CHART OF THE MONTH

NOVEMBER 2013

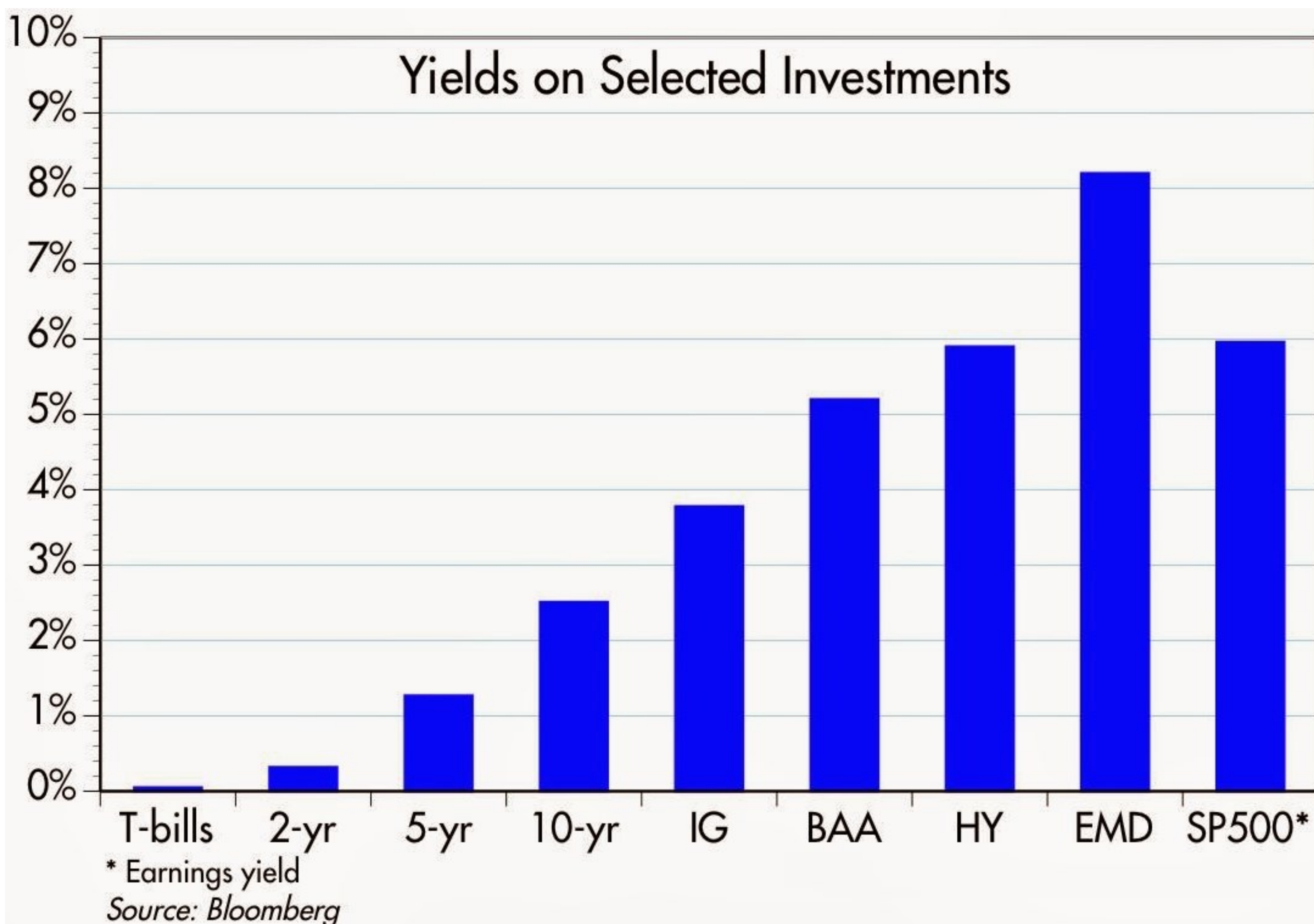
As shown in the bar chart below, risk-based assets remain attractive versus U.S. Treasury Bills and Notes. The yields on lower investment-grade (BAA) and high-yield (HY) corporate bonds, emerging market debt (EMD), and stocks (S&P 500) are significantly higher than those on short- to intermediate-term governments, which range from essentially zero on cash to 2.75% on 10-year maturities.

With respect to the S&P 500, the earnings yield is defined as the last 12-months EPS ($107.55) divided by the index price (1771). It is also the reciprocal of the price-earnings ratio. A 6% earnings yield equates to a P/E of 16.7. Of note, the earnings yield rises to nearly 7% and the P/E falls to 14.5 based on the consensus EPS projection of roughly $122 for 2014.

Stocks are either wildly undervalued relative to government bonds or U.S. Treasury Notes are substantially overvalued compared to equities. While the truth probably lies somewhere between these two extremes, we are predisposed toward stocks given the improving fundamentals, reasonable valuations, ultra-easy monetary policy, and historically favorable seasonal factors.

Absent an unforeseen geopolitical event, we believe stocks are more likely to melt *up* than *down* over the next six months. We will turn more cautious and take profits without hesitation if stocks explode to the upside. Otherwise, we continue to maintain that prices will grind higher, albeit with intermittent corrections along the way, until the next recession.

Meanwhile, the most recent economic reports have been beating expectations. Gross Domestic Product grew at an annual rate of 2.8% in the third quarter and employers added over 200,000 employees to their payrolls in October. Add it all up and there is little not to like at this time.



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