

THE RETURN TO LARGE CAPS

Why these stocks are looking attractive again to high net worth investors.

Presented by Glazer Financial Network

Large caps have kept up with small caps this year. 2010 was a great year for small stocks - the Russell 2000 advanced 25.31% while the S&P 500 returned 12.78% (15.06% including dividends). This year, the story may be different: when the market closed on March 4, the Russell 2000 was +5.28% YTD and the S&P 500 +5.05% YTD.^{1,2,3,4}

The 4Q earnings on the large caps were very encouraging. In fact, companies in the S&P 500 have beaten 4Q earnings estimates by an average of 7.3%. Firms in the S&P SmallCap 600 Index have beaten their earnings estimates by an average of 4.9%.⁵

Investors are taking notice. Data from Morningstar Inc. shows a January inflow of \$5.2 billion into mutual funds investing in the biggest U.S. companies. Compare that to an outflow of \$13 billion in December 2010.⁶

In February, the Spectrem Group (a financial services industry consulting firm) took a survey and found that a majority of the respondents with investable assets in the range of \$5-\$25 million said they would probably buy stocks this year. That doesn't sound like 2010, when investors pulled more than \$77 billion out of large-cap funds.⁶

Are these stocks overdue? That is what some Wall Street strategists think, looking at small-cap valuation versus large-cap valuation. On February 23, the Russell 2000 had a price-earnings ratio of 31 while the S&P 100 had a P-E ratio of 14. At the close on March 4, the forward P-E ratio for the Russell was rounding up to 22, while the forward P-E ratio for the S&P 500 was below 14.^{6,7}

This year, we have seen something of a selloff in the emerging markets thanks to China raising interest rates and other factors (a popular barometer, the MSCI Emerging Markets Index, was down 1.78% YTD as of March 4). These developments may be attracting investors back to large caps, and to some investors who have watched the stock market for decades, some of the large caps may appear as cheap as they are ever going to get, or close.⁸

A "great rotation" may be taking place. Even with unrest in the Middle East adding volatility on Wall Street and attracting investors toward hard assets, a trend may be underway. Bank of America Merrill Lynch analysts have termed it "The Great Rotation" - a global movement away from certain commodities, bonds, money market funds and emerging market stocks toward developed-market large cap equities that may benefit from "a normalization of economic growth, interest rates and asset allocation." Perhaps the large caps will take the lead in 2011.⁹

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