Trend Macrolytics, LLC
Donald Luskin,
Chief Investment Officer
Thomas Demas,
Managing Director

MACROCOSM

A New EPS High-water Mark

Wednesday, May 11, 2011
Donald Luskin

Now stocks just have to grow into their earnings. The slow-motion melt-up will continue.

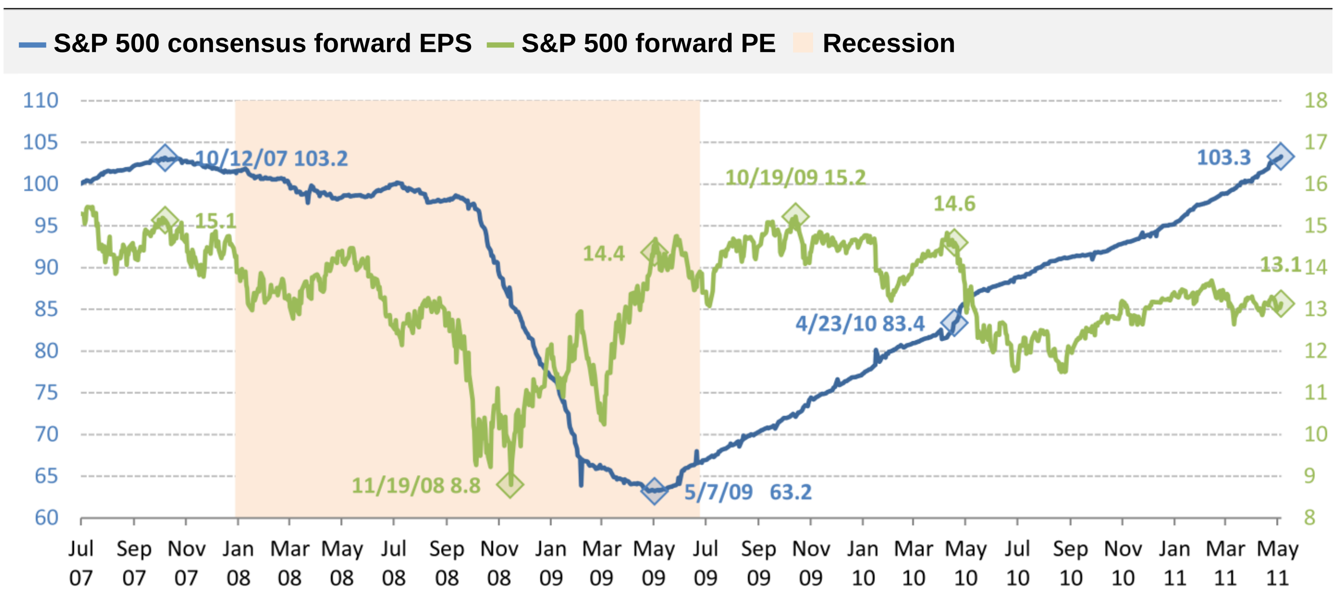
It's a risk-off day, but there is very good news afoot. As of yesterday consensus forward S&P 500 earnings per share made a new all-time high of 103.3, besting the previous record of 103.2 on October 12, 2007 (please see the chart below). This is a 12% rise since six months ago when we first predicted that a new earnings acceleration would power the second leg up in the present bull market (see "Sell On *Good* News" October 20, 2010). Since then the S&P 500 has been in a slow-motion melt-up resulting in a total return gain of 15.4%.

- We believe the slow-motion melt-up in stocks will continue as forward EPS continue to grow.
- We think that stocks will rise faster than earnings, as there is ample room for multiple expansion before there is the slightest whiff of euphoria. At the 2007 EPS peak, the forward multiple was a not especially princely 15.1 -- nothing like the multiples in the mid-20's seen in 1999 and 2000. The present multiple of 13.1 is particularly modest given today's very low interest rates.

Update to strategic view

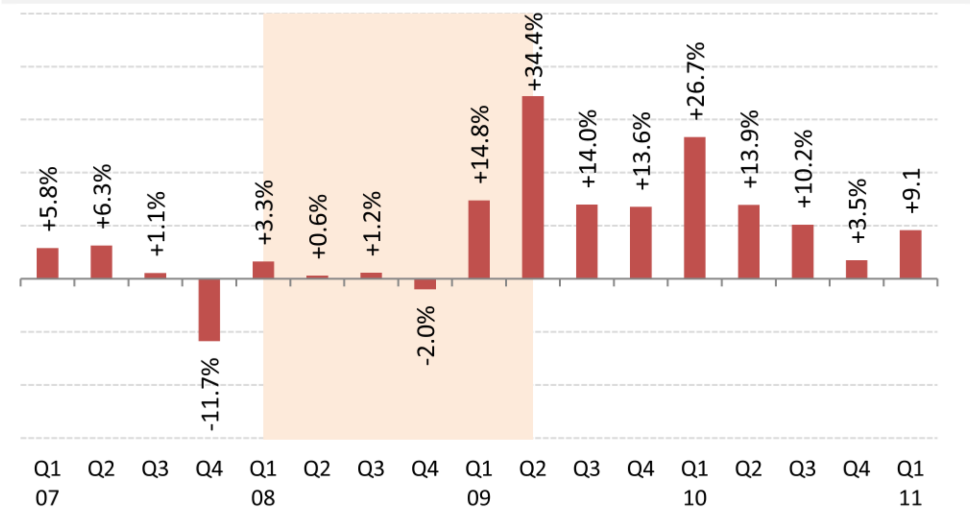
US STOCKS: S&P 500 forward consensus earnings per share have just made a new all-time high, besting the October 2007 peak. With the earnings surprise factor still high, upgrade momentum strong, and the forward multiple still modest, we expect the slow-motion melt-up in stocks to continue.

[Strategy Dashboard home]



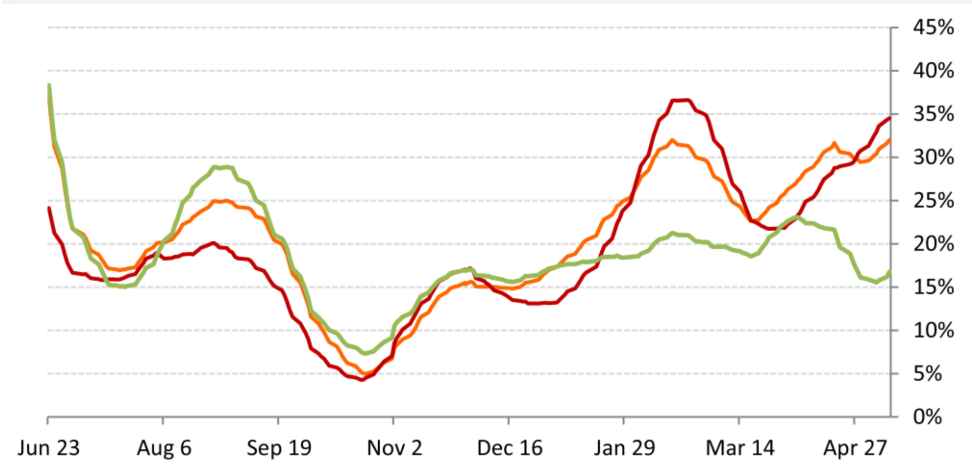
Source: Zacks, NBER, TrendMacro calculations

- Investors continue to underestimate earnings. In the earnings season just completed, the average S&P 500 stock beat by 9.1% (or 9.6% on a cap-weighted basis). Typically in the mature phase of an earnings cycle, the average surprise is less than this, or negative (please see the chart below).



Source: Zacks, NBER, TrendMacro calculations

- This can't be dismissed as a result of the energy sector's windfall gains from higher oil prices. Excluding the energy sector, the average surprise was higher -- 13.6%.
- Neither can this be dismissed as the result of mere cost-cutting. We find in conversations with clients that this is widely expected, which explains why in this earnings season the top line surprised by 2.1% (or 1.9% excluding energy), which is a very substantial beat.
- Coming into the second quarter there is substantial earnings upgrade momentum (please see the chart below), despite several



Source: Zacks, TrendMacro calculations

Contact TrendMacro

On the web at
trendmacro.com

Follow us on Twitter at
twitter.com/TweetMacro

Donald Luskin
Menlo Park CA
650 429 2112
don@trendmacro.com

Thomas Demas
Charlotte NC
704 552 3625
tdemas@trendmacro.com

[About us]

confidence-eroding event shocks that have clustered over the last two months (see "On the April Jobs Report" May 6, 2011).

Bottom line

S&P 500 forward consensus earnings per share have just made a new all-time high, besting the October 2007 peak. With the earnings surprise factor still high, upgrade momentum strong, and the forward multiple still modest, we expect the slow-motion melt-up in stocks to continue.