March Quarter Foreshadows Strong 2012 Investment Returns

With the completion of the March quarter, we might know more about 2012 equity market returns than we realise.

A 12% gain in the S&P 500 stock price index has been widely reported in the financial press as the best start to a calendar year in the US market since 1998.

The finance sector has led the gains after being sold down heavily following the 2008 credit crisis. Improved U.S. economic conditions have helped a change in perception. Some switching amongst international investors from even more parlously positioned European banks has also helped restore US bank market values.

Technology shares have performed strongly with the Apple share price topping $600 and component supplying companies benefiting from Apple's outstanding track record for innovation. Some social media shares have been reminiscent of pre-2000 technology returns. Expectations of business loosening the purse strings to spend on productivity boosting technology have also helped share prices.

The third best performing segment of the S&P 500 - consumer discretionary stocks - is also symptomatic of some greater optimism about the state of the US economy.

US market gains have recently shown a tendency to peter out as the year progresses. Nonetheless, the unusually strong start sets up 2012 for potentially more gains, according to the history of the US market.

In the 60 years or so since 1950, the S&P 500 has risen by more than 7% in the March quarter on 13 occasions prior to this year.

The eventual average gain for the full calendar year in those 13 years was 23%. None of the 13 years had a negative return. Every year but one had a higher full year return than the March quarter price increase.

The exception to this was 1987, arguably the most traumatising market experience since the great depression up to then.

The Australian market displays a remarkably similar pattern to this almost incredible sequence of returns from the S&P 500.

The gain in the Australian All Ordinaries share price index in the March quarter this year was 7.5%. There have been 11 years since 1959 in which the index has risen by more than 7% in the March quarter. The average gain in the related 11 calendar years was 23%.

In the Australian case, there were two years in which the outcome for the year fell short of the first quarter rise. It happened in 1974 and, unsurprisingly, in 1987. In both these years, the Australian market fell: 31% in 1974 and 10% in 1987.

The resources segment of the Australian market has proven slightly less reliable in following through on early year starts but also shows a clear bias to the upside once the first quarter sets the direction.

Resource sector shares have not performed as well in 2012 as the industrial part of the market. The S&P/ASX 200 resources index has risen 5.8%.

Since 1959, there have been 21 occasions in which the resources market has risen by more than 5% in the first quarter of the year. The average full year gain following this first quarter result has been 31%.

There were five years over this 50 year stretch, including 1974 and 1987, in which a 5% plus first quarter was followed by negative full year returns. The last of these was in 1987.

Since 1987, there has not been a single year in which the sector has shown a negative result after a 5% plus first quarter outcome (of which there have been eight) and the average gain in these years has been 34%.

What does this mean for 2012? Perhaps, nothing since, as we are constantly told, past results have no bearing on future outcomes.

That said, the tendency for investors to extrapolate their most recent experiences when forecasting future outcomes is a well established phenomenon. If the most recent experience has been a positive one, expectations will be rosier and the preparedness to incur risk slightly greater. To that extent, a solid first quarter might be an important ingredient in a positive outcome for the full year.

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