As stock market soars, financial advisers batten down the hatches

String of negative earnings don't support stock price valuations

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By **Jeff Benjamin**

As the S&P 500 Index notched another record high shortly after the stock market opened for trading Monday, financial advisers were doubling down on calls to proceed with caution.

The index, which is up 5.5% from the start of the year, stands in stark contrast to corporate earnings, which are expected to show a fourth consecutive quarterly decline on a year-over-year basis.

Despite the **general euphoria surrounding a rising stock market**, a lot of financial advisers are focused on the less rosy bigger picture.

"It's amazing that stocks are at these record levels, but with all the negative earnings coming in, it doesn't make sense, because at some point there will have to be a reversion to the mean," said Ed Butowsky, managing partner at Chapwood Capital Investment Management.

Second-quarter **earnings season** officially kicks off after the stock market closes Monday, with reporting by Alcoa Inc. (AA).

Some sectors, including consumer discretionary, health care, industrials and utilities, are expected to show earnings growth, but the outlook for the S&P overall is for a year-over-year earnings decline of 5.31%.

“Just because stock prices are going higher doesn't mean you continue to ignore the valuations,” said Mr. Butowsky, who recommends cutting equity market exposure by 20% as a defensive strategy.

Brian Koslow, president of Clarus Financial, is concerned that the market has become “very complacent, and we're seeing investors overextend on the risk side.

“I'm growing very cautious of the market at these levels,” he said. “Investors are chasing yield without giving much thought to the risk profile of higher yielding investments. In the end, corporate earnings are the thing that will drive stock prices.”

Mr. Koslow's defensive strategy involves raising cash levels and buying index puts for clients that are qualified for options trading. For clients who can't or won't use options, he's allocating to the **iPath S&P 500 Futures ETN (VXX)**, an exchange-traded note that acts as a hedge against falling stock prices.

He also has become more focused on the trading of individual securities to try to flesh out the winners and losers in the broader indexes.

Kashif Ahmed, president of American Private Wealth, said the disconnect between earnings and stock prices involves too much emphasis on prices by the “media and financial punditry.”

“This will serve to lure in amateur investors, who are quick to get in and just as irrational to try to get out,” he said. “This irrational behavior and the fact that those realities will eventually dawn on the broader investing public will likely lead to potential pullbacks and enhanced volatility.”

The string of negative quarters proves that **most investors are not paying attention to investment fundamentals**, according to Kristi Sullivan, owner of Sullivan Financial Planning.

“Four straight quarters of negative corporate earnings seems like a bad thing,” she said. “But it is possible that the stock market reacts in no predictable way to news, numbers or prognostications.”

The reality of the disconnect between stock prices and negative earnings “should concern every financial adviser,” said Rose Swanger, principal at Advise Financial.

“Unless you're a long-term investor who has taken advantage of the past market dips, this is not an ideal buy-and-hold environment for near-retirees,” she said. “The overpriced equity market in conjunction with the negative earnings create uncertainty and volatility. And this is where advisers can add value.”