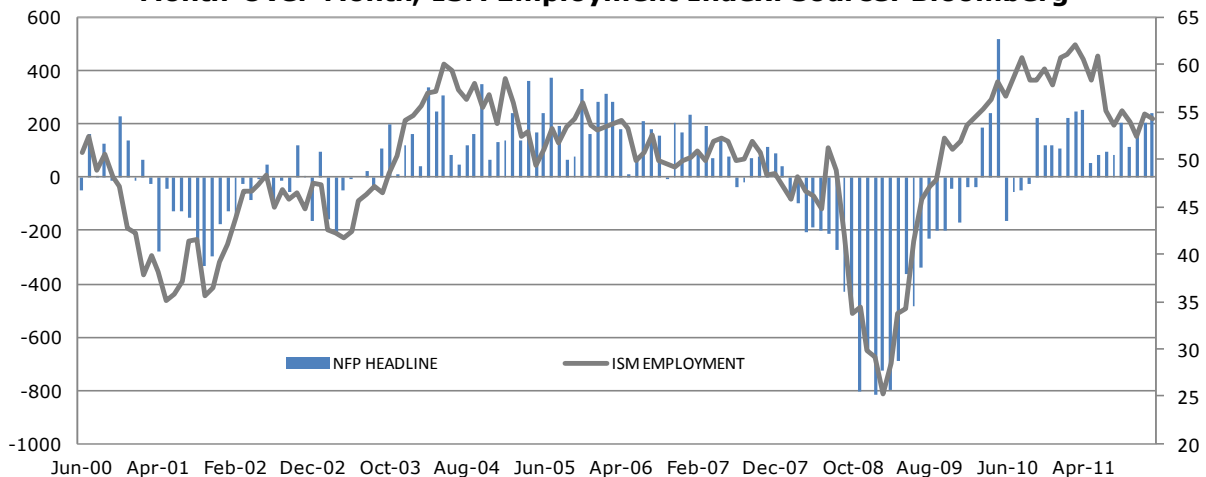
MARKET UPDATE—Revising Our Year-End 2012 S&P 500 Target To 1,600

KEY POINT: The labor department announced on Friday morning that the US economy had created a total of +243k new jobs in January, delivering a significantly better performance compared to analyst expectations of the US economy creating +140k last month, and above our own estimations of the US economy creating a total of +175k new jobs in January (see our January 4, 2012 Mid-Day Report). The authorities also reported that the US unemployment rate had fallen to 8.3% in January, such being the lowest unemployment rate that the Street has seen since February 2009. Also on the positive side, the *Financial Times* is reporting that China is getting increasingly involved in the European rescue process, something that we have been forecasting to occur for more than a year already. In our view, with the Fed remaining on hold until 2014, the US employment picture looking increasingly rosy, with the UST yield curve shifting north as the year progresses, and with the threat of a full disintegration of Europe falling by the minute, there will not be any real obstacles left for the US equity markets (and most other world equity markets) to enter into a major bullish move. Why? Because most of these markets still remain dirt-cheap (on a historical basis). **Hence, we are revising our 2012 year-end target for the S&P 500 to 1,600 from our long-held 1,400 year-end target.**

THE MARKET IS SIMPLY TOO CHEAP...

We, just as pretty much every other investor in the Street, were very positively surprised by the publication of the latest NFP reading out of the US. The labor department reported that the US economy had created a total of 243,000 new jobs during January, the most jobs since April of last year. On the private sector front, the rate of job creation came at 257k, way above the market expectation of the private economy generating a total of 160k new jobs. On a 12-month rolling basis, the rate of new monthly job creation now stands at 159k (1.9 million annualized), up from December's 149k (1.79 million annualized) rate. According to our models, the US economy will create a total of 2.5 million new jobs during 2012, implying that by year-end 2012, a total of 134.67 million people will be working in the US, materially higher compared to the 129.24 million that were working in February of 2009 (current cycle low). Also on the positive side, the rate of unemployment fell to 8.3%, such being the lowest rate of unemployment seen since February 2009.

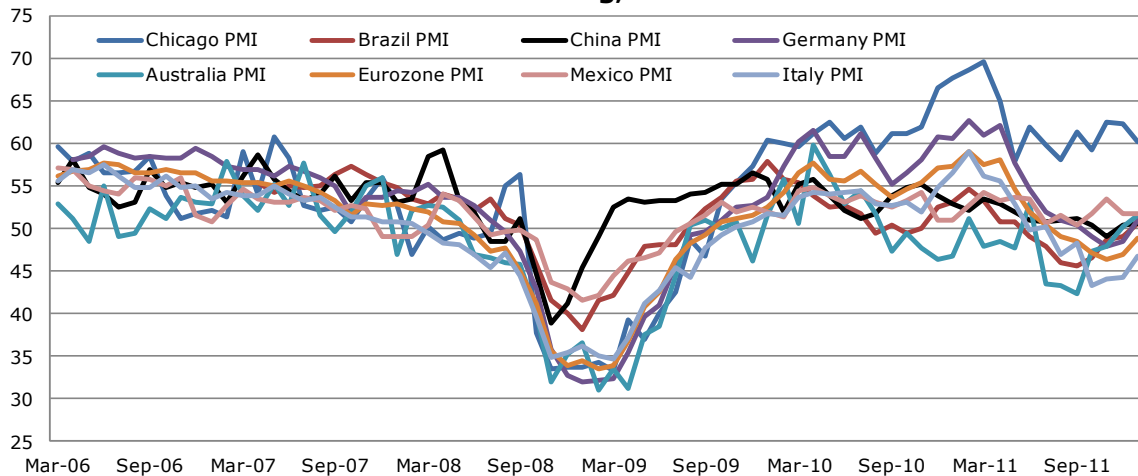
**US ECONOMY--NFP Employment Change (In Thousands),
Month-Over-Month, ISM Employment Index. Source: Bloomberg**



On top of the positive news on employment, the Institute For Supply Management reported on Friday that the ISM non-manufacturing index had increased to 56.8 in January from 52.6 in December, delivering a significantly better than expected performance compared to market expectations of the reading coming at 53.2. Clearly, the services sector of the US economy, which accounts for more than 2/3 of US activity, is showing clear indications of an ongoing acceleration taking

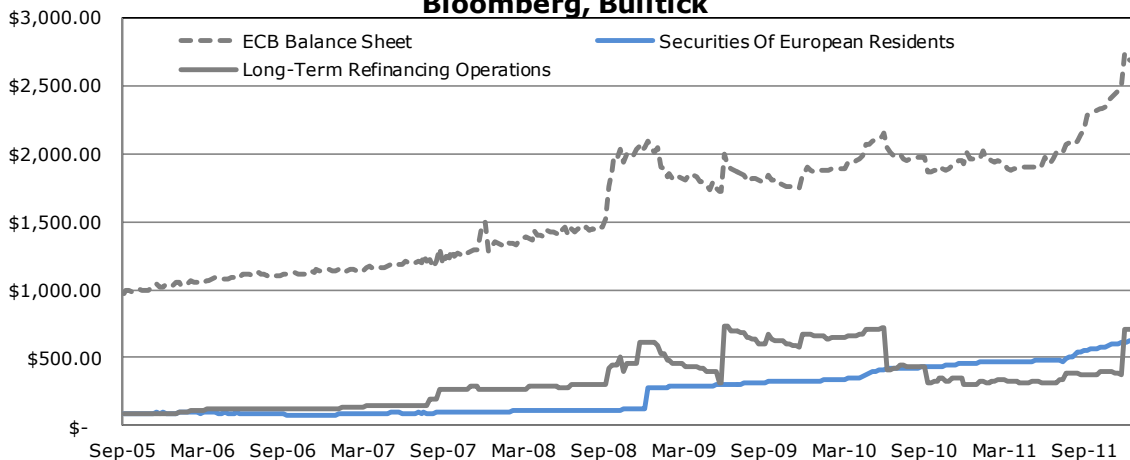
place. Going deeper into the ISM components, the data shows that the employment component accelerated to 57.4 from 49.8 in December, that export orders accelerated to 56.5 from 51 in December, and that the critical new orders component increased to 59.4 from 54.6 in December. Also of relevance, some other world non-manufacturing indexes delivered a picture of a rebound being on the making at this time (France's non-manufacturing PMI increased to 52.3 from 51.7 in December, and Germany's non-manufacturing PMI fell to a still benevolent/expansionary 53.7 from 54.5 in December).

World Manufacturing Purchasing Managers Index's. Source: Bloomberg, Bulltick



Also on the positive side, the *Financial Times* is reporting that the Chinese government is entertaining the possibility of getting increasingly involved in solving the European crisis via the IMF (this likely means capitalization of the IMF in exchange for more power). **We have been speculating for more than a year that the Chinese would get increasingly involved in this rescue story, because the Chinese leadership understands that their economy would be very affected if the € were to collapse (and because they have "the cash")**. We think that the timing of this news is positive, since Italy needs to amortize USD \$36 billion in the remainder of February, USD \$58 billion in March, and another USD \$58 billion in April. In total, from now until the end of 2012, the Italian government needs to amortize USD \$408 billion of its public debt load (of its total USD \$2.15 trillion outstanding in debt).

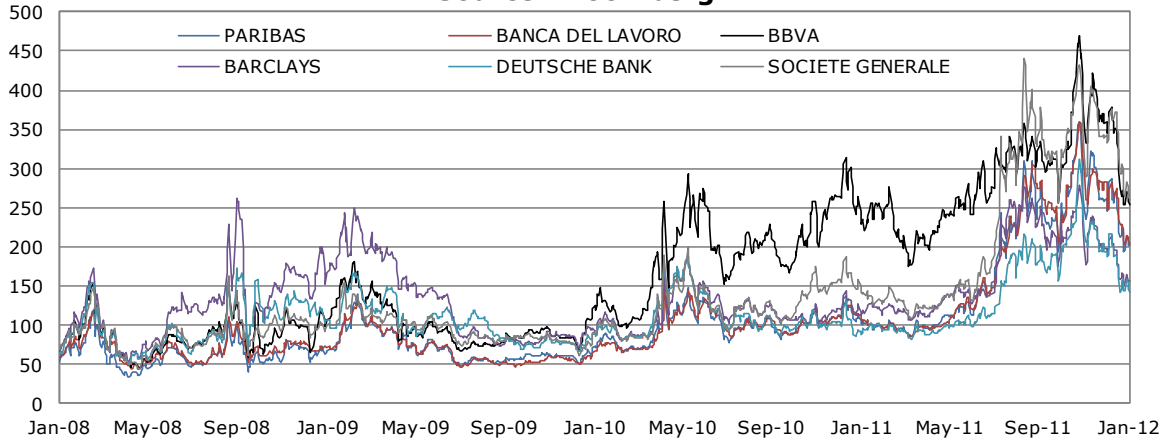
EUROPE--ECB's Balance Sheet (In € Billions). Source: Bloomberg, Bulltick



We feel that the impressive increase in liquidity that the ECB has delivered into the market via secondary market bond purchases and the full allotment of the 3-year credit line for the banking sector (LTRO), coupled with the likelihood that European banks will tender bids to received another € 750-1 trillion in

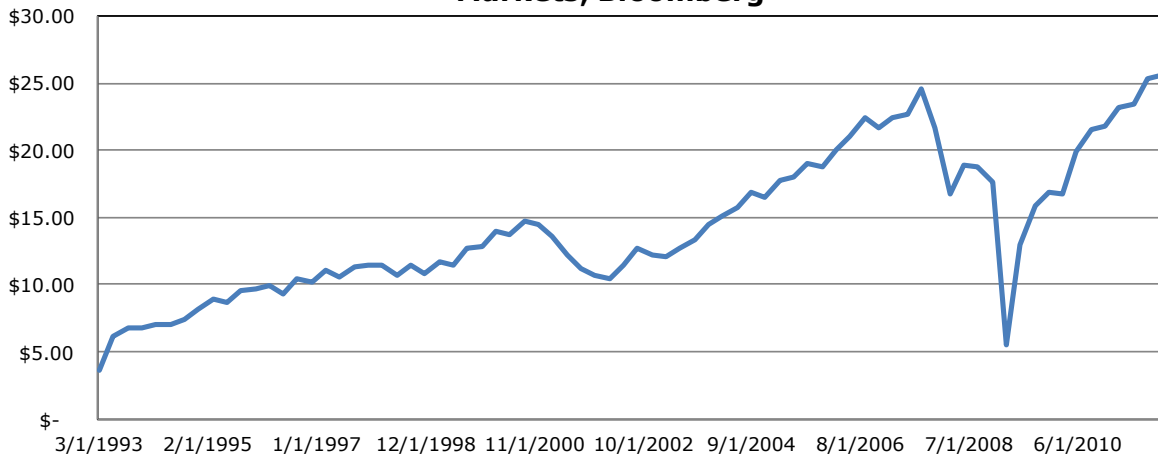
liquidity on the auction of the 29th of February, has made a material difference in liquidity and risk aversion expectations. Why? **Very simple: because European banks will now be able, if they so wish, to refrain from tapping the primary bond market for a couple of years.** Clearly, if we are right in our view, then the institutional investor community will see a very astringent (supply-wise) market.

EUROPE FUNDAMENTALS--European Bank 5-Year CDS Levels.
Source: Bloomberg



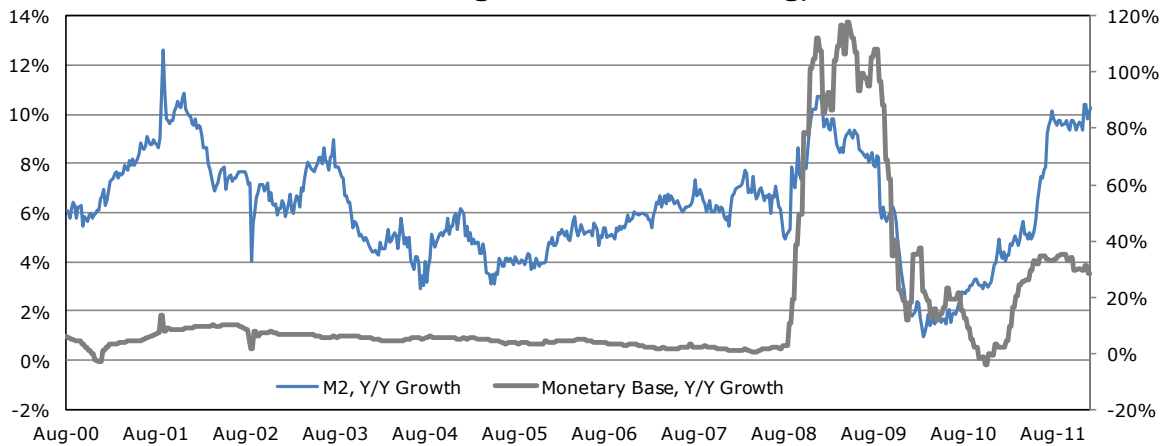
We think that all the fundamental variables around the world economy are becoming increasingly aligned with a major world equity market rally being in the horizon. As we argued in our January monthly publication, the S&P 500, the world's benchmark, remains very "cheap" in a historical context. Here is why: (1) we think it is quite feasible that S&P net income could reach more than USD \$1 trillion by year-end 2012, up from an estimated USD \$900-950 billion in 2011. (2) We consider that the current and next year estimate PE ratio of the S&P 500 remains are simply too low in historical terms -now at around 13.9 and 11.4 respectively, compared to the historical +17-level. (3) The discount rate in the world economy will likely remain very low for a very long time, following anemic rates of growth in most of the developed world and, therefore, lingering very expansionary monetary policy stances from most of the world's relevant central banks. (4) And because the level of cash in the corporate sector of the US remains very sizable -according to S&P, the industrial component of the S&P 500 index had total cash of USD \$963 billion as of the middle of 2011. Logic implies that if the world does not enter into a protracted financial crisis, companies will choose to either boost dividends and/or repurchase their own dividend yielding stocks, because hoarding too much cash carries very material opportunity costs for companies.

S&P 500 Index Quarterly Earnings. Source: Bulltick Capital Markets, Bloomberg



The very difficult question to answer at this time is the following: *What is a fair PE ratio for the S&P 500 under the current world environment?* Again, according to our math, at this time the S&P is trading at 13.9 times earnings of \$96.5, and at 11.3 times consensus expected next-year earnings of \$117. What should be this "fair-value" number? There is no possible empirical answer to this question, yet we believe that 2012 will be a year in which the multiple of the market will increase from the current (we think) abnormally low level. As argued before, the world is awash with liquidity, the money multiplier continues to come back (see graph below), and the *black-swan* of a complete disintegration of Europe appears to be fading into oblivion.

US-M2 (NSA Series, Left Axis), Base Money (Right Axis), Year-Over-Year Change. Source: Bloomberg, Bulltick



Therefore, despite lingering concerns on Greece's PSI negotiations, Portugal's 2013 fate, and upcoming Italian public debt rollovers, we are now prepared to forecast that the S&P 500 will finish 2012 at 1,600, and not at 1,400, as we had previously forecast (implies a return on the index of +20% from now until the end of the year, and a return of +26% in the year). Consistent with these changes in our S&P 500 outlook, we also see the Latin American equity counterparts rallying strongly, with the Bovespa ending 2012 at 80,000 (up 38%) and the Mexican Bolsa ending the year at 47,000 (up 26% in the year).

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