Exhibit No.:	
Issue:	*Rate of Return*
Witness:	*Shana Atkinson*
Sponsoring Party:	*MoPSC Staff*
Type of Exhibit:	*Rebuttal Testimony*
Case No.:	*ER-2011-0004*
Date Testimony Prepared:	*April 18, 2011*

MISSOURI PUBLIC SERVICE COMMISSION

UTILITY SERVICES DIVISION

REBUTTAL TESTIMONY

OF

SHANA ATKINSON

THE EMPIRE DISTRICT ELECTRIC COMPANY

FILE NO. ER-2011-0004

Jefferson City, Missouri
April 2011

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3 **SHANA ATKINSON**

4 **THE EMPIRE DISTRICT ELECTRIC COMPANY**

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1 **REBUTTAL TESTIMONY**

2 **OF**

3 **SHANA ATKINSON**

4 **THE EMPIRE DISTRICT ELECTRIC COMPANY**

5 **CASE NO. ER-2011-0004**

6 Q. Please state your name.

7 A. My name is Shana Atkinson.

8 Q. Are you the same Shana Atkinson who prepared Section V, Rate of Return,
9 of the Staff's Cost of Service Report ("COS Report") filed in this proceeding on
10 February 23, 2011?

11 A. Yes, I am.

12 Q. What is the purpose of your rebuttal testimony?

13 A. The purpose of my rebuttal testimony is to respond to the direct testimony of
14 Dr. James H. Vander Weide. Dr. Vander Weide sponsored rate-of-return ("ROR") testimony
15 in this proceeding on behalf of The Empire District Electric Company ("Empire").

16 **<u>EXECUTIVE SUMMARY OF REBUTTAL TESTIMONY</u>**

17 Q. Please summarize your rebuttal testimony.

18 A. I will critique Dr. Vander Weide's comparable groups, his exclusive use of
19 projected earnings growth rates for purposes of calculating his constant-growth discounted
20 cash flow (DCF) analysis and his use of forecasted yields. I will also update Dr. Vander
21 Weide's DCF analyses with more current stock prices and growth rates.

1 **DR. VANDER WEIDE'S COST OF COMMON EQUITY FOR EMPIRE**

2 Q. Please summarize Dr. Vander Weide's recommended cost of common equity
3 for Empire in this case.

4 A. Dr. Vander Weide's recommended cost of common equity of 10.6 percent is
5 based on five cost of common equity estimation methods: (1) DCF; (2) ex ante risk
6 premium; (3) the ex post risk premium; (4) historical capital asset pricing model ("CAPM");
7 and (5) DCF-Based CAPM. Dr. Vander Weide determined the cost of common equity to be
8 10.5 percent using the DCF method, 10.9 percent using the ex ante risk premium method,
9 10.6 percent using the ex post risk premium method, 9.3 percent using the historical CAPM
10 method and 10.4 percent using the DCF-Based CAPM method. Dr. Vander Weide averaged
11 his two risk premium estimates for a final risk premium estimate of 10.8 percent. Dr. Vander
12 Weide did the same for his CAPM estimates for a final CAPM estimate of 9.8 percent.
13 Dr. Vander Weide's final recommended cost of common equity of 10.6 percent was
14 calculated by taking a simple average of his DCF method (10.5%) and the average of his risk
15 premium methods (10.8%). He did not give any weight to his CAPM estimates in his final
16 recommendation. Dr. Vander Weide also performed a multi-stage DCF cost of common
17 equity analysis but does not give it any weight in his final recommendation. His multi-stage
18 DCF cost of common equity is 10.6 percent.

19 Q. Does Dr. Vander Weide plan on updating his cost of equity estimate in his
20 rebuttal testimony?

21 A. No, according to Empire's response to Staff data request No. 0233.

1 Q. Is there sufficient reason for Dr. Vander Weide to consider an update to his
2 cost of equity estimate in this case due to the fact that he used capital market data through
3 June 2010 for purposes of his direct testimony?

4 A. Yes. As Staff reported in the COS Report, regulated utility stocks performed
5 quite well in the second half of the year. This was due in large part to the decrease in bond
6 yields that occurred over these months. This information, while not available to Dr. Vander
7 Weide at the time he filed his testimony, is now available and worthy of consideration.

8 Q. Has Dr. Vander Weide updated his cost of equity estimate in any
9 previous cases?

10 A. Yes. He updated his cost of equity estimate in a previous Empire rate case,
11 Case No. ER-2006-0315.

12 Q. Based on Dr. Vander Weide's criteria for his proxy group, page 27 lines 10
13 through 16 of his direct testimony, would any companies be eliminated from Dr. Vander
14 Weide's proxy group if he updated his testimony?

15 A. Yes. Duke Energy ("Duke"), Northeast Utilities, NSTAR, and Progress
16 Energy ("Progress") would be eliminated because they have each announced possible
17 mergers after Dr. Vander Weide filed his testimony in September 2010. Northeast plans to
18 merge with NSTAR. Duke plans to merge with Progress.

19 Q. Would Dr. Vander Weide's DCF results be different if he updated his
20 testimony using more recent data?

21 A. Yes.

22 Q. What data would need to be updated to provide a more recent DCF cost of
23 equity estimate?

1 A. Stock prices, dividends, growth rates and the proxy group.

2 Q. Did you perform analyses of what the results might be if Dr. Vander Weide
3 had updated his DCF analyses in this case?

4 A. Yes. However, I performed these analyses only for the purpose of this
5 rebuttal testimony. The Staff is not changing its rate of return recommendations in this
6 proceeding from that which I sponsored in the February 2011 COS Report.

7 Q. What stock prices did you use in the update?

8 A. A three month average of the high and low stock prices of December 2010,
9 and January and February, 2011.

10 Q. As of what date did you research updated five-year EPS growth rates?

11 A. March 16, 2011, using Reuters.

12 Q. What dividends did you use in your update of Dr. Vander Weide's analysis?

13 A. The dividends for the most recent last four quarters for the constant growth
14 DCF and the annual 2010 dividend for the multi-stage DCF.

15 Q. Did you eliminate the aforementioned companies that announced
16 possible mergers?

17 A. Yes.

18 Q. What are the results of your update of Dr. Vander Weide's DCF and multi-
19 stage DCF?

20 A. His constant-growth DCF cost of equity result would be 10% and his multi-
21 stage DCF result would be 9.89%.

22 Q. Why did Staff only update Dr. Vander Weide's DCF analyses, and not his
23 other cost-of-common equity analyses?

1 A. Staff updated Dr. Vander Weide's constant-growth DCF and multi-stage DCF
2 analyses because Staff believes the DCF methodology is the most reliable method available
3 for estimating a utility company's cost of common equity. The DCF methodology analyzes
4 data specifically related to current common stock prices and expected growth rates associated
5 with the proxy group.
6 Q. Dr. Vander Weide uses forecasted yields in his risk premium and CAPM
7 methods. Does Staff believe it is appropriate to base a risk premium and CAPM cost of
8 equity estimate on projected yields?
9 A. No. In this case, using projected yields overstates the current cost of equity
10 capital. Basing risk premium cost of equity estimates on projected bond yields is similar to
11 basing a DCF estimated cost of equity on projected stock prices. Dr. Vander Weide did not
12 use projected stock prices in his DCF analysis because current stock prices reflect investors'
13 expectations regarding changes in interest rates as well as company-specific risks. Current
14 bond prices, and therefore current bond yields, reflect investors' expectations concerning
15 future interest rates. Therefore, the current yield does not need to be adjusted.
16 Q. What would Dr. Vander Weide's risk premium cost of equity estimates have
17 been if he had used the average yield to maturity on A-rated utility bonds in June 2010, the
18 month that Dr. Vander Weide used for his forecasted yields, rather than projections in
19 this case?
20 A. The average yield to maturity on A-rated utility bonds in June 2010, according
21 to the Mergent Bond Record, was 5.46 percent. If Dr. Vander Weide had used this yield, his
22 estimated risk premium would be 5.10 percent for his ex ante risk premium method. If you
23 add the 5.46 percent to the risk premium of 5.10 percent, the estimate for this method would

1 be 10.56 percent compared to the 10.9 percent estimate using projected yields for the ex ante
2 method. If you add the 5.46 percent to his estimated risk premium of 4.1 to 4.6 percent for
3 his ex post risk premium method, the estimate for this method would be in the range of
4 9.56 to 10.06, with a midpoint of 9.81, compared to the midpoint of 10.6 percent using
5 projected yields for the ex post method.

6 Q. What would Dr. Vander Weide's CAPM estimates have been if he had used
7 the average yield to maturity on 20-year Treasury bonds for June 2010 to estimate the risk
8 free rate for his CAPM methods?

9 A. The average yield to maturity on 20-year Treasury bonds for June 2010,
10 according to the St. Louis Federal Reserve's website, was 3.95 percent. Using 3.95 percent
11 as the risk-free rate in Dr. Vander Weide's Historical CAPM method results in an indicated
12 cost of equity of 8.51 percent. If Dr. Vander Weide had used 3.95 percent for the risk-free
13 rate in his DCF-Based CAPM method, the indicated cost of equity would have been
14 10.10 percent.

15 Q. What is Dr. Vander Weide's estimated risk premium for his DCF-Based
16 CAPM analysis?

17 A. Dr. Vander Weide's estimated risk premium for his DCF-Based CAPM
18 analysis is 8.28 percent.

19 Q. Is Dr. Vander Weide's estimated 8.28 percent risk premium for his
20 DCF-Based CAPM analysis reasonable?

21 A. No. This equity risk premium is far beyond what investment
22 advisors use for purposes of asset and stock valuation analyses. For
23 instance, the following was reported in a recent article in the Wall
24 Street Journal ("WSJ"): As well, the so-called equity risk premium—
25 the extra return investors demand to lure them into stocks and out of
26 the safety of government bonds – remains higher than the historical

> norm. The risk premium moves lower as investors become more comfortable with owning stocks. The 50-year average for the equity risk premium is around 3.5%.
>
> Right now, it is at 5.5% by Bank of America Merrill Lynch's reckoning, an elevated level that suggests investors are still reluctant to move back into stocks.[1]

While Bank of America/Merrill Lynch is valuing stocks and we are estimating the cost of equity for a utility rate case, the goal of estimating a reasonable cost of equity is the same. Therefore, the equity risk premium should not vary due to the purpose for which it is used. Thus, the equity risk premiums estimated in rate cases should not be much different than those used for stock valuation purposes. A market-driven cost of equity estimate is based on market fundamentals, whether the cost of equity is being estimated for a utility rate case or utility stock valuation assessments.

Q. What would Dr. Vander Weide's DCF-Based CAPM results be if he used a risk premium of 5.5 percent?

A. His DCF-Based CAPM results would be 7.69 percent.

Q. Does Dr. Vander Weide incorporate his CAPM results in his recommendation for the cost of equity?

A. No.

Q. Did Dr. Vander Weide incorporate his CAPM results in his recommendation in the last Empire case, Case No. ER-2010-0130?

A. Yes.

[1] Matt Phillips, "Anxiety Lingers Following Dow Rally," *The Wall Street Journal*; March 7, 2011, pp. C1-C2 (see Schedule 1).

1 Q. What would Dr. Vander Weide's indicated cost of equity have been if he
2 incorporated his CAPM results into his overall return on equity ("ROE") recommendation in
3 this case?
4 A. Approximately 10.0 percent, after adjustment of his CAPM and risk premium
5 cost of equity estimates by using actual bond yields rather than projected bond yields.
6 (Average of the following: DCF method - 10.5%, average of risk premium methods -
7 10.185% and average of CAPM methods - 9.305%).
8 Q. Do you believe Staff's adjusted cost of equity estimates using Dr. Vander
9 Weide's proxy group would be a reliable cost of equity estimate for Empire's regulated
10 electric utility operations?
11 A. No. Staff's adjusted results reflect Dr. Vander Weide's constant-growth DCF
12 estimate of 10.5 percent and use of Dr. Vander Weide's proxy group. Again, this analysis
13 was prepared for rebuttal purposes only.
14 Q. What concerns do you have about the companies Dr. Vander Weide selected
15 for his electric utility proxy group for his DCF estimation?
16 A. The Staff believes the objective of selecting a comparable group is to find
17 companies that are as "pure play" as possible. "Pure play" means that the comparable
18 company is confined, as much as possible, to the operation that is the subject of the cost-of-
19 capital study. To meet this objective, Staff only includes companies that have at least 70%
20 electric utility operating revenues and are classified as "Regulated"[2] by the Edison Electric
21 Institute in its comparable group. Dr. Vander Weide does not use a revenue criterion in
22 selecting his comparable companies. According to the March 2011 AUS Monthly Utility

[2] EEI's "Regulated" classification means 80%+ of the company's total assets are regulated.

1 Report, five of Dr. Vander Weide's comparable companies do not receive at least 70 percent
2 of their revenues from electric utility operations. These companies are Nextera Energy,
3 Consolidated Edison, Inc., Dominion Resources, Inc., Exelon Corporation, and SCANA
4 Corporation, which have electric operating revenue of only 69%, 62%, 45%, 59%, and 51%
5 respectively. Also, according to the Edison Electric Institute "Q4 2010 Financial Update",
6 six of Dr. Vander Weide's comparable companies are not classified as "Regulated." Based
7 on this criteria, Staff would eliminate seven of Dr. Vander Weide's twenty comparable
8 companies

9 Q. What growth rate does Dr. Vander Weide use in his DCF analyses?

10 A. Dr. Vander Weide relies exclusively on equity analysts' five-year earnings per
11 share ("EPS") growth forecasts.

12 Q. Please explain why exclusive reliance on analysts' projected five-year EPS
13 growth rates currently produces upwardly biased results.

14 A. The DCF model requires constant and sustainable growth rates. Equity
15 analysts' EPS forecasts are based on nearer-term expectations (five years or less). Such
16 growth rates are not likely to be sustainable if not consistent with long-term industry growth
17 rates, which Staff provided in the COS Report. Dr. Vander Weide's average growth of
18 projected EPS growth rates used in his DCF model is 5.9 percent. Staff does not believe
19 investors would consider an average projected growth of 5.9 percent to be sustainable in the
20 long term. This 5.9 percent is not sustainable due to the fact that it is higher than long-term
21 projected economic growth rates provided by the Congressional Budget Office (4.4 percent
22 for 2017 through 2021). It is also higher than long-term realized growth rates in the electric
23 utility industry for the period 1968 through 1999.

1 Q. On page 30, lines 13 through 15 of his direct testimony, Dr. Vander Weide
2 states the following about using a multi-stage DCF method: "I believe they should be used
3 only when there is incontrovertible evidence that the results of the single stage model are less
4 reliable. I am unaware of such evidence for my proxy companies." What evidence shows
5 that the single-stage DCF model is less reliable for Dr. Vander Weide's proxy group?

6 A. The growth rates Dr. Vander Weide uses in his single stage DCF model have
7 a wide variance. For example, in his proxy group Exelon has the lowest projected EPS
8 growth rate of 1.52% and Alliant Energy has the highest of 9.93%. This wide range of
9 projected 5-year EPS growth rates does not produce a reasonable perpetual growth rate in his
10 constant growth DCF estimation. Although the average growth rate of his proxy group is
11 5.9 percent, this wide variance illustrates that many of his companies are not in a "steady-
12 state" growth pattern.

13 Q. What perpetual growth rate did Dr. Vander Weide use in his multi stage
14 DCF analysis?

15 A. He used a long term GDP growth forecast of 4.82 percent used by the Energy
16 Information Administration ("EIA") for the years 2015 to 2030 based on EIA's Reference
17 Case study of their *Annual Energy Outlook 2010.* Dr. Vander Weide did not use EIA's
18 overall GDP growth forecast, he chose to only use the long term GDP growth forecast for the
19 years 2015 to 2030, but EIA's forecast included the years 2008 to 2035.

20 Q. What is EIA's long term GDP growth forecast according to their Reference
21 Case study of their *Annual Energy Outlook 2010* (years 2008-2035) and their *Annual Energy*
22 *Outlook 2011* (years 2009-2035)?

1 A. The *Annual Energy Outlook 2010* (years 2008-2035) Reference Case Study
2 presents a long term GDP growth forecast of 4.43 percent and the *Annual Energy Outlook*
3 2011 (years 2009-2035) presents a long term GDP growth forecast of 4.56 percent.
4 Q. What would Dr. Vander Weide's updated multi-stage DCF analysis result be
5 if he used a 4.5 percent perpetual growth rate, with updated stock prices, dividends and
6 eliminating the companies involved in mergers from his proxy group?
7 A. Dr. Vander Weide's result would be 9.69 percent
8 Q. What did Staff's independent analysis of the Value Line Central Region
9 companies indicate about the actual long term average industry growth?
10 A. Staff's analysis indicated that the long-term average industry growth rate
11 ranged from 3.18 percent to 3.99 percent.
12 Q. What would Dr. Vander Weide's updated multi-stage DCF analysis result be
13 if he used a 3.5 percent perpetual growth rate?
14 A. Dr. Vander Weide's result would be 9.1 percent.
15 Q. Do you have any concerns about Dr. Vander Weide's ex ante risk premium
16 approach?
17 A. Yes. Dr. Vander Weide's estimated risk premium is based on his application
18 of the DCF to an index of "electric" utility companies. Therefore, his risk premium is only
19 as reliable as his DCF cost of common equity estimates are and the comparability of this
20 index to Empire. The index used by Dr. Vander Weide includes companies that are not
21 comparable to Empire. According to the March 2011 AUS Monthly Utility Report, nine of
22 Dr. Vander Weide's twenty companies in his comparable group for his ex ante risk premium

1 approach have less than 70 percent of revenues from electric utility operations. Six of these
2 nine companies have less than 50 percent of revenues from electric utility operations.
3 Q. Did Dr. Vander Weide make any mistakes in his ex ante risk
4 premium analysis?
5 A. Yes. In Appendix 3-4 of Dr. Vander Weide's direct testimony, Dr. Vander
6 Weide stated that he had eliminated Reliant from his proxy group for his ex ante risk
7 premium DCF analysis. However, when I reviewed Dr. Vander Weide's workpapers, I
8 found that he did not eliminate this company. If he had properly eliminated this company,
9 his average DCF-estimated cost of common equity of his ex ante risk premium analysis
10 would have been 10.86 percent rather than 11.08 percent. This would reduce Dr. Vander
11 Weide's ex ante risk premium result by 22 basis points.
12 Q. The companies used in Dr. Vander Weide's ex ante risk premium DCF
13 analysis, except for the three companies he stated he excluded (IPALCO Enterprises Inc.,
14 CH Energy Group and Reliant Energy Inc.), are the same companies identified in the 2003
15 *Mergent Public Utility and Transportation Manual* that Staff used to research an actual
16 long-term electric utility industry growth rate (See Schedule 15 in Staff's Cost of Service
17 Report). What did Staff's analysis show regarding the actual rolling average of historical
18 10-year compound growth rates for EPS, DPS and BVPS provided by Mergent?
19 A. The rolling average of 10-year compound growth rates for these per share
20 financial indicators for the period 1947 through 1999 was far below the perpetual growth
21 rates assumed in Dr. Vander Weide's ex ante DCF risk premium analysis. A simple average
22 of all the growth rates Dr. Vander Weide assumed in his analysis was 6.05 percent.

1 Q. Do you have any concerns about Dr. Vander Weide's ex post risk premium
2 approach?
3 A. Yes. Dr. Vander Weide uses the average of both the S&P 500 and the S&P
4 Utilities' historically based risk premiums as his estimate of the required risk premium in his
5 ex post risk premium method. A broad index should not be used to make a specific cost of
6 common equity estimate. The S&P Utilities include companies such as AES Corp. and NRG
7 Energy that have Betas of 1.20 and 1.15 respectively, which is much higher compared to
8 Empire's Beta of .70.

9 **SUMMARY AND CONCLUSIONS**

10 Q. Please summarize the conclusions of your rebuttal testimony.
11 A. The Commission should recognize Dr. Vander Weide's DCF cost of common
12 equity estimate would have been lower if he had appropriately updated his testimony, as he
13 did in Empire's 2006 rate case. By using projected yields instead of average current yields
14 for his Risk Premium and CAPM methods, Dr. Vander Weide's cost of equity estimates were
15 overstated. The estimation of the cost of common equity using the DCF methodology with
16 reasonable inputs and an appropriate proxy group easily supports an estimated cost of
17 common equity in the single digits.
18 Q. Does this conclude your rebuttal testimony?
19 A. Yes, it does.

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of The Empire District Electric Company of Joplin, Missouri for Authority to File Tariffs Increasing Rates for Electric Service Provided to Customers in the Missouri Service Area of the Company	))))	File No. ER-2011-0004

AFFIDAVIT OF SHANA ATKINSON

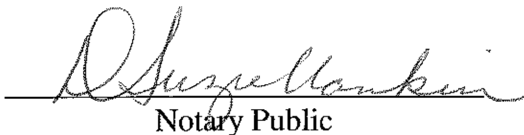
STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

Shana Atkinson, of lawful age, on her oath states: that she has participated in the preparation of the foregoing Rebuttal Testimony in question and answer form, consisting of 13 pages to be presented in the above case; that the answers in the foregoing Rebuttal Testimony were given by her; that she has knowledge of the matters set forth in such answers; and that such matters are true and correct to the best of her knowledge and belief.

Shana Atkinson

Subscribed and sworn to before me this 18th day of April, 2011.

D. SUZIE MANKIN
Notary Public - Notary Seal
State of Missouri
Commissioned for Cole County
My Commission Expires: December 08, 2012
Commission Number: 08412071



Notary Public

\Q 2784.67 ▲ 0.13% 10-YR. TREAS. ▼ 19/32, yield 3.494% OIL $104.42 ▲ $6.54 EURO $1.3986 YEN 82.32 See more at WSJMarkets.com

ıam's Biggest Bet Yet

ent to Testify Is the 'Hardest Decision...in Any Trial'

Stand and Deliver?

L. Dennis Kozlowski

Didn't take stand in first trial; testified at second trial. Found guilty in 2005 of looting Tyco (with a co-defendant) of more than $150 million.

Martha Stewart

Didn't testify at her 2004 trial. Found guilty of obstruction of justice.

John Rigas

Didn't take stand in 2004 fraud trial; likely will at tax trial next year. Found guilty of lying about the financial condition of Adelphia Communications.

Bernard Ebbers

Testified at 2005 trial in effort to undermine government's star witness. Found guilty of being mastermind of $11 billion fraud at WorldCom.

Getty Images (Kozlowski, Stewart); Associated Press (Rigas, Ebbers)

:oss-examination by prosecu- ›rs. In 2005, WorldCom Inc. ›under Bernard Ebbers was ›und guilty of an $11 billion ·aud at the telecommunications company. Jurors said afterward that they couldn't square Mr. Ebbers's insistence that he was unaware of the fraud with his hands-on image.

Former Enron Corp. President Jeffrey Skilling and **Tyco International** Ltd.'s former finance chief Mark Swartz also took the

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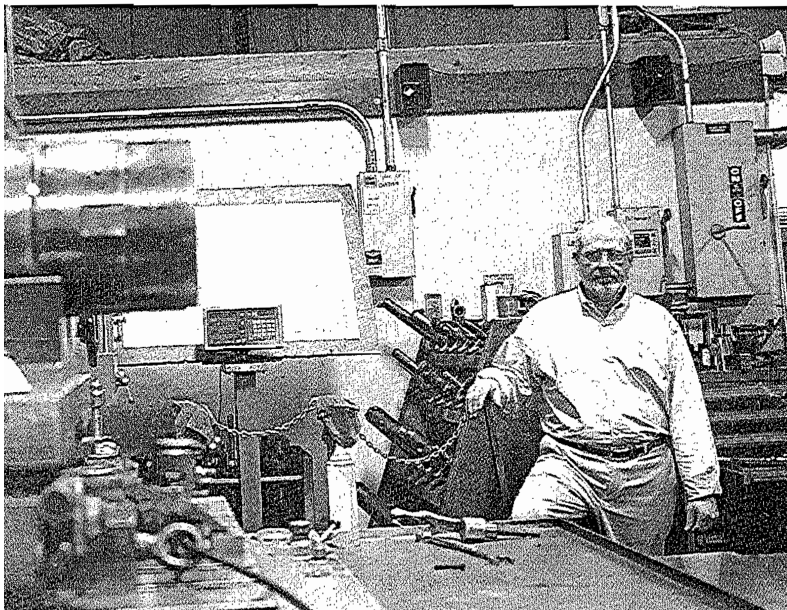

Christopher Capozziello for The Wall Street Journal

r was a key part of its decision to increase credit to his Connecticut business, J.L. Lucas Machinery Co.

Back to the People Business

Webster Financial Corp., ›ased in Waterbury, Conn., ›shes loan officers to scrutinize ›e tough decisions business ›wners made to help keep their ›mpanies afloat during the re- ›ssion.

At **PNC Financial Services** **roup** Inc., the "call sheet" filled ›ıt by some bankers as part of nesses rate themselves against rivals.

Jordan Peterson, a PNC senior vice president, says the questions are helping the Pittsburgh bank make or renew loans that it would have passed up if bankers weren't trying so hard to gauge a borrower's character.

For decades, deep customer pecially at small financial institutions. That ended at many regional and big banks with the rise of computer-driven credit-scoring models, which are fast and cheap but have sometimes backfired.

"We got somewhat lulled to sleep because things were great for so long," said Robb Hilson,

Anxiety Lingers Following Dow Rally

BY MATT PHILLIPS

It has been two years and one epic rally since the market bottomed in March 2009.

The Standard & Poor's 500-stock index, at 1321.15 on Friday, is almost double its closing low of 676.53 on March 9, 2009. The Dow Jones Industrial Average is at 12169.88, up 86% from its low of 6547.05.

The difference between now and then is stark. Back then, money was flooding out of stock mutual funds. Now, it is returning. Companies are expected to report record profits this year, and the economy is generating jobs. The market is calmer, too. The Chicago Board Options Exchange's Volatility Index, commonly known as the "fear" index, is at just over 19, down from above 49 in March 2009.

ABREAST OF THE MARKET

Yet many investors remain skeptical about the market's strength. They worry the economy isn't strong enough to stand on its own once the Federal Reserve ends its latest round of support in June, and they fear high oil prices and inflation from other commodities may quash the nascent recovery and weigh on the market. And after such a blockbuster rally, a correction must be around the corner, the reasoning goes.

"Things are really renormalizing. But they're renormalizing because of historical measures by the Fed and others to really relubricate the system and keep it going," said Jonathan Golub, chief U.S. equity strategist at UBS. "There's this lack of conviction that everything would be fine by itself."

That doubt is reflected in several market measures.

Investors are willing to pay only a bit more than 13 times expected earnings for the next 12 months. While that is above the roughly 10 times they were paying in March 2009, it is below the 10-year average of about 15.5, according to FactSet Research Systems. When the market is very bullish, investors tend to pay a higher price for earnings, and the price/earnings ratio goes up.

Thanks to cost cutting, companies have returned to levels of

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April Nymex crude oil futures were up 83 cents at $105.25 per

its deal to buy Netherlands-based **Wim Bosman Group.**

SKEPTICAL EYE? The New York Stock Exchange, seen here, and the Nasdaq Stock Market report short-selling positions on Tuesday.

* Thomson Financial earnings-per-share estimates don't include extraordinary items (Losses in parentheses)
Note: Forecasts are from Dow Jones weekly survey of economists

Investor Anxiety Lingers Following Stocks' Strong Rebound

Continued from the prior page
profitability last seen before the recession. And analysts expect earnings to hit records later this year. But the price investors are willing to pay for those earnings betrays the begrudging nature of the rally.

As well, the so-called equity risk premium—the extra return investors demand to lure them into stocks and out of the safety of government bonds—remains higher than the historical norm. The risk premium moves lower as investors become more comfortable with owning stocks. The 50-year average for the equity risk premium is around 3.5%.

ABREAST OF THE MARKET

Right now, it is at 5.5% by Bank of America Merrill Lynch's reckoning, an elevated level that suggests investors are still reluctant to move back into stocks.

As a result, it seems many have missed out on the biggest stock-market rally since the Eisenhower administration. Those who parked in Treasurys would have received a total return of 4.55%, according to Barclays Capital index data. Even picking stocks, it would have been hard to go wrong. Of the S&P 500's stocks, 287 have doubled in price, and 405 have jumped by at least 50%.

And the market continues to forge ahead without them. Even amid turmoil in the Middle East, oil prices rising above $100 a barrel and mild disappointment in Friday's jobs data, the Dow rose last week—and it is up in four of the past five weeks.

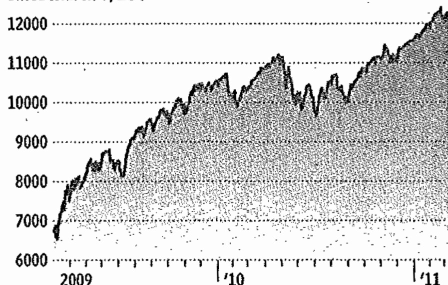
There are signs that doubts are ever-so-slowly being overcome.

The levels of cash flowing into stock mutual funds have turned higher recently. Over the five weeks ending Feb. 23, more than $21 billion poured into stock-market mutual funds, outpacing the less than $7 billion that went into bond funds, according to the Investment Company Institute.

That is in direct contrast to the preferences of investors over the past couple years, when they

Back From the Bottom

The Dow Jones Industrial Average is up 86% since March 9, 2009



Sources: WSJ Market Data Group; FactSet; Investment Company Institute

	NOW	THEN
P/E ratio (next 12 months)	13.6	10
February nonfarm payrolls (job growth)	+192,000	-726,000
VIX ('fear' index)	19.9	49.7
Inflows to U.S. stock-mutual funds	+$1.5 billion as of Feb. 23	-$13.66 billion

vastly preferred bond funds to stock funds.

It is understandable that some investors seem to have trouble shaking off the traumatic effects of the stock-market collapse they endured.

In early 2009, investors were looking at an investment landscape of utter destruction. The Dow closed at a 12-year low of 6547.05; the S&P 500 was at its lowest since 1996.

From the October 2007 peak, the decline in S&P 500 stocks destroyed $7.91 trillion in market capitalization by March 9, 2009. The biggest pain was inflicted in the financials. The S&P financial index sank 83% in that time. It still remains 53% below what it was at its peak.

William Lefkowitz, of vFinance Investments, told The Wall Street Journal at the time: "I don't know if I've ever heard as many people being negative on the market as what's happening right now."

Two years later, Mr. Lefkowitz, a 49-year-old options strategist, still describes investors' attitude as "very cautious." He has witnessed the 1987 crash, the dot-com bust, and the rout following the September 2001 terrorist attacks. Investors were able to get over those steep drops much more easily than the collapse that ended two years ago, he said, when reached Friday afternoon.

"It's hard for them. They're not going to forget what happened," he says. "It might take a whole generation. We're not really sure."

That echoes Billy Horn's feeling. The 71-year-old retiree says he feels more optimistic than he did during the dark days of the financial crisis, but he isn't counting on further stock gains.

"When I see a common stock run like many of them did in 2010, and I own them and have a 30% gain, I sell them," said Mr. Horn, who lives in Houston. "I take my profit and float back into cash and start looking for something else."

He sums up his mood: "While optimistic, I'm also very cautious." *—Mark Gongloff contributed to this article.*

A Man, a Band, a Family

FOREX VIEW

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