# Bull & Bear Bulletin

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## First Quarter Earnings Fail to Impress:

In our February publication, we outlined the possibility of a flat U.S. stock market, believing corporate earnings needed to catch up with the market valuation expansion in 2013. Highlighted is the fact that two-thirds of last year's stock market performance was based on an expansion in what investors were willing to pay for earnings versus price appreciation on the support of higher corporate earnings. First quarter earnings growth did little to diminish the market's valuation premium (Chart 1). The average earnings growth of companies in the S&P 500 Index was just 2.3%, barely outpacing the 1.84% the market advanced in the quarter.

The lackluster earnings growth in the first quarter was exhibited across nearly every sector of the economy (Chart 2). The few exceptions were the Telecommunications, Utilities and Health Care sectors. Telecommunication stocks reported the largest earnings growth in the quarter, fueled by Verizon's 94% jump in earnings after acquiring Vodafone's 45% stake in Verizon Wireless. Utility companies experienced broad strength, while the Health Care sector benefitted from strong growth in biotechnology and technical instrument sales.

While many of the economic sensitive sectors, often referred to as cyclical sectors, failed to report meaningful growth in the first quarter, an acceleration of earnings may be right around the corner. Stronger consumer confidence readings, four straight months of consistent job creation and a consensus expectation that business spending will accelerate throughout the rest of the year should generate more favorable tailwinds for the economy and the cyclical sectors.

If the economy does accelerate from higher consumer and business spending, investors can anticipate broad economic strength and higher corporate profits. Ideally, higher corporate profit growth would help reduce the premium built into the market, which would be more supportive of current prices and diminish the probability of a significant market pullback this year on fears of an overvalued market.

Corporate earnings announcements should occupy equity investors' attention and influence market action over the next two months. Looking beyond this summer, the prospects of the Federal Reserve ending its stimulus measures in the fourth quarter will likely trump corporate earnings and take center stage. Based on previous attempts by the Fed to exit its direct stimulus measures, we anticipate extra volatility in both the stock and bond markets as we look to the third and fourth quarter.



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Chart 1

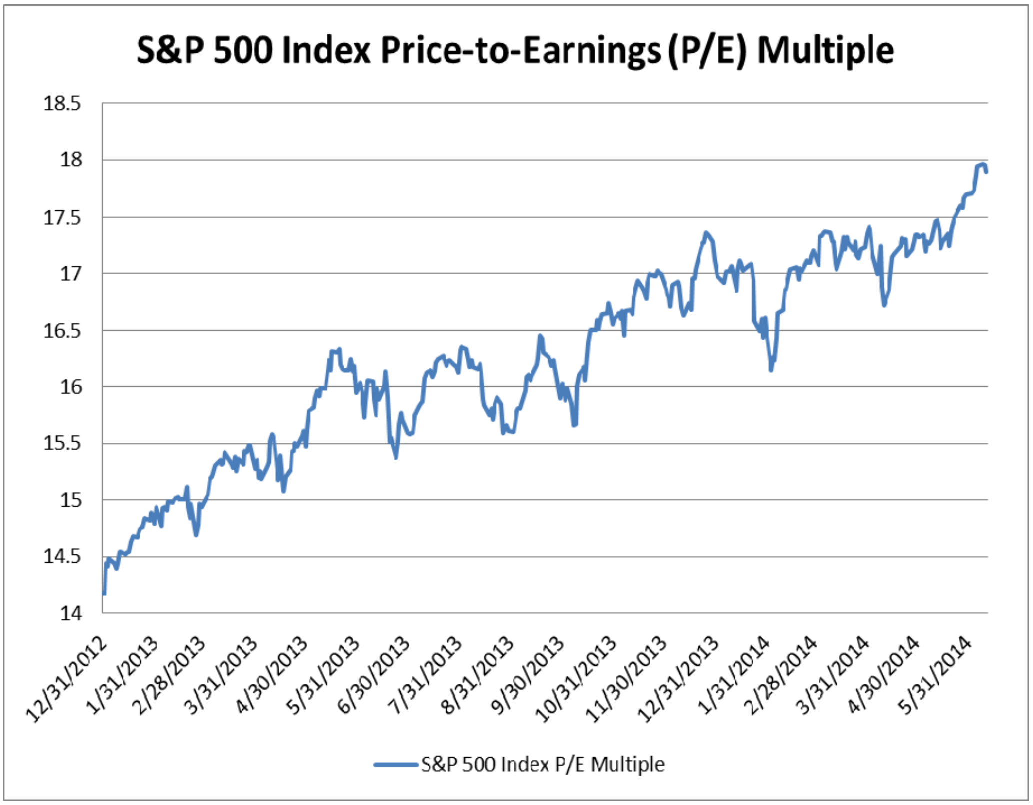


Chart 2