Market Update
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We can now look back through the lens of fourth quarter earnings season to see 2012 as a year defined by loud concerns and quiet incremental gains. U.S. companies collectively retained more earnings for shareholders last year than ever before. It may not have felt like a record breaker, but the numbers tell us S&P 500 companies produced 2012 operating earnings slightly higher than the record breaking earnings of 2011.

Fourth quarter profits helped push us over the top amidst economic growth at year end that was essentially flat. Markets remained stable because slow growth has remained the prevailing expectation for many quarters and it tends not to be greeted by investors as a surprise.

Looking ahead, earnings estimates for the S&P 500 in 2013 seem fairly rosy at $111.21 for the full year, which provides a PE ratio around 13.7 and an earnings yield of about 7.3 percent at current levels. Compare this to $96.99, 14.46 and 6.91 percent, respectively, at the end of 2012 for estimated earnings growth over 14 percent.

The S&P 500 earnings yield, which is calculated by taking operating earnings (profits) divided by the current price (S&P 500 level), has historically averaged between 6 and 6.5 percent.

We expect 2013 to mimic 2012 in the sense that earnings expectations are overstated and guidance will be lowered slightly each quarter. There should still be enough room to eke out growth for the full year.

Could we get derailed on our path to another record year? Absolutely. But even the lack of resolution to the sequestration standoff has failed to rattle markets decisively, which can be taken as a sign that we enjoy sound footing at the moment.

The U.S. equity market experiences an average of 1 or 2 corrections in the 10 percent range every year. There were 2 in 2011, 1 last year and we are prepared for the likelihood that our next pullback will occur in 2013.

We cannot predict market events with any certainty, but a correction in 2013 would be considered a normal occurrence. In fact, a 10 percent pullback may even represent an opportunity to put free cash to work as long as market fundamentals remain attractive.

For the short term, however, the trend is favorable for stockholders. Cash flows into equity funds turned positive recently for the first time in five years, representing a key tailwind for stocks. Investors may finally recognize that slow growth is still growth and that companies remain able to increase profits at these levels. Barring a large change to current fundamentals, we expect 2013 to be another quiet, record breaking year.