**Martone Capital Management: Weekly Investment Commentary (7/24/2012)**

Notwithstanding a pullback on Friday, stocks managed to post gains last week despite a generally negative tone to the economic data. In some ways, the recent trend of relatively weak data has actually been beneficial for stocks in that it has been boosting hopes for additional policy stimulus around the world.

Since the middle of the spring, the global economy has been faltering. Manufacturing levels around the world have been erratic, even in such emerging powerhouses as China and Brazil. Europe is already in recession, and growth in the United States has certainly slowed from where it was late last year and early in 2012.

It would be an overreaction, however, to suggest that the US economy is also heading into a recession. There are a number of important sources of strength within the United States: the strong financial health of the corporate sector, a healing banking system, historically low levels of credit card delinquencies and signs of increased discretionary spending by consumers. Our view is that absent some sort of new catastrophic event, US growth should remain positive, if hardly stellar.

We are currently in the midst of second-quarter earnings reporting season and results have been at least decent, with forward guidance being fairly tepid. Over the past several years, US companies have been diligently cutting expenses, hoarding cash and deleveraging their balance sheets. Given the uncertain global economic environment, we expect most companies will remain conservatively positioned and will remain focused on retaining strong balance sheets. Companies are likely to continue returning cash to shareholders in the form of dividends, dividend increases and share buybacks, but below-trend levels of business reinvestment will likely provide a headwind for longer-term earnings growth. Looking ahead, given that we believe the economic recovery will be sustained, we would expect to see corporate earnings continue to grow, but the pace will be sluggish.

Our forecast is that stocks should continue to climb higher, but that we will see some continued back-and-forth in prices. There is still room for additional policy easing around the world given weak growth levels and low levels of inflation. Equities do generally benefit during times of policy reflation, but they do so in a volatile fashion given the associated backdrop of economic concerns.

At present, many investors are positioned defensively (if not bearishly) and the macro risks are already priced into the markets. Valuation levels for stocks would also appear to provide support. Our long-term view for equities is still a positive one, but we are not expecting to see a significant upside breakout unless and until more policy clarity emerges.