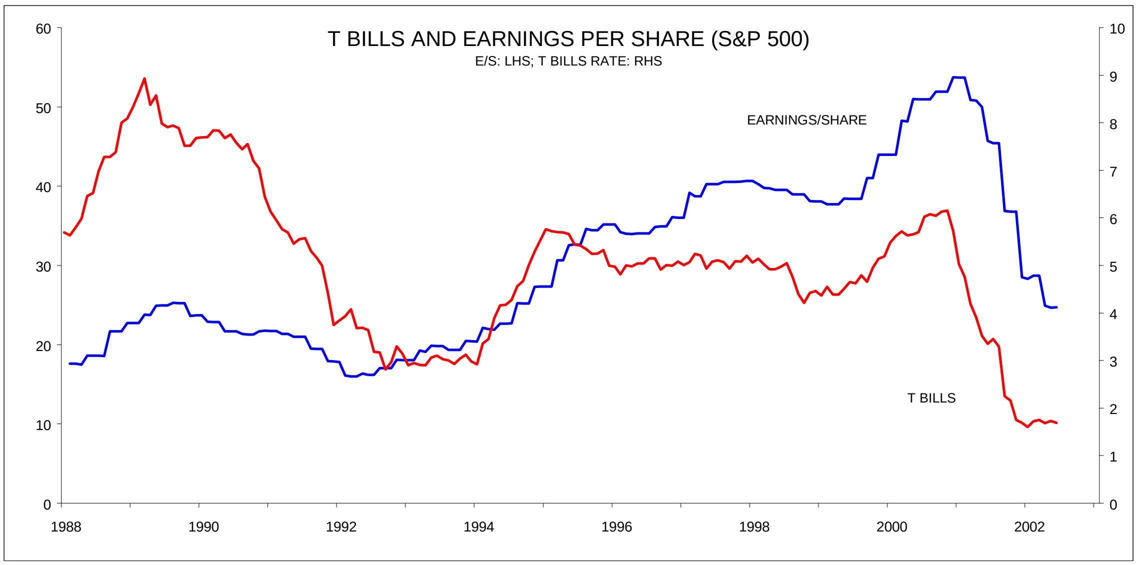
<u>The myth of earnings driving the market</u>

Wall Street believes that the market will strengthen when earnings start rising again.

The problem with this notion is that earnings per share and short-term interest rates have exactly the same cyclical turning points as shown quite clearly in the chart below. In other words, the two graphs suggest that saying that the market rises when earnings per share go up is like saying a new bull market starts when short-term interest rates rise. And this is preposterous.



Short-term interest rates and earnings per share have exactly the same cyclical turning points.

In mid 1990 the market took off in spite of declining earnings per share. On the other hand, in 1994 the market stalled as earnings per share were in a strong up trend since early 1992. What was happening to earnings did not seem to matter.

What ignited the market in 1990 was the increase in liquidity accompanied by lower short-term interest rates. And what worried the market in 1994 was soaring commodity prices and short-term interest rates.

It looks like trends in short-term interest rates and commodity prices are much better indicators than earnings per share to assess the prospect of a bull or bear market.

For further analysis on the same subject please also read *The stealth bull market* and *Market risk barometer* shown in this area of the website.

For more details on the same subject we recommend you read Dr. George Dagnino’s book ***Profiting in Bull or Bear Markets*** (McGraw-Hill publisher).

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