The US presidential campaign is getting more focused and we expect the US elections on November 6 to be a pivotal variable for risk assets. At the same time, despite surging gasoline prices, consumer confidence has shot up to a 12-month high, up quite a bit from January's report. Looking forward, along with the progress of the US economic upswing, the presidential election in France and geopolitical variables like Iran will play important roles as market drivers. For the time being, the safety net called Long Term Refinancing Operations (LTRO) initiated by the European Central Bank (ECB) to support the region's banks has made European sovereign debt issues a bit less important than they were only very recently. And while the Chinese economic growth rate is important, in our view the range of outcomes has narrowed.

The US presidential election will clearly have a substantial impact on a variety of issues, and the range of outcomes is wide. The White House, the House of Representatives and the Senate each are in play, and could end up being held by either Democrat or Republican. The impacts will be far-ranging: spending, taxes, Federal Reserve, dollar, regulation and geopolitics. However, Republican ambitions to take control of the Senate were dealt a setback with the announcement by Senator Olympia Snowe of Maine that she would not seek re-election. Our view is that the House of Representatives is likely to continue in Republican hands.

The US stock market bounce off the October low has been impressive. The Dow Jones Industrial Average has broken 13,000 for first time since the global financial crisis erupted four years ago. So for most investors the obvious question is: What's next? At the same time, many investors doubt the durability of the rally in risk assets, saying it is all the result of extraordinarily accommodative monetary policy and when that stops it will be a tougher road to travel. With global growth at less than 3%, the trajectory is insufficient to repair high unemployment and government debt loads.

However, the ECB's LTRO program is a game-changer in our view. The program not only addresses funding stress in the banking system but has done so without compromising the central bank's principle of not lending to sovereign governments. But ultimately, there is no quick remedy to slow economic growth except monetary and fiscal stimulus. Most central banks have realized that deflation is a bigger risk than inflation and therefore monetary reflation is the order of the day.

While we have no crystal ball, it seems that most of the gloom and doom and mispricing in stocks has been discounted away to some degree in this rally, and as such perhaps further gains will be harder to come by. Nevertheless, we believe it is premature to expect a significant stumble. Corporate profits have done amazing things despite the lukewarm recovery, benefiting from low wage pressures, among other things. Are stock prices up too much based on the ECB's LTRO program? Our view is: not necessarily. While there is a lot of skepticism and many investors do not believe in the rally, cynicism and disbelief are probably what is needed to keep the rally going.

As for the outlook, there are positives and negatives as always. We believe the positives outweigh the negatives. With global markets braced for global recession and major European financial fallout last fall, the equity risk premium in almost every market went up to levels past what we saw at the height of the 2008 great recession. So in hindsight, last year's surge in risk premiums globally was excessive, as the world economy has been doing a bit better since 2008. The average investor knew that we were facing a binary world outcome where the tail risk was much higher than normal and stocks were then hit with a much bigger risk premium than they would otherwise have been. This was especially true when neither politicians nor the ECB were willing to stonewall the contagion of a few months ago.

Even with the S&P setting new post-crisis highs, we don't necessarily think stocks are ahead of themselves. While we may not be pricing in a recession like we did last October, markets are in the same place as last April but earnings are up nearly 15% since then. In addition, the October market bottom also seemed to have technical characteristics of an important low. While there remain plenty of problems, including rising oil prices and profit margins at very high levels, we recommend overweighting equities.

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