

Weekly Marketmail

Monday, August 01, 2011

Catastrophe Narrowly Averted! - Government Remains Open!

By Louis Navellier

The market fell 4% last week while Congress dithered over the debt ceiling, but global markets rallied (briefly) after U.S. politicians reached a last-minute compromise on Sunday night. Still, I want to remind everyone (once again) that the stock market responds more to corporate profits than to politics! With over 330 of the 500 S&P 500 companies reporting so far, S&P earnings and revenues are up 13.9% and 13.3%, respectively, over the same quarter last year. The primary reasons are: (1) a weak U.S. dollar, which creates windfall profits for multinational businesses, (2) strong GDP growth in emerging markets, due to a rising middle class and (3) relentless stock buybacks, which boost earnings per share.

The Debt Ceiling Crisis is Resolved...for Now

As we go to press, the President and Congress have agreed on a compromise that promises about \$2.4 trillion in federal spending cuts over the next 10 years. However, most of these cuts were deferred until after the 2012 elections - "kicking the can down the road" once again. Only a few tiny cuts are proposed for this year and next. Then, after the 2012 elections, everything is on the table again. In 2013, Congress will be free to spend recklessly once again - depending on the results of the 2012 elections. (This makes me wish they would only talk about one budget at a time, not some theoretical cuts 10 years from now).

After this Congressional compromise was announced late Sunday night, stocks rallied in Asian markets, particularly in Japan, Australia and South Korea. August began with a bang in New York, too, but then stocks sagged when investors realized the real budget cuts were elusive, and U.S. GDP growth is slowing.

This compromise may not be enough to avoid a U.S. Treasury credit downgrade. S&P President Deven Sharma told some members of Congress last week that S&P analysts were awaiting details of the final debt plans before weighing a change in the U.S.'s AAA credit rating. And on Friday, Moody's implied that the debt plans put forward by Congress are insufficient, saying that "reductions of the magnitude now being proposed, if adopted, would likely lead Moody's to adopt

a negative outlook on the AAA rating."

Due mostly to chaos in Washington, DC, the S&P and Dow each fell about 2.2% in July, while gold rose 8.5% to hit an all-time high of \$1,637 on Friday. Silver rose even more in July, up 13.2%. But perhaps Sunday's midnight compromise will push gold down and help lift stocks and bonds higher in August.

The Mood in Europe is Even Gloomier than in the U.S.

I have been in Europe for most of the last week and I can tell you that Europeans are not happy after so many European companies (like BASF, Danone and Siemens) warned that demand is deteriorating and the cost of materials are rising, so profits might be squeezed in the upcoming quarters. Additionally, Britain announced on Tuesday that its GDP growth is flat for the last three quarters: Up 0.2% in the second quarter, following 0.5% growth in the first quarter and a 0.5% drop in 2010's fourth quarter.

The euro and the U.S. dollar are suffering from the debt crises in Europe and America. By comparison, most Asian currencies have been remarkably strong. This caused the central banks of South Korea and Thailand to intervene last week to prevent their currencies from rising too rapidly. In the meantime, the Australian dollar, Singapore dollar and Swiss franc hit new highs last week against the U.S. dollar. The Canadian dollar, New Zealand dollar and many Latin American currencies also remained an oasis last week. For instance, the Brazilian real reached its highest level to the U.S. dollar since 1999, despite \$36 billion in central bank intervention in the past six months in a futile effort to stop the real's appreciation!

There is still a lot of concern in Europe about the European debt crisis. On Wednesday, Germany's Finance Minister Wolfgang Schauble said in an open letter to members of his Christian Democratic Party that the euro-zone debt crisis is

not solved; more fiscal discipline is needed, he said. Finance Minister Schauble also stressed that Germany would not write "blank checks" for distressed EU members.

Interestingly, Schauble cautioned against putting Italy and Spain in the same boat as Greece, which he described as being the root of the EU's financial crisis. But Italy and Spain are certainly not as healthy as Germany. Italy had to pay a 4.07% yield on 10-year bonds last week, up substantially from 2.51% at the previous 10-year auction. Still, Greece is in a category all its own! Last week, Moody's slashed Greece's credit rating three notches from Caa1 to Ca, just one notch above Moody's lowest possible rating! Ouch!

Stat of the Week: Anemic (0.85%) First-Half Growth

Friday's second-quarter flash estimate of just 1.3% annualized GDP growth was disappointing enough, but then came a massive downward revision of first-quarter growth to only 0.4%. Combined, these two quarters average an anemic 0.85% growth rate in the first half of 2011. Most economists were baffled more by the first-quarter revision (from 1.9% to 0.4%) than second-quarter news (economists expected 1.6% growth). The first-quarter revision was caused by lower inventories and lower consumer demand.

In fact, Friday's GDP figures were so shocking that they caused many economists to recalibrate their full-year 2011 and 2012 econometric models. On Friday, for instance, Deutsche Bank lowered its third and fourth quarter 2011 GDP estimates by over 1%, to 2.5% and 3.0%, down from 3.5% and 4.3%, respectively. Many other major firms also made substantial downward 2011 GDP revisions on Friday.

Another piece of bad news came on Wednesday, when the Commerce Department announced that weak orders for planes and vehicles caused June's durable goods orders to fall 2.1%, the second big drop in the last three months, after a revised 1.9% rise in May and a 2.5% drop in April. Economists expected June's durable goods to be unchanged, so this latest drop raises fears that the manufacturing sector is declining.

Two pieces of good economic news were released on Thursday. First, the Conference Board announced that consumer confidence rose to 59.5 in July, up from a revised 57.6 in June. This was a pleasant surprise, since economists were expecting a decline to 55.3. Also, the Conference Board's expectations index rose to 75.4, up from June's 71.6. Consumers apparently are spending, but they are price-sensitive.

Then, the Labor Department announced on Thursday that new claims for unemployment declined 24,000 to 398,000 in the latest week. This is the first time since April 2 that weekly jobless claims fell below the important 400,000 threshold, where new job creation tends to pick up. The more reliable four-week moving average of new jobless claims declined by 8,500 to 413,750, so the trend seems to be heading in the right direction. On Friday, we'll see if the July payroll report will confirm this positive trend with rising job creation in July, but the August job picture does not look rosy, with major layoffs announced by Boston Scientific, Cisco Systems, Delta Airlines, Lockheed Martin, HSBC, Goldman Sachs and others.

Marketmail gets updated on Fridays and whenever the DOW closes up or down 300 points or more.

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