EMERALD ASSET ADVISORS, LLC

Investment Strategists for
Successful Families

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Thank you for reading GreenThought$. It is our privilege to provide you with our insight on current financial market events and our outlook on topics relevant to you.

Is There Value in U.S. Equities?

U.S. Large-Caps Look Poised For a Rebound

The U.S. stock market’s dismal performance during the first decade of the new millennium has been well chronicled. During the so-called “lost decade” for U.S. stocks, a $1,000,000 investment in the S&P 500 Index on December 31, 1999, was worth roughly $900,000 at the end of 2009 (including dividends).

However, these numbers don’t necessarily reflect what most investors actually earned. There were periods of exceptional gains as well as periods of steep losses. As always, actual investor returns depend on their overall asset allocation and the timing of their investment decisions, among other factors.

The importance of asset allocation and timing was again evident last year. After rallying earlier in the year, stocks took investors on a gut-wrenching ride over the summer before rallying again in the fall. And for all of the twists and turns, in the end the S&P 500 essentially ended the year where it began.

But that’s history. What do we expect looking ahead? As we examine today’s investment landscape, we believe opportunities can be found in U.S. stocks, particularly large-cap stocks. There are several trends in place that support our view, including:

1) Low Valuations
Whether you examine valuations in absolute terms or relative terms, large-cap U.S. stocks appear inexpensive. Price-to-earnings (P/E) ratios have been compressing for the past 12 years. The forward twelve-month (FTM) P/E ratio on the S&P 500 was 12.3x, down from 14.0x a year ago.

Index	P/E Trailing 12 mos	P/E Forward 12 mos	Dividend Yield
S&P500	14.98	12.31	2.08%
DJIA	13.67	11.92	2.55%
Russell 2000	47.65	19.65	1.50%
Nasdaq 100	11.68	13.15	1.00%

Some of America's biggest companies are trading at P/Es significantly below the market multiple. For example, consider the low forward P/Es for these household names (based on 2012 consensus earning-per-share estimates):

Company	Forward P/E
Johnson & Johnson	12
Oracle	12
Cisco	11
Microsoft	11
Lockheed	11
Avon	10
Chevron	8
Xerox	7

Looking at price-to-book ratios, we find that large-caps are trading at their narrowest premium to smaller caps in many years. Part of this can be explained by the unusually low stated price-to-book value of large financial stocks during and since the financial crisis. However, it still appears that investors are overlooking the franchise value of large companies and their ability to dominate their sectors, acquire competitors, and adjust pricing.

2) Healthy, Growing Dividends
For the first time since the 1950s, the dividend yield on the S&P 500 is higher than the yield on the 10-year Treasury (2.08% vs. 1.97%). As long as corporate earnings remain strong, large companies may continue to boost their dividend payouts. Recently, Standard & Poor's announced that dividend increases reached $50 billion in 2011, an 89% rise over the $26 billion in dividend increases posted in 2010. Actual cash payments increased more than 16% and the forward indicated dividend rate was up 18%.

Given strong corporate cash-flows and cash reserves, S&P expects dividend payments to set a new record in 2012. Payout rates, which historically average 52%, are near an all-time low at 28%, suggesting there is more room for improvement. Of course, while dividends alone won't deliver the gains most investors seek from stocks, they are an important component of total returns over the long haul. In fact, dividends accounted for all of the S&P 500's total return in 2011.

3) The Pendulum Swings Both Ways

Over the past 10 years, U.S. Treasury bonds have been on an extended bull run. Meanwhile, as discussed above, U.S. stocks just suffered through their worst decade since the Great Depression. While it's certainly possible that this trend could continue, we believe the odds favor a reversal of fortune. As Jim Morrison of the Door's once sang,

> Well, I've been down so (Gosh-darn) long
> That it looks like up to me

History shows that the S&P 500 has never suffered back-to-back losses in calendar decades. In the 1930s, the S&P 500 posted an annualized loss of 5.3%, excluding dividends. It then posted average annual gains of nearly 9% in the 1940s and 19% in the 1950s. Of course, past is never prologue in the stock market, but we believe that the odds favor a return to a scenario where risk assets return more than risk-free assets.

Risks Remain

As always, we believe a diversified approach that includes a wide variety of assets with low correlations can deliver the best risk-adjusted returns. While valuations for large-cap U.S. stocks are attractive, we are cognizant of the many risks that remain.

First and foremost is the fragile U.S. economic recovery. Employment numbers have ticked up in recent months, but we still have more than 13 million Americans out of work. As local, state, and federal governments grapple with burgeoning budget deficits, additional layoff notices are likely. Meanwhile, the housing market remains mostly stalled and GDP growth is nowhere close to the levels of past recoveries. In the private sector, company managements face a plethora of new laws and regulations which defer their investment decisions until they can get more clarity on procedures and consequences.

Many geopolitical risks dot the landscape as well. It's likely that parts of Europe are already in recession, and if the sovereign debt crisis there spirals into a severe recession, that would have a negative impact on large companies here and around the world. Political tensions with Iran, Syria, and elsewhere in the Middle East could disrupt world oil supplies and cause a spike in energy prices.

Due to these risks, we are not advocating that anyone simply back up the truck and pile into U.S. large-cap stocks. However, we do believe that large caps present an attractive absolute and relative value proposition. Thus, for those who do not have adequate exposure, we believe now may be a good time to increase allocations to large-cap U.S. stocks.

We encourage your questions and are always happy to share our thoughts with you in further detail. Feel free to contact us any time by e-mail at info@emeraldeas.com or by phone at 954-385-9624.

About Emerald

Emerald Asset Advisors, LLC is a Registered Investment Advisor (RIA) founded in 1998. For more information, please visit our website.
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