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July 24, 2009

Earnings Season in Full Swing

With the second quarter in the books, companies have been reporting how businesses fared over the three-month period through June, serving up plenty of fodder for the markets to chew on over the last two weeks. Here are some of the highlights.

Last week, we began to put the pedal to the recession "mettle." JPMorgan Chase, financial giant, reported that earnings were up higher than expected, driven mostly by record investment banking fees; the company's consumer loan and credit card businesses are still seeing losses, however. CIT Group is a thorn in the financial sector's side right now, as bankruptcy may be looming for the small-business lender. We already have a positive trajectory of top- and bottom line data as well as forecasts from Johnson & Johnson, Abbott Labs, and Biogen, from Intel, IBM and Google, to, critically, GE, (even the willingness to deliver them is a positive). The absence of any dire warnings ahead of this round of reporting lends credence to our cautiously optimistic view that economic and market recovery remain the most probable outcome of past and current conditions.

Intel gave the markets a big boost last Wednesday, when the chipmaker reported that it saw sales jump 12% in the second quarter, pointing to an increase in demand for personal computers, particularly in China. Goldman Sachs also reported strong earnings, which enabled the banking giant to repay \$10 billion in TARP loans to the U.S. government. Goldman Sachs is not considered a financial bellwether, however, so the firm's results are not necessarily an indicator of a rebound in that sector.

While it was announced last week that the inflation-indicating Consumer Price Index rose 0.7% in June (slightly higher than the expected 0.6%) on rising gas prices, the report had little effect on stocks. This was buttressed by Fed Chairman Bernanke's testimony this week that inflation is not a present threat and should be

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manageable when it materializes. The rate of unemployment and jobless claims are still a concern to some—this week, initial jobless claims topped expectations as 554,000 people filed for unemployment (total unemployment fell to the lowest level since April, however). But as we have stated in the past, this is a lagging indicator, and the markets have priced in a 10%-plus unemployment level, so it will take significant surprises on that front to impact the markets.

The markets were heartened on Thursday by a positive housing number—existing home sales (which account for 85% of the overall housing market) were revealed to have risen 3.6% from May to June, the third straight month of increases on that front. This week has also seen better-than-expected earnings reports from Ford Motors (benefiting from a gain in debt reduction), Apple (which beat its second quarter earnings projections based in a large part on price cuts spurring an increase in sales and, hence, profits), Wyeth, Philip Morris and Hershey. Several significant acquisitions are also in the works, with drug maker Bristol-Myers Squibb announcing plans to acquire Medarex and Amazon.com set to buy Zappos.com, an online shoe retailer.

Retail sales have rung in better-than-expected consumer-related (even car) sales. Overall, retail sales posted the biggest gain in June since January, with some car buying in the mix. Discounters were still the leaders, while luxury brand sellers lagged. Consumers are down, not out.

Our clients have benefitted from the technology sector's market leadership this year through investments in some of Fidelity and Vanguard's tech-heavy funds, such as Fidelity's Contrafund (26% in technology stocks through June), up 9.7% for the year through Wednesday, and Magellan (34% in tech), up 21.3%, as well as Vanguard's PRIMECAP-run funds, Capital Opportunity (39% in tech), up 24.0% (this closed fund's alternative, PRIMECAP Odyssey Aggressive Growth, run by the same team in a similar style, is up 19.1%), and PRIMECAP Core (26% in tech), which is up 15.8% so far in 2009 (our chosen alternative, PRIMECAP Odyssey Growth, is up 17.9%).

In a number of our clients' portfolios, we have also seen some pop from recent positions in the booming Emerging Markets—Fidelity Emerging Markets is up 39.0% and Vanguard Emerging Markets Index is up 43.2% for the year through Wednesday.

Finally, we've been pleased by the performance of the bond fund components of our clients' portfolios. While interest rates have moved a bit higher (pushing bond prices down), the corporate bond funds we've selected for our clients, such as Fidelity Intermediate Bond (up 10.9% year-to-date), Vanguard Short-Term Investment-Grade (up 9.4%) and Vanguard Intermediate-Term Investment-Grade (up 10.2%) have all significantly outperformed the overall bond market—Vanguard's Total Bond Market Index is up just 3.0% year-to-date.

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