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October 30, 2009

Are We Heading For a Crash?

It's earnings time, and over the last two weeks the news has been coming out fast and furious. The net upshot so far is that, at the very least, the overall picture will remain one of a market and economy that is in less bad shape than a year ago; and one inclined toward being in better shape by this time next year.

Signs (and measurable metrics) are pointing towards a growing economy in recovery, but unemployment and the rapid rise from March's lows leave us cautiously optimistic. There may yet remain significant market corrections over the horizon, but for now, there are a plethora of indicators that the grass is growing greener as earnings season hits full swing.

On Thursday, the Commerce Department reported that third quarter GDP rose at annual rate of 3.5%, which was higher than expected, spurring a turnaround in the markets from declines earlier in the week. In fact, the number was the best in two years, and the first positive report in four quarters' worth of declines, an indication that the recession may be coming to an end. However, there are concerns that the figure was inflated by government stimulus plans, so there is still some doubt for the naysayers to latch on to.

This week, Procter & Gamble reported better-than-expected earnings and raised its outlook going forward. Cell phone maker Motorola also saw profits go up in its latest report, making that two positive quarters in a row, while fuel giant Exxon Mobil showed a 68% drop in the third quarter from last year (when oil prices hit \$147 a barrel), but gave reason for hope, as the company said oil production and crude oil prices are bouncing back.

Google reported that the online advertising business is coming back with strength, and showed profits in line with that thinking. Both IBM and Citigroup were able to show some profits as well, though not of the sort shown by Intel or JP Morgan Chase, for example. And

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Southwest Air's earnings announcement included their belief that the airline industry's bumpiest days are behind them. Apple and Caterpillar were two of the big names that came through with better-than-hoped-for earnings. Financials and tech are up strong. The new Windows 7 upgrade cycle could help the techs, though both Intel and Texas Instruments, despite counting out a big Windows 7 sell, still think things are on the upswing.

Caterpillar was a big surprise as it blew past estimates with its report and also said it thinks global GDP growth will be in the 3% range next year, with developing economies posting 5% growth. As a global company with its finger on the pulse of both developed and developing economies, Caterpillar, like FedEx, can speak from direct experience. And McDonalds, a global consumer discretionary company if there ever was one, cited "strong global results" as it posted a 10% increase in earnings last week. Maybe the Chinese, where GDP expanded at 8.9% over the prior year's quarter, are eating more Big Macs. If China's numbers are even slightly accurate, then this enormous economy will certainly pull others up in its wake. China's recovery, if the numbers are to be believed, is not only back on track but steaming ahead.

Last Wednesday, futures were under a margin of pressure thanks to disappointments from Boeing (here) and Peugeot and Deutsche Bank (overseas) raising the question of whether or not the market is ahead of the recovery. Morgan Stanley had an answer: It's back in the black after the worst year on its record books. Yahoo! has another kind of answer: Deep cost cuts and business closing enabled it to trounce estimates on bottom line improvement. A number of Dow components beat their estimates: Travelers upped its dividend and increased a buyback of shares; AT&T beat on iPhone sales; Xerox copied an upbeat note.

Rising industrial production in September marked the third month in a row that activity gained, lending more evidence to the growing body of data that shows we are seeing the beginnings of a slowly expanding economy.

On the economic front, last week was all about housing. Builders' confidence, housing starts, mortgage apps, house prices, and existing home sales, in conjunction with earnings, had a hand in momentum and market direction. In sum, the housing reports suggest a stall, and the market could have a bit further to fall on that supposition alone.

We aren't hearing any good news on the job front yet. A slight uptick in jobs lost did little to move the markets which have already priced in a 10% number. Keep your eyes on the fact that the lack of hiring is due in large measure to productivity gains. *The Wall Street Journal* came around to writing what we've been telling our clients for some time now, and on the 20th posted an article on companies that have seen productivity improve and have no need, or desire to resume hiring just yet.

Cash on the sidelines is earning next to nothing. That's one reason you're seeing, and reading about big flows of money into bond funds

and bond ETFs. Apparently, investors are still nervous about the stock market, but we can almost guarantee that if the Dow moves above 10000 again and remains there for any length of time, there'll be a cascade of cash from those who despair over having missed the 3,500 Dow points since March 9.

One last thing. The Index of Leading Economic Indicators, which is calculated in part by using stock prices as well as a host of other economic factors like industrial production and personal incomes, bounced to its October 2007 levels in September, marking a sharp "V" in its recovery. The question in our minds is when the official arbiter of these things, the National Bureau of Economic Research announces that it has dated the end of what's now called the Great Recession. Expect to hear this announcement soon.

As we progress through earnings reports, rather than looking at each seed, we'll continue to look at the lawn for signs of a drought or, better yet, greener pastures. So far, we like what we see.

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