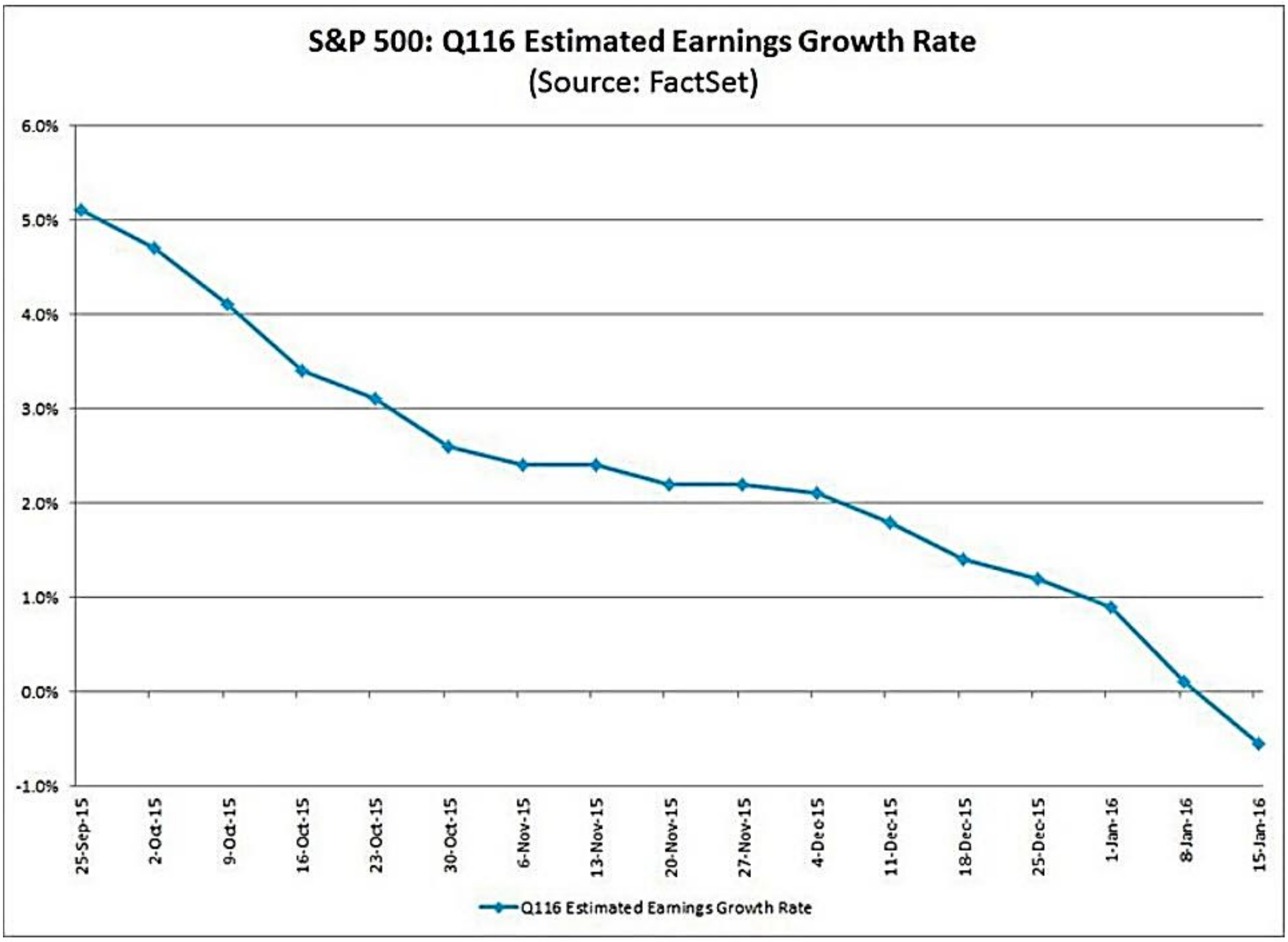
THE FICTION OF EARNINGS GROWTH

The financial establishment's wonderful corporate earnings forecasts of last year are going up in smoke. It was all hype, probably with the goal to keep investors from selling, as that would have interfered with the selling from the establishment's own portfolios.

Look at the cuts in earnings forecasts. In late 2014, some Wall Street forecasts were for a 15% **rise** in corporate earnings in 2015. I wrote in our Dohmen Capital services that there would be a **decline**. As it turned out, earnings declined 4.9% year-over-year in the 4th quarter of 2015 according to FactSet.

It's always good to treat forecasts from Wall Street with great skepticism. In September 2015, expectations according to FactSet were for S&P 500 earnings to grow by almost 5% in **Q1 2016.** Here is a chart (courtesy of FactSet) of those forecasts since September 2015 for Q1 2016 earnings as time progressed.



Seven sectors have lower expected earnings growth rates today compared to September 30 (due to downward revisions to earnings estimates), led by the Energy sector. On September 30, the estimated earnings decline for the Energy sector for Q1 2016 was -17.7%. Today, it stands at -56.1%.

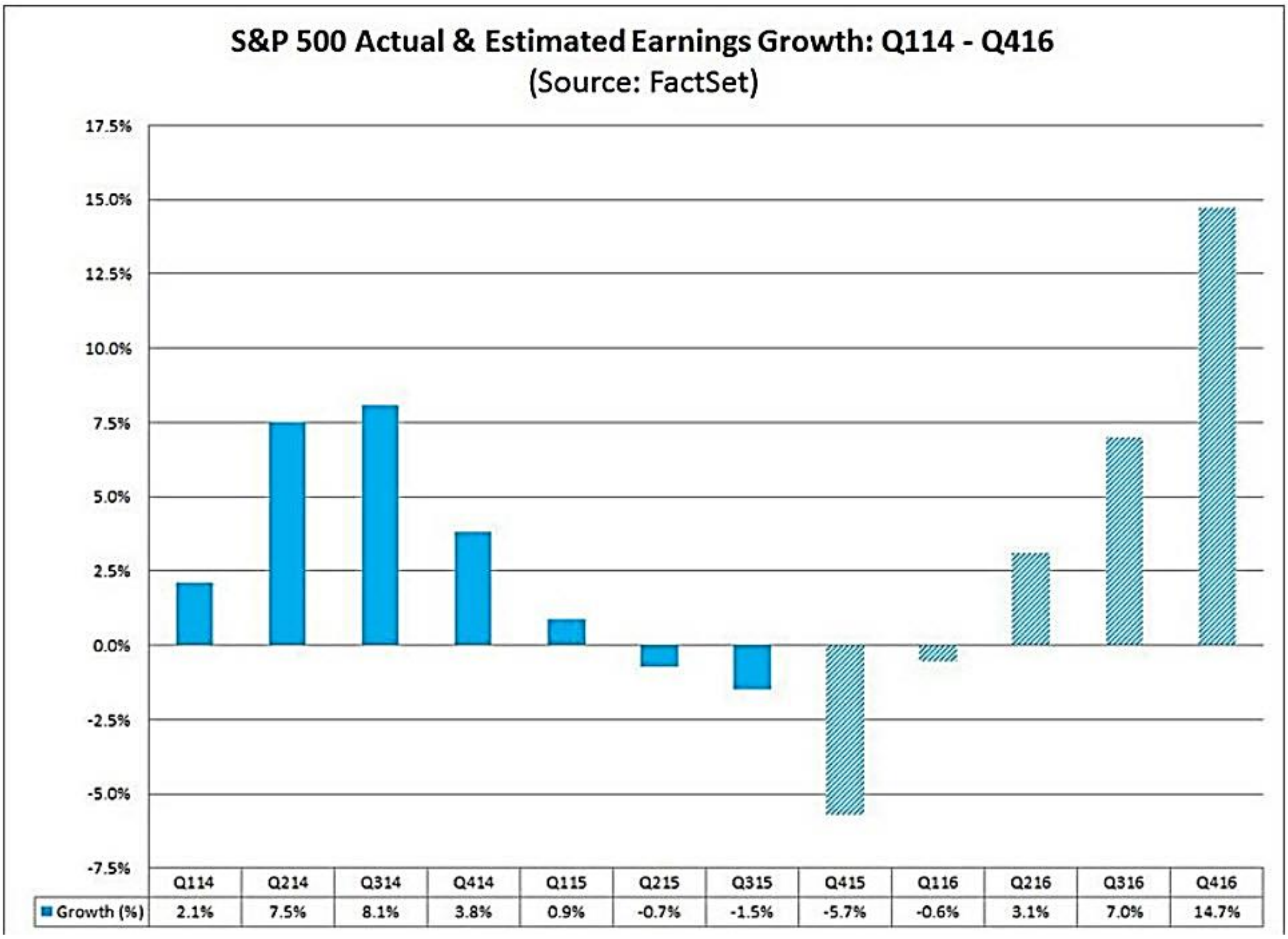
Note how they had to adjust forecasts downward each week.

Their latest update is now (minus) -6.9%. These forecasts basically reflect Wall Street thinking. I have never worked there, which is a blessing.

But there is a more serious measure of earnings, namely GAAP. The number usually seen for earnings is “pro-forma.” But 2015 **GAAP earnings** for the S&P 500 had a **huge drop of 12.7%** vs. the year 2014.

That’s what last January’s market plunge was all about… adjusting to reality

After all the bad earnings forecasts of the past several years, Wall Street now tries again with forecasts of corporate earnings magically rising strongly mid-year 2016. They never explain what would cause that sudden turn-around. Here is a chart of the forecasts, according to FactSet. The light blue is the forecasts. Please note the sudden, unexplained rise in earnings estimates for the rest of 2016.



Thus, the bulls will now argue that the stock market adjustment to weak earnings is completed and that the market will rise in anticipation of rising earnings.

I just don’t see anything that would change total earnings growth. The only possibility is that “per share earnings” of firms that do big stock buybacks will rise because of fewer shares outstanding.

Aside from that, I will follow my Theory of Liquidity & Credit, which I first presented at a conference in 1978. It says that the primary determinant of a major stock market trend is a **trend change** in liquidity and credit availability. Because the latter is now shrinking rapidly, the long term stock market trend must now be downward.

The big question for investors: Is the current rally the continuation of the seven year bull market, or is it a bear market rally that will soon fail? I am watching it carefully. I have my preliminary opinions, but I am waiting for confirmation. If earnings fail to rise, how can a rise in the stock market be justified?

January 20th was the first low in the market. I identified that turn the next day in my trading service, Smarte Trader. After a rally, the next drop finished on February 11th. Although some of the major indices returned to their January 20th lows, a number of my indicators were nicely higher at the February low. That meant that many stocks were in much better shape at the February low. I gave the signal for a good bear market rally one day later.

I will post another article at a later time to discuss all the clues about what will happen next. Is this a continuation of the seven year bull market, or will it end in a giant trap for the bulls?

This will be a very exciting year for investors, bringing great profits to those who know what to look for, and great pain for those who follow the crowd. Remember, “in the investment markets, what everyone knows is not worth knowing.”

Remember, anything coming out of Washington and Wall Street should be treated with a great amount of skepticism.

Wishing you successful investing,

Bert Dohmen, Founder
Dohmen Capital Research, Inc.