



**RIVERPOINT**  
CAPITAL MANAGEMENT  
INVESTMENT ADVISORS

## IF HISTORY IS ANY GUIDE, STOCKS SHOULD CONTINUE RISING

Since bottoming on October 9, the S&P 500 Index has been on a tear, gaining nearly 20%. Can this continue? We think so.

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*October was the best month for the S&P 500 Index since December 1991*

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We laid out the case for higher equity prices in our 9/1 *RiverPoint Report* (“Despite Risks, Stocks Could Still Finish 2011 With A Flourish”), but in case you didn’t memorize the text, we’ll summarize the points here:

1. Problems in the Euro Zone – while still not solved, European leaders have finally begun to act like they’re serious about solving the problems. France and Germany appear to be stepping up, and the recent agreement (announced 10/27) regarding Greek debt write-downs and the ultimate size of the European Financial Stability Fund (“EFSF”) finally provides some sort of boundaries on the size and shape of a final solution. While it appears that the European situation is under control, the path up until this point has been anything but predictable; headline-related volatility could still impact stock prices in the future.
2. A “double dip” for the US – fears of a “double dip” recession seem to have faded into the background as macroeconomic data continues to surprise to the upside. While the domestic economy is not quite firing on all cylinders, there seems to be enough strength to keep us from falling back into a recessionary hole.
3. Fear of a 2008-style financial crisis – these fears have also become less intense as the problems in the EU and US economy appear to be on the right track. One gauge of investor worry – the CBOE Volatility Index, or “VIX”, aka “the fear index” – has fallen over 40% since its high in early August.

It appears that improvements in the investment markets have played out nicely in recent weeks. The main question now is can this run of strong

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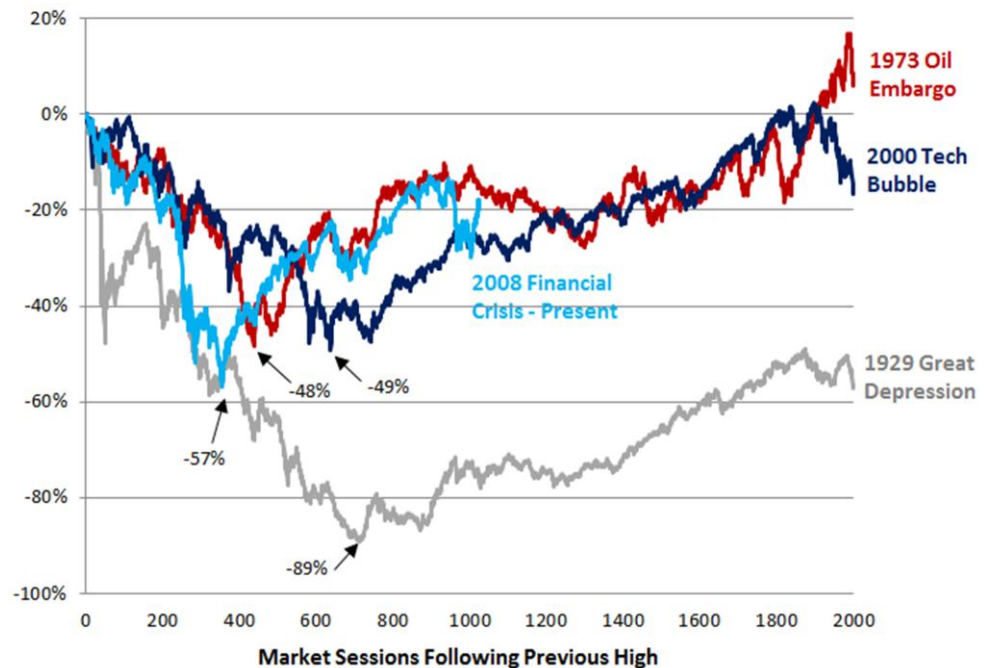
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performance continue? We think that it can, based on market history, company fundamentals, and certain technical indicators that point to solid returns in the future.

At the moment, market history seems to be squarely in the “bull” corner. The following chart depicts the four biggest market declines – the 1929 Crash, the 1973 oil embargo, the 2000 tech bubble burst, 2008’s financial crisis – in terms of percent above or below the previous high (used Dow Jones Industrial Average for 1929, S&P 500 Index for others).




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**14% + Moves in 4 Weeks:**

October, 1974  
 February, 1975  
 September, 1982  
 January, 1988  
 February, 1991  
 November, 1998  
 March, 2000  
 May, 2001  
 August, 2002  
 November, 2002  
 December, 2008  
 March, 2009  
 April, 2009  
 August, 2009  
 October, 2011

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What is interesting about the above chart is that, in each case, the market never revisited its low point once it decided to move on. Twice now, the current recovery has spooked investors into thinking that we’d re-live those scary days of 2008 and 2009, only to move onward and upward each time. Though no two markets are alike, human psychology never changes much. In great crashes like those above, psychology takes over, just like it does during the subsequent recoveries.

Another positive sign from an historical perspective is the recent abnormally strong 20-day run (gaining 14%) the market has experienced since early October. Since 1950, the S&P 500 has only had a handful of such quick (+14% in about 4 weeks) upward surges (see table at left). On average, the market surged 22% in the next twelve months following such a move, with positive returns 95% of the time.

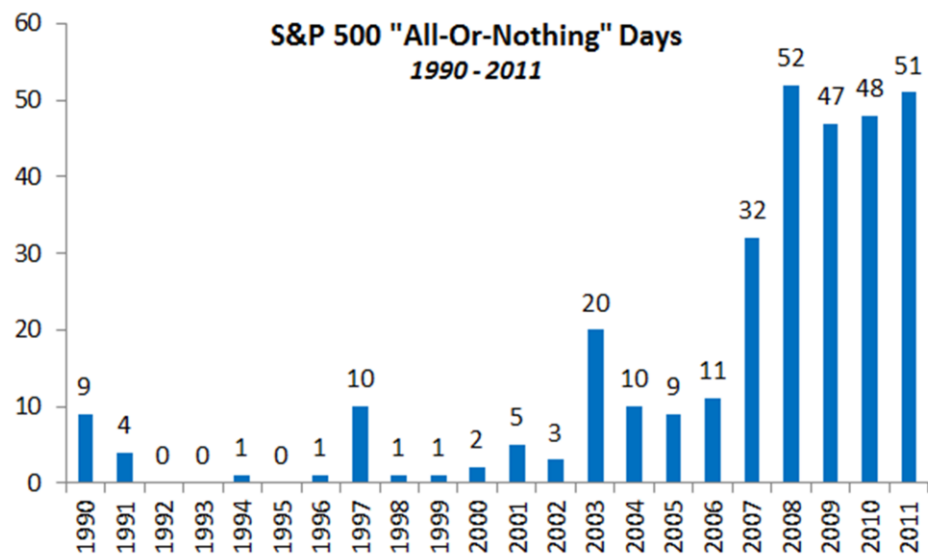
While history can be a good guide, it's not a perfect map. The stock market feels more volatile than it has been in the past; in fact, it's more volatile than ever. One measure of extreme volatility is a measure called "all-or-nothing days." An "all-or-nothing" day is a trading session when the difference between the "gainers" and "losers" in the S&P 500 is plus / minus 400.

The concept of "all-or-nothing days" goes hand-in-hand with the psychological traps of the stock market – if investors are fearful, they'll sell everything; if investors are feeling greedy they'll bid up the price of everything in sight.

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*The record volatility we've seen in the stock market makes a longer-term view that much more important*

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So far in 2011, we've had more "all-or-nothing" days than in the entire DECADE of the 1990s! That kind of volatility is unprecedented, but it just points out the increased importance of keeping your head above the fray and focusing on the longer-term.

Speaking of longer-term, company fundamentals are looking the best that they have in a few years. Third quarter earnings reports are coming in, and so far they are much better than expected. A full 63% of companies are exceeding their earnings targets, while 2/3 are exceeding sales targets. These levels have not been seen in years. On top of that, company balance sheets are their strongest in years, following a period of low rates that has allowed debt refinancings and cheap money for expansions and acquisitions.

It's easy to think that there's no looking back when the stock market has a

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*We remain conservative as uncertainty and volatility will continue to be an issue.*

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nice run; however, we must remember that we aren't quite out of the woods yet. Europe still has plenty of issues, and while the leaders appear to finally "get it," there are a lot of details left to sort out. In the US, surprisingly good macroeconomic data is nice, but we're still not growing very rapidly; we'd feel much better if the economy was set to grow at 4% per year instead of 2%. Also, questions about leadership in Washington will resurface if the budget "Super Committee" doesn't deliver on its promises (and, unfortunately, this looks to be a possibility more and more these days). Because these issues will cause more volatility and uncertainty, we remain conservative in our asset allocations and continue to troll the market for high-quality, dividend paying stocks that offer strong balance sheets and good growth potential. We still favor high-quality corporate bonds over US Treasuries.

## FOR OUR CLIENT ACCOUNTS CUSTODIED AT CHARLES SCHWAB

The recent financial crisis spurred new regulations for the securities industry. Many of the new regulations involved account custodians. As a result, this year will be the first time that custodians like Charles Schwab will report cost basis information directly to the Internal Revenue Service, as well as to the taxpayer. For the 2011 tax year, account custodians will report cost basis for equities (aka "covered" securities) acquired on or after 1/1/2011. Next year, custodians will repost cost basis on mutual funds, exchange-traded funds, and dividend reinvestment plan shares acquired on or after 1/1/2012.

In order to make things easier for clients, Schwab has redesigned its Form 1099 Composite to include cost basis and gain / loss information. Now the Year-End Summary, Form 1099-B, and other 1099 forms you might receive will be consolidated into one report, which will indicate cost basis information for both "covered" and uncovered securities. Please note that cost basis will be reported by the custodian to the IRS only for "covered" securities, but Schwab is providing cost basis on uncovered securities as well (you are still required to include this information on your tax return). On the new statement, uncovered securities will have an "X" next to the cost basis. Also, investment management fees will be summarized on the new form. If you have any questions, please contact us and we will be happy to walk you through these changes.