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In This Issue

This Earnings Season, It's "Every Company for Itself"
Stat of the Week: 2.8% Fourth-Quarter GDP Growth
Highlights from the Fed's Shocking News Conference

This Earnings Season, It's "Every Company for Itself"
By Louis Navellier

The S&P 500 has now risen for the fourth week in a row...but just barely. The combination of weaker-than-expected fourth-quarter earnings and lower-than-expected fourth-quarter GDP growth delivered a microscopic 0.95 gain in the S&P 500. But with just two trading days left in January, we're up nicely for the month in both the S&P 500 (+4.67%) and NASDAQ (+8.11%). This week, all eyes will be focused on Friday's monthly jobs report for the latest clue on the strength of the current recovery.

This Earnings Season, It's "Every Company for Itself"

So far, the fourth-quarter earnings announcement season resembles the Florida GOP presidential primary, where it's "every man for himself." Likewise, earnings announcements are entering a phase I would call "every stock for itself." Some companies are showing great earnings while others miss badly. For example, Google got hit hard, while Apple surged in the wake of its latest quarterly results.*

Many stocks are fast approaching their "peak earnings" phase due primarily to some difficult year-over-year earnings comparisons. According to Bespoke Investment Group, only 57.9% of the S&P 500 reporting companies have exceeded analyst earnings estimates. That may sound good, but it's the lowest proportion of earnings surprises since the bull market began in 2009. Top-line revenues delivered only 54% positive surprises – also the weakest number in the current bull market.

Three sectors account for the bulk of earnings disappointments: consumer staples, energy, and financial.

Meanwhile, industrial companies with a global footprint seem to perform better than others. For example, Caterpillar reported better-than-expected earnings on Thursday as the company remained optimistic on global growth and also forecasted an increase in U.S. construction spending for the first time since 2004.*

Mike DeWalt, Caterpillar's head of investor relations, said that the upturn in demand was helping his company experience its "best growth since Harry Truman was president." Other big industrial companies that were upbeat last week included Eaton, Nucor and Steel Dynamics, which all reported better-than-expected earnings. Clearly, this upbeat outlook bodes well for industrial companies around the world.*

Stat of the Week: 2.8% Fourth-Quarter GDP Growth

On Friday, the Commerce Department announced that its preliminary fourth-quarter GDP estimate is 2.8%, the fastest growth rate in 18 months, but below economists' estimates of 3%. When you dig into the details of the GDP report, however, the number looks better, reflecting something like +4% growth in the private economy and -1% for government spending. Inventory growth added 2%, while another 2% came from consumer spending, but defense spending cuts and lower government spending (mostly at the state and local level) subtracted about 1% from the overall GDP figure. The U.S. economy will keep growing this year, but due to the big distortion from inventory growth, gains are unlikely to exceed 3%.

Most of the other economic news last week was positive. The Conference Board announced on Thursday that its index of leading economic indicators (LEI) rose 0.4% in December, as 7 of 10 LEI components were positive in December, namely

the interest-rate spread, jobless claims, manufacturing hours, stock prices, overall new orders, manufacturers' new orders for nondefense capital goods (excluding aircraft), and manufacturers' new orders for consumer goods and materials. One component remained unchanged (building permits), while two components declined, consumer expectations and a barometer of credit.

On the brighter side, one of those declining indicators, consumer expectations, has already turned sharply up in January. On Friday, the University of Michigan/Reuters consumer sentiment index surged to 75, up sharply from 69.9 in December, and a point above the economists' consensus forecast of 74. Consumer sentiment is now at its highest level in a year, which bodes well for future GDP growth.

Also on Thursday, the Commerce Department announced that December durable goods orders rose by a stronger-than-expected 3%, reflecting the third straight monthly rise. "Core" orders (non-defense capital goods, excluding aircraft) were up a very healthy 2.9%. For the full year of 2011, core orders rose 10%!

On the jobs front, we learned that new weekly jobless claims rose 21,000 to 377,000, but that increase was expected after the previous week's sharp decline. More importantly, the four-week moving average of new claims fell by 2,500 to 377,500. We'll learn more about jobs in Friday's January payroll report.

Highlights from the Fed's Shocking News Conference

On Wednesday, the Fed announced after its Federal Open Market Committee (FOMC) meeting that it is only forecasting 2.2% to 2.7% GDP growth for 2012. The FOMC also forecasts an unemployment rate of 8.2% to 8.5% for 2012. Finally, the Fed provided its first-ever interest-rate forecast, predicting that long-term rates will rise to 4% to 5%, up substantially from current 10-year Treasury bond yields of 1.96%.

The biggest news coming out of the Fed's unprecedented series of announcements last week was that the Fed pledged to extend its current 0% interest rate policy through at least late 2014. This shocking news is essentially an 18-month extension from the Fed's previous guidance of mid-2013. Fed Chairman Ben Bernanke's official reason for extending 0% short-term rates for six years (i.e., late 2008 to late 2014) is that the U.S. economy is "fragile." He said that the weak housing market is deterring economic growth.

Without saying so, what the Fed is really doing is protecting the banking system. Many banks have made "workout mortgages" with only 2% interest rates for homeowners that fell behind in their mortgage payments. Since banks are underwater on many of these low interest-rate mortgages, the Fed can't raise key interest rates, since that would further strain the U.S. banking system's tier-3 (i.e., mortgage) capital.

Economists were shocked that the Fed simultaneously issued a promise of 0% short-term interest rates while predicting much higher (4% to 5%) long-term rates on the same day! In addition, the Fed threw a bucket of cold water on the U.S. economy, predicting slow growth and high unemployment, just when we're seeing a wave of better economic news, such as the GDP report and rising durable goods orders.

Clearly, the Fed is overwhelmed by the ongoing problems in the financial sector and the ongoing drag that housing continues to have on the banking system. The FOMC is now being run by the "doves," who want to rescue overburdened banks while keeping the interest-rate service on \$15.2 trillion in federal debt as low as possible. But the good news is that the Fed's 0% interest rate policy helps stocks, since the Fed is essentially telling investors to take their money out of banks and bonds and put it into the stock market.

Since the average stock in the S&P 500 offers a 2% dividend yield – higher (and more tax-advantaged) than most Treasury yields – stocks should continue to gain favor. When investors buy stocks, they get a higher yield than in banks or Treasury bonds, and they essentially get the company for free! What a deal!

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

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