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Bulls of March Look Set to Trade in Their Horns

Those Who Called Bottom in March Say Prices Look Overvalued

By MARK GONGLOFF

It feels good to be right. But the few analysts who accurately called the market's bottom in early March aren't feeling so great about where stocks are headed.

One of the most famous of this group, Jeremy Grantham, penned a note on March 10 entitled "Reinvesting When Terrified" that encouraged investors to buy, suggesting stocks were 30% undervalued.

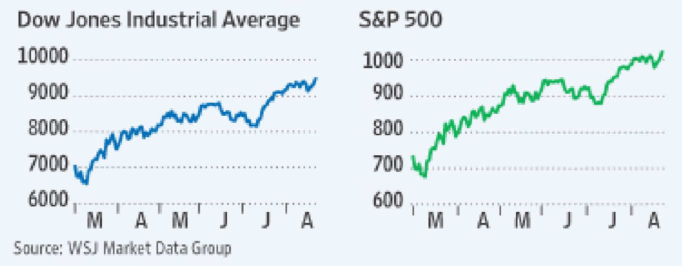
Since then, the market has roared ahead, without stopping for a correction of 10% or more. Standard & Poor's 500-share index ended last week at 1026.13, up nearly 52% from its 12½-year low on March 9 and its highest close since Oct. 6. The Dow Jones Industrial Average is at 9505.96, up 45% since its March low.

Now, the chairman of Boston asset-management firm GMO and his colleagues say the S&P 500 has zoomed right past what they consider fair value of about 880, based on earnings estimates and historical price-to-earnings ratios.

Mr. Grantham sees "seven lean years" of a sluggish market ahead, to atone for what the firm believes was a long era of overpriced stocks, according to his newsletter.

"The past 12 years have seen two bubbles that were really good for corporate profits," says Ben Inker, GMO's director of asset allocation. "Now things are unlikely to be anywhere near as good as people have gotten used to, because we're not going to have a bubble to help us."

Several other analysts who got it right in March say they aren't roaring bulls about the long-term outlook, although their views for the next 12 months are split.



In March, analysts who picked the bottom were a lonely lot. Panic was widespread, and previously bullish analysts were advising clients to stay out of the market. Yet rather than double down on their bearish take, some long-time market skeptics decided a bottom was near.

One who shifted gears, Michael Darda, chief economist at brokerage firm MKM Partners in Greenwich, Conn., is optimistic about stocks' prospects for next year. But he harbors doubts about stocks' ability to eke out gains past 2010.

On Feb. 24, after months of advising clients to invest defensively, Mr. Darda released a note entitled "Getting More Constructive," in which he said, "Several indicators that caused us to go bearish on equities last summer have recently improved."

Though he now suggests the market could be due for a pause after its breakneck rally, Mr. Darda says he believes the economic recovery will be more robust than most investors expect, driving the S&P 500 to 1200 or 1300 next year.

"The depth of the recession, the turn in leading economic indicators and the shift in credit markets, which has been pretty dramatic, lead us to an above-consensus view on GDP and earnings, in line with our stock-market target," he says.

Beyond 2010, the outlook may not be so sunny given the prospect of Federal Reserve monetary tightening, the potential for higher tax rates as a result of swollen government budget deficits and other headwinds.

Other analysts are glummer about the near-term outlook.

Among them is Vinny Catalano, chief investment strategist at Blue Marble Research. After months in the bear camp, Mr. Catalano on March 5 published a piece on the Minyanville Web site titled "Bears Out of Momentum," in which he identified what he called "the first signs of a cyclical bullish scenario."

Like Mr. Grantham, Mr. Catalano now thinks stocks are slightly overvalued. He thinks the S&P's fair value is closer to 945, based on earnings estimates and traditional P/E ratios, and could retreat to that point, or lower, in a hurry, possibly as soon as autumn.

The last time market indicators were flagging a market move this consistently, he says, was early March. Of some comfort to the bulls, Mr. Catalano doesn't expect a retest of the March lows; at most, he sees a correction of about 10%.

He has company from former newsletter publisher Peter Grandich. On March 6, Mr. Grandich, now the chief commentator for Canadian online investment community Agoracom, put out a note entitled "Bye, Bye Permabear Camp -- It's Been Great!" After 18 months of "feasting on bull meat," he turned slightly more positive.

"I no longer believe it's worthy to sell rallies and one should now look to buy declines," he wrote at the time.

Mr. Grandich now thinks the Dow is likely to stall roughly at 10500. While that would be a gain of about 10% from here, foreign markets offer more juice, he says, given that they have less of a debt overhang than the U.S. does.

He also doesn't expect a retreat to March lows, but says he thinks headwinds from an aging population that will pull money out of stocks, lost wealth and household debt will keep stocks in a rut in the coming years, churning between the March lows and the pre-Lehman highs.

Like all of the analysts who got the March call right, Mr. Grandich warns that past performance is no guarantee of future results.

"Those of us that live by looking in a crystal ball," he says, "learn to eat a lot of broken glass."

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