TONGE INVESTMENTS

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Jobs...Earnings...Market Conditions

I want to address three items this month: the job market, corporate earnings with their associated price-earnings ratios, and general market conditions. These are all interrelated, with the first two directly affecting the third. I have noted previously that economic recovery without meaningful job growth is not a cause for celebration. Job growth is tied directly to the demand for a company's product and the consequent corporate revenues. Corporate earnings are derived from those same revenues. The price-earnings ratio is the value placed on those earnings by the market, taking into consideration the company's overall prospects.

The job market is a tough problem. We expect any economic recovery to create jobs. But we've come to a place in our overall economic development where some jobs are leaving for foreign countries, never to be seen again, and others are simply being eliminated from the corporate table of organization. The jobs we're looking for in the economic recovery are those created by increased demand for a company's product--which will almost certainly happen as the economic recovery gains some momentum. This job growth may be obscured in the reporting, however, because of the enormous numbers of jobs simply disappearing from our economy.

Corporate earnings and P/E ratios: The P/E ratio is the most commonly used yardstick for market valuation. Dividing the current price of a stock by the current earnings tells us how many times earnings we're paying for the stock. This measure can be calculated by using reported earnings (last 12 months), current earnings (last two quarterly reports plus estimates for next two), or estimated earnings (forward 12 months). A lot of press just now notes that P/E ratios are as high as or higher than they were at the height of the market. The raw numbers support this conclusion, but I think it's a little misleading. When the market was at its height, companies were earning substantial amounts of money AND were trading at high P/E ratios. Now, as we are recovering from a recession, companies have very small earnings. The prospect that companies will earn more money six months or a year down the road makes a current calculation seem high. Indeed, the numbers *are* as high as they were several years ago. The difference is that earnings are at a low point right now and are likely to increase, as opposed to being at a high point after years of substantial growth.

Market conditions: the market has been moving generally forward for the last six months. All sectors showed positive activity, boosting the value of many stocks. As we enter October, and the positive news we have been anticipating is not evident, the market is pausing. Six percent of sectors have changed from a positive to a negative stance. By itself, such a change does not constitute a trend, but the market is at a critical place and I will be watching carefully for any further deterioration.

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