

FISCAL FITNESS



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The Surprising Run Up of the Dow

The members of the Investment Policy Committee (IPC) at Vorpahl Wing Securities have been surprised by the run up of the Dow near the end of July and the first part of August. It looks like investors are optimistic that the sheriffs of the European Central Bank (UCB) and the Federal Reserve will ride to the rescue, pulling the trigger on their monetary six-shooters with the hope of driving the bad economy out of town. But I think there are a few problems with this “drive em out of town” approach—the UCB and the Feds are shooting with blanks.

The Feds aimed and shot the economy with Quantitative Easing 1 (QE1) and that didn't work. Then there was QE2. That didn't work either and here's why: unemployment still stands above 8% and that doesn't even take into consideration the under-employed. The under-employed are those workers who have been looking for full-time work, couldn't find any, but accepted a part-time job. According to the Bureau of Labor Statistics, the under-employment rate stands at 15.3%. Ouch!

Then there's earnings. Ac-

ording to data from Thomson Reuters, the negative-to-positive ratio for companies in the S&P 500 making pre-announcements of earnings for the third quarter stands at 5 to 1. That's the most negative since the second quarter of 2001. Third-quarter earnings are now expected to decline by 0.4% from a year ago. This estimate is down from a 1.4% growth rate forecast only a few weeks prior.

We on the IPC watch earnings (EPS) each quarter but we also watch revenue growth. EPS can increase based on lower costs; however, revenue growth could be a better indicator of slowing economic growth. According to data from Thomson Reuters, 60% of companies in the S&P 500 did not beat revenue estimates for the second quarter. This is the highest amount since the first quarter of 2009.

And what about the dollar and its apparent strength compared to the euro? It currently takes about \$1.30 U.S. to buy \$1 euro. This dollar-euro ratio is a standard measure of the strength of the U.S. dollar. What isn't watched as closely, though, are how other currencies compare to the U.S.

dollar and the euro. According to David Bloom, HSBC strategist, if we compare the U.S. dollar and the euro to other currencies like the Japanese yen and the Australian dollar, both the euro and the U.S. dollar are falling. Mr. Bloom said it is very unusual for both the Australian dollar and the Japanese yen to appreciate against the U.S. dollar. Are investors starting to think that the U.S. dollar and the euro are hanging on to a “fiscal cliff” and it won't take much for these currencies to plunge to the bottom?

Earlier, I mentioned that I think the Feds and the UCB are shooting with blanks. I think more sheriffs who are using real bullets need to be brought in. Leo Grohowski, CIO of BNY Mellon Wealth Management in New York, said, “The Fed continues to be in the news . . . but it should be clear to most investors and market participants that the Fed alone cannot restore confidence, cannot create jobs, and cannot determine tax policy.” A client recently said to me that she doesn't want to lose money. I told her I will do my job and do all I can so that doesn't happen, but the sheriffs in Washington need to do theirs.