From right to left:

Rod Smyth
CHIEF INVESTMENT STRATEGIST

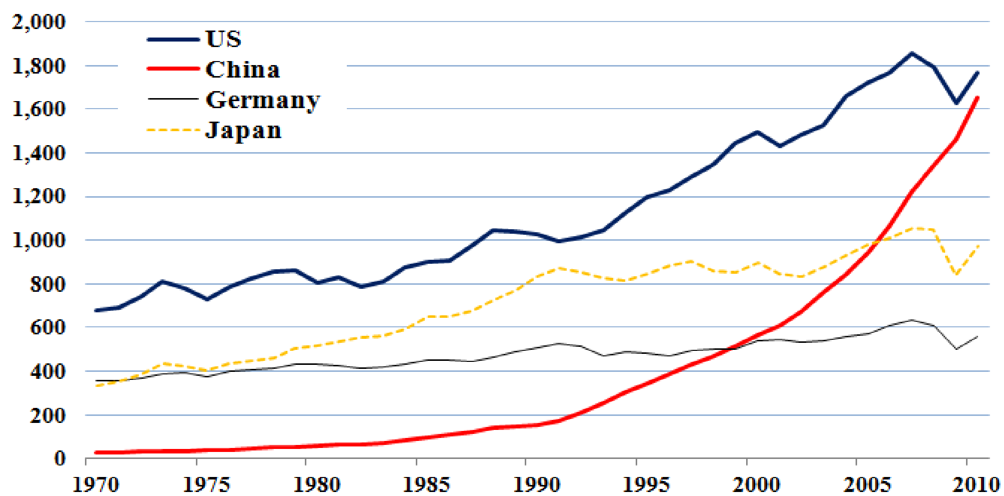
Bill Ryder, CFA, CMT
DIRECTOR OF QUANTITATIVE STRATEGY

Ken Liu
GLOBAL MACRO STRATEGIST

Rally Mature, but Cyclical Bull not Over

- We recently raised our S&P 500 trading range to 1250 –1500 for the rest of the year (see *The Weekly View* 2/6/12). At Friday's close of 1361, we therefore believe stocks have further upside this year. From the October 3rd low of 1100, the S&P 500 has finally returned to last April's high, a volatile round trip that has driven many investors to the perceived safety of bonds. Following significant volatility right through the end of the year, stocks' rally since Christmas has been remarkably steady and eerily similar to the same period last year. We expect the very flat primary trend (the 200-day moving average is our proxy) to turn back up, justified by improving economic fundamentals in the US and a reduction in investor fear regarding both Europe and China.

Manufacturing Output (Billions US$)

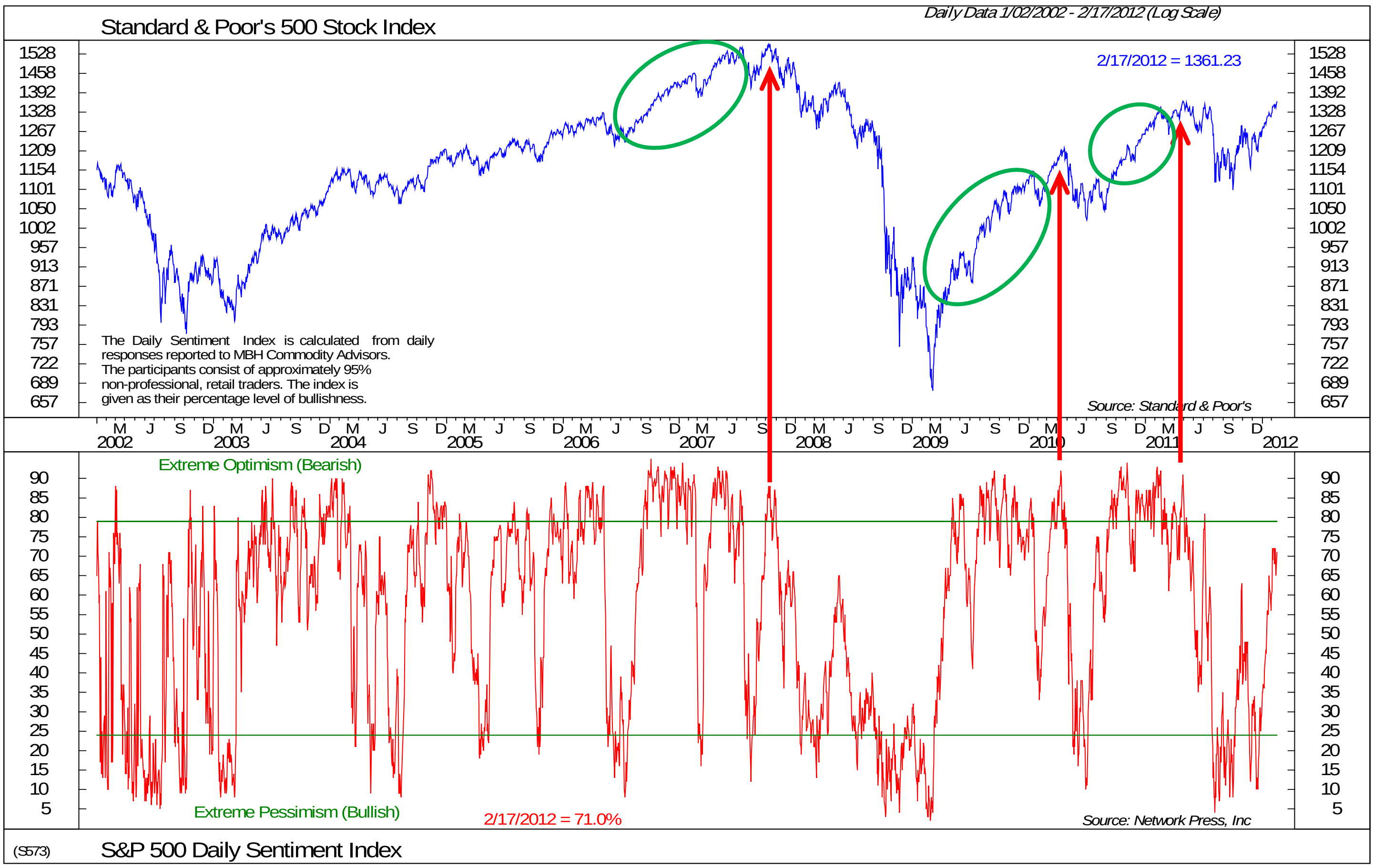


Source: RiverFront, United Nations

- Following up on our discussion last week on the revival in US manufacturing, the chart above shows that the US is still the world's largest manufacturer. This speaks to the tremendous growth in manufacturing productivity, i.e. the growth in the amount of output from each American worker. We would also point out that since 1990, the US has significantly stretched its lead on both Germany and Japan, the latter's rise during the 1970s and 80s having stalled since 1990, when China's extraordinary transformation into a manufacturing powerhouse began in earnest. Note that the latest US upturn is one of the strongest and how the law of large numbers will require China to consume more of its output.

- The NDR Crowd Sentiment Poll, our preferred short term sentiment measure, has now risen to extreme optimism. Other measures, such as the one below are not quite there. Based on the last ten years, the current level of optimism is consistent with a bull market that has resumed, and suggests stocks will likely break above last year's high in the coming months. However, extreme optimism implies that the rally from the October lows should be considered 'mature,' i.e. the pace may become more labored as investors are less easily impressed by good news and traders with profits from recent purchases are more likely to quickly sell on any bad news.

THE WEEKLY CHART: RALLY IS MATURE BUT LIKELY NOT OVER



Past performance no guarantee of future results

The S&P 500 Daily Sentiment Index in the bottom panel of the chart above closely tracks NDR's Crowd Sentiment Poll and highlights the rise in sentiment from extreme pessimism last October to current levels of optimism. Sentiment has some room to rise higher and can remain high for weeks at a time during a bull market (green circles). **However, since significant pullbacks almost always begin when the crowd is extremely optimistic (red arrows), sentiment is no longer supportive for stocks. Following the S&P 500's 24% rise from its early October low, where sentiment swung from 10% to 71% bullish on the chart above, we are inclined to wait for a pullback to add exposure to our generally benchmark equity weightings.**