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Market Outlook:

<u>What value earnings?</u>
In the four and one-half year market recovery since the "Great Recession" there has been a remarkable transformation in the construction and analysis of corporate earnings. This is something that gives me pause for concern.

For the past several quarters new trends are emerging in how earnings are derived and what, exactly, they consist of.

Doubts about the accuracy or derivation of profits can raise serious issues about the pillars upon which current stock price appreciation is being built. While most, including myself, believe the rally to be absolutely sustainable and real, the problems may lie in the outlying years when true *demand* must ultimately be quantified into new *sales*.

Most governmental analytics foresee a modest growth in corporate output starting this year, but the market's schizophrenic behavior to start the year has some questioning the virility of consumer spending. A scan of exogenous current events makes us concerned that political and economic unrest amongst developed and emerging market trading partners has placed in peril an array of potential consumers for corporate manufacturing worldwide. Without willing clients, the duration of any rally, any economic surge, would surely be put at risk.

At the same time, in order to build sales, many companies are reducing prices, and therefore potential profits, inverting the "veracity" of earnings acceleration patterns that they claim is occurring.

These mixed, and sometimes confusing, signals send up a whole host of red-flags which have the *"schizophrenia-meter"* on high alert. The glass is filling up, to be sure, maybe all the way to "half-full". But living half-full is a sorry excuse for going full bore, believing in the potential of profitability driven by discretionary consumer cash and high demand for innovation and new product.

The first, and most significant, change to earnings devolution is coming from employment and wage data. At least in the short-run, claiming that one is "more profitable" because you either lay people off ("technological efficiencies") or lower their wages is a specious argument when trying to support equity price expansion. **Ultimately, if you lose or alienate a network of potential new clients...as well as your existing employees...you turn off a passion for your product and/or expectations about your mission statement, corporate governance, or the believability in your future.**

Job gains, and wage increases, go hand in hand with new product development, as does an expanding pricing power for that innovation. For the first time in decades corporations are *suggesting* profitability, at your peril, and potentially exacerbating, certainly elongating, the cycle of probable earnings acceleration in the future.

I might suggest that we have extracted about as much profitability as we can out of downsizing, restructuring, merging, and manipulating. If top-line revenue remains stagnant, it is ill advised to impose that failure upon consumers who you rely upon to support your enterprise. The "five year plan" is dead in most boardrooms, and that's an argument the 24 hour business cycle has created, but fails to comprehend.

<u>Don't get stuck</u>
Investing based upon these "popular mechanics of accounting" also has its risks. Instead of looking at demographics and secular shifts, some investors buy last year's hottest angels believing they can ride its coat tails indefinitely. That is methodologically, intellectually, and creatively bereft, setting up a recipe for failure. **A herd mentality creates *fewer* alternatives for success, especially if one can't apply proper diagnostics or methodologies of investing.** It amounts to a market built for "adrenaline highs", short burst enthusiasm, and a destiny of volatility-based returns.

The underlying weakness of failing to address long term planning is that recoveries, booms and busts, will occur more frequently. We already had dot.com. We just went through credit collapse. I *am* a believer in this market, but we now have an economy that fails to heal, like a scab that keeps being pulled off too soon. This might lead, I believe, to a more profound problem of corporate accounting chicanery.

Markets and fundamentals need time to improve, by definition. We need to allocate the right amount of patience and compassion to planning for successful economic recovery without imposing artificial timelines upon those who might, in fact, do the most good in bringing that innovation and research to the people we expect them to serve.