

Martone Capital Management: Weekly Investment Commentary (5/1/2012)

Over the past month, stocks have traded in a somewhat volatile pattern as investors have been weighing both the positives and negatives. Last week, despite some renewed flare-ups in terms of the ongoing European debt crisis, investors focused on the continued string of positive corporate earnings reports.

At this point in the first-quarter earnings season, nearly half of the S&P 500 companies have reported and between 70% and 80% have surpassed expectations. While this alone points to strong results, the magnitude of the positive surprises has been even more impressive. The long-term average of positive surprises is close to 3% over expectations and this quarter the average has been above 6%. The one caveat to all of this is that while earnings growth remains strong, the pace of growth compared to recent years is slower.

Last week, the preliminary gross domestic product report for the first quarter was released and it showed that the US economy grew at a slightly-less-than-expected rate of 2.2%. While this number represents a slowdown from the fourth quarter of last year, it is consistent with our expectation that the United States will continue to grow at a slow, but positive, pace for 2012.

For its part, the Federal Reserve met last week and made only some minor cosmetic changes to its outlook and interest rate policy statement. The Fed has made it clear that it is focusing on supporting economic growth and intends to keep rates at an exceptionally low level for some time. The bottom line is that the US economy is likely to continue to grow at a modest pace and that interest rate policy is likely to remain accommodative, trends that should be "good enough" for risk assets.

The central downside risk for the global financial markets remains the European debt crisis. The risks for investors are clear. Should European policymakers (meaning both central bankers and elected officials) take their time in addressing escalating problems, the crisis would likely worsen, which could trigger some significant disruptions in global financial markets. This was the mistake that policymakers made last year, and it does appear that at least some policymakers have learned from their mistakes. The European Central Bank has remained committed to promoting greater liquidity and while politicians have been moving more slowly, our view and

our hope is that policymakers will step in to prevent another full-blown crisis from erupting and to defend their hard-fought gains.