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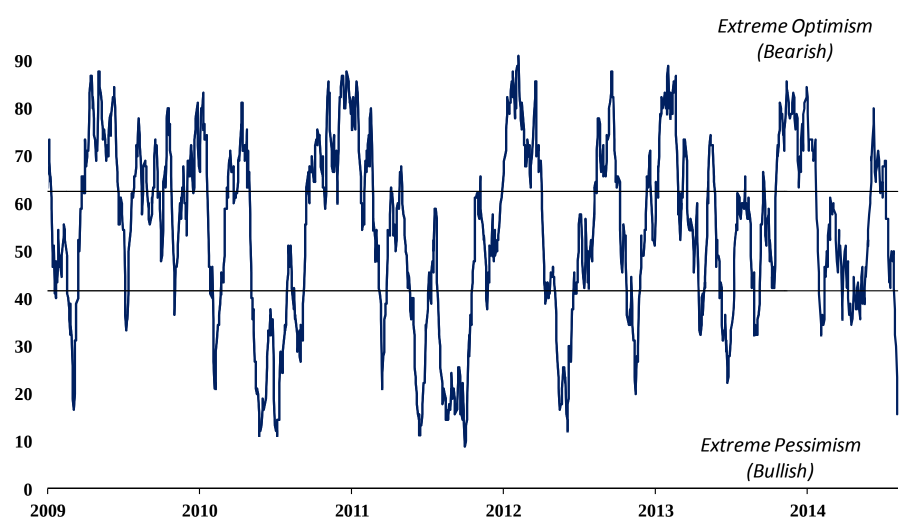
With the crowd at a negative extreme, our momentum indicators suggesting odds of stocks being higher over the coming months, and second-quarter earnings coming in better than expected with potential for third-quarter earnings to be revised upwards, we remain bullish.

Playing the Odds; We See a Buying Opportunity

The S&P 500 was almost unchanged last week following the previous week's worst weekly decline in more than two years, as increasing geopolitical tensions unnerved investors. It is currently 2.85% off its July 24 record high. We think this pullback is setting up a buying opportunity for stocks. Second-quarter earnings have been better than expected, data continues to suggest economic growth, and crowd sentiment has reached a pessimistic extreme. We do not expect double-digit gains for the S&P 500 this year; rather, based on our Price Matters® analysis, we expect real growth to center around the long-term trend of 6.5%. For any further declines, our first level of expected technical support is 1869, a 6% decline from the high. This would be about the same magnitude as the two biggest pullbacks since November 2012: in June 2013, following Ben Bernanke's introduction of the concept of tapering the Fed's bond purchases; and February 2014, following the start of the Fed's tapering. We see the next level of support around 1850 (support in February and March, roughly the 200-day moving average and the 23% retracement of the November 2012 through July 2014 rally).

NDR Daily Crowd Sentiment Poll



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Sentiment for stocks reached a pessimistic extreme last week, based on Ned Davis Research's Crowd Sentiment Poll hitting 16% bullish (see chart above). Since 1980, this condition has occurred 20 times while the primary trend (we use the 200-day moving average) has been positive, as it currently is. Under these conditions, the odds of the S&P 500 being higher over the subsequent three month were about 80%, 13 percentage points higher than the S&P 500's odds for all periods. Furthermore, average returns were about three percentage points better than the overall average for the S&P 500. We calculate similarly favorable odds for the S&P 500's subsequent three-month performance based on the behavior of our momentum indicators – the Relative Strength Index (RSI) fell to the low 30s last week while the primary trend's slope was around 20% on a one-month annualized basis. *Past performance is no guarantee of future results.*

THE WEEKLY CHART: BEST EARNINGS SURPRISE IN 13 QUARTERS

S&P 500 Earnings Surprise

Actual QEPS vs estimate 6 months prior to report date

	Q2 2011	Q3 2011	Q4 2011	Q1 2012	Q2 2012	Q3 2012	Q4 2012	Q1 2013	Q2 2013	Q3 2013	Q4 2013	Q1 2014	Q2 2014*
% Above Estimates	44.6%	45.3%	43.5%	46.0%	31.9%	34.8%	44.3%	48.5%	49.4%	49.9%	47.1%	48.8%	**53.8%**
Median Positive Surprise	14.7%	12.1%	16.4%	18.5%	14.0%	10.8%	21.6%	8.3%	8.7%	6.7%	7.6%	9.3%	6.5%
Median Negative Surprise	-14.0%	-12.0%	-16.2%	-20.0%	-15.3%	-17.2%	-16.4%	-8.4%	-9.0%	-8.4%	-7.6%	-8.6%	-5.9%

*companies reported: 424

S&P 500 Sales Surprise

Actual Quarterly Sales Versus Estimate 6 Months Prior To Report Date

	Q2 2012	Q3 2012	Q4 2012	Q1 2013	Q2 2013	Q3 2013	Q4 2013	Q1 2014	Q2 2014*
% Above Estimates	28.7%	29.1%	34.3%	36.6%	40.4%	35.0%	46.1%	41.0%	**50.1%**
Median Positive Surprise	5.5%	3.6%	7.3%	3.2%	3.3%	2.6%	2.6%	3.2%	3.3%
Median Negative Surprise	-6.3%	-5.2%	-8.0%	-3.2%	-3.0%	-3.0%	-2.8%	-2.8%	-2.5%

*companies reported: 421

Source: RiverFront Investment Group, FactSet Research Systems

We have long been uncomfortable with the traditional way Wall Street measures earnings surprises. Analysts typically adjust their quarterly estimate – with the company's guidance – up until the day before a company reports actual earnings. This usually allows companies to beat consensus analyst estimates and declare great results, even if the company beats the estimates by just a few pennies. Thus, 70% of companies are 'beating' their second-quarter estimates and the percentage of 'beats' has mostly ranged between 60% and 75% for the past ten years, according to Bloomberg.

We prefer to compare a company's actual earnings with the consensus estimate six months prior to the reporting date. We think this way of comparing actuals with estimates provides more realistic measure of 'surprises.' By this measure, with 85% of companies having reported earnings, 53.8% of the S&P 500's companies beat their second quarter earnings estimates, the best results in 13 quarters, as shown in the top table. Furthermore, the median positive surprise of 6.5% and the median negative surprise of -2.5% are the smallest misses in 13 quarters. We also see the greatest amount of companies beating their six-month-prior estimate for sales in nine quarters, as shown in the bottom table.

With most of the companies having reported, second quarter S&P 500 earnings are up 11.2% year over year, compared to an estimate of 5.3% as of the end of June. Second-quarter earnings are $117 and ISI Group points out that because this is higher than the third-quarter estimate of $116 and earnings seem unlikely to decline, third-quarter estimates will likely be revised higher.

In conclusion, with the crowd at a negative extreme, our momentum indicators suggesting odds of stocks being higher over the coming months, and second-quarter earnings coming in better than expected with potential for third-quarter earnings to be revised upwards, we remain bullish.