The improvements in equity markets in the early weeks of 2012 are particularly notable given that stock market gains have been global in nature. In fact, the past three weeks mark the first time since 2007 that markets in the United States, Europe and China have all advanced at the beginning of a year. Despite the gains, however, it is important to point out that mutual fund flows are still showing that investors are moving out of equities, indicating that risk aversion remains high.

One of the key recent economic data releases showed that US jobless claims fell by 50,000 last week to 352,000. That drop represents the largest weekly decline since 2005 and suggests that the January payrolls report could be a strong one. Our estimate is that when that data is released in a couple of weeks, it will show that around 150,000 new jobs will have been created.

As we have been saying for some time, improvements in the employment market is a critical factor in helping to create positive "feedback loops" for the economy, and it does appear to us that jobs data is continuing to slowly get better.

It is still quite early in the fourth quarter 2011 earnings season, but results to date have been mixed and are weaker than they have been in recent quarters. About 15% of companies have reported, with just over half delivering better-than-expected results. At this point, it looks like overall earnings will exceed estimates by somewhere around 1% to 2%, the lowest rate we have seen in some time.

At present, analysts are downgrading their 2012 earnings forecasts. The current bottom-up consensus estimates are that earnings will grow by around 12% in 2012. Our guess is that growth will come in at around half that rate.

The recent bounce in stocks and in other risk assets can be attributed to a combination of some improved US economic data, a lack of significant new negatives in the euro debt crisis and further evidence of a soft economic landing in China. For the rally to continue, we believe at least two developments need to occur. The first is that we need to see policymakers in the euro area continue to stabilize conditions. The second is that we need to see global economic data continue to improve enough to support corporate earnings growth.

At some point, it is inevitable that markets will take a break from the pace they have been on since the year began, but our outlook for stocks remains a positive one. Despite the likely moderation in earnings growth, stocks remain attractively valued, and we believe that equities should outperform cash and Treasuries in 2012.

January 24, 2012