U.S. markets prove resilient in 2011

Despite a year of volatility, domestic equities outgunned those in developed and emerging countries

December 11, 2011 6:01 am ET

As investors say goodbye to a year that will be remembered for its volatility as much as anything else, one of the most battered, bruised and, yes, volatile markets has quietly reclaimed its spot as the world's best performer.

It is, of course, the United States.

Through Nov. 15, the S&P 500 was up 1.8% year-to-date, the Dow Jones Industrial Average rose 6.9% and the Nasdaq Composite Index was up 1.3%.

Meanwhile, the rest of the world's major equity indexes were covered with red arrows, all pointing down.

London's FTSE 100 (-6.5%), Paris' CAC 40 (-17.5%) and Frankfurt's DAX (-18%) were all well below break-even. Given the continuing debt drama in Greece and Italy, and the specter of prospective European Union bailouts of both nations, it isn't surprising that European markets have languished.

In Tokyo, the Nikkei 225's performance (-17.3%) reflects, in part, the economic impact of the earthquake and tsunami that devastated Japan in March, combined with a national economy that has been in the doldrums for many years.

That leaves the emerging markets of Asia and Latin America. Unfortunately, emerging markets didn't provide the haven sought by some investors and financial advisers. China's Shanghai

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Composite Index was off more than 12%, Hong Kong's Hang Seng Index was down 19%, India's Sensex was almost 18% in the hole and Brazil's Bovespa Index was more than 16% negative year-to-date.

Debt and inflation fears also have taken their toll on these markets.

But the long-term fundamentals for U.S. stocks are positive. The broad market continues to trade at an attractive multiple relative to its history, and its future sales and earnings potential.

According to the U.S. Treasury, global demand for U.S. stocks, bonds and other financial assets totaled $68.6 billion in September, the highest since November 2010.

Meanwhile, corporations reported strong third-quarter earnings, and U.S. equity markets came roaring back, with the S&P 500 rising 10.9% in October, its biggest monthly gain since September 1991.

But the U.S. economy remains stuck in neutral.

Third-quarter gross domestic product grew 2.5% on an annualized basis, following a 1.3% rise in the second quarter. Meanwhile, China's third-quarter GDP growth was 9.3%.

Still, there are some encouraging signs that bode well for stocks. U.S. consumers are deleveraging; U.S. banks, unlike their European counterparts, are stronger financially, having recapitalized their balance sheets a few years ago.; and the United States remains a country with a long and impressive history of addressing and resolving its most challenging issues.

WHAT'S AHEAD

That isn't to say that it will be smooth sailing ahead.

To be sure, U.S. equity markets are likely not out of the woods.

Our old nemesis, volatility, isn't disappearing. Serious global and domestic macroeconomic issues remain and will continue to affect U.S. markets, as will the politics of a presidential election year.

Still, we see strength in equities — specifically, companies involved in oil and gas exploration in North America, infrastructure outside the United States, and well-capitalized regional banks.

In general, we look for companies with what we call a sustainable competitive advantage.

The characteristics these companies possess include a leading market presence in a product or a service, an executive management team with a track record of success, innovation and vision, strong financials and attractive valuation, which we define as 3-to-1 upside potential, versus downside risk.

In technology, these include the biggest of the big, Google Inc. (GOOG), to smaller, lesser-known but also vitally important companies such as Acme Packet Inc. (AKPT) and Riverbed Technology Inc. (RVBD).

In the energy sector, new technology is reopening areas of the United States that were heretofore considered closed to new discoveries of oil and gas. EOG Resources Inc. (EOG) is one of the leading independent oil and natural gas companies that is finding and adding to its reserves in North America.

In financial services, American Express Co. (AXP) is benefiting from consumers' desire to maintain access to credit and is a leader in the global shift away from cash to plastic. The company posted the highest earnings in its history this year.

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