

THE RULES HAVE CHANGED, AND I HAVEN'T (AT LEAST FOR NOW) DON'S BLOG 2017.10.24

What appears to have been the trigger that sent the stock market roaring upward last week was IBM's (Big Blue) "great" third quarter 2017 earnings. Never mind for the 22nd quarter in a row, sales year over year have been lower. The last year over year quarter that was positive was the first quarter of 2012, and that was only +0.3%. But of course, they did find a way to report higher per share earnings. How? They set their tax rate at 11%, the lowest in modern history I believe. For the day this was reported, the market was up 150 points (23,100) and 100 was due to IBM and 50 due to Goldman Sachs. That was early in the week. Later the same week, GE (the only company that remains of the original Dow Jones 30) announced a probable 30% decline in this year's earnings and the stock sold off 10%. But guess what? It gained all of it back. Why? It's in the index, therefore those passive funds that have to be fully invested at all times in the Dow Jones 30 came to the rescue. At the time of this writing, it was even in the green for the day.

This action of GE illustrates what can happen when one gives up the buy and sell decision to a passive fund. In a rising market, that's fine; in a declining market it's a real problem. Where are we now? To date, passive has been a self-fulfilling move. Do you really want to own GE now? Some day one might want to have the sell decision in their own hands. I have covered the passive versus active switch some time ago. As we know, active managers have lost billions under management, while passive funds have gained that amount and more. The reason of course was that for some four years, active managers who buy and sell based on fundamentals underperformed. One more point about IBM and GE. They well represent a major part of the American economy. Does it bode well for the future that such pillars are having difficulties?

One final item for this go around. Note the chart below which traces the identity of recent buyers and sellers, year to date 2017. Does this look like a good trend to you? Which way is money moving? Weak to strong hands or strong to weak? Needless to say, for the life of me I can't understand why the stock market is doing what it's doing. Maybe if I had been around in the roaring 1920s era, I would have some idea. Where is Joe Kennedy when we

need him? By the way, in my writings from the 1980s forward, I labeled Nixon and Carter the worst back to back presidents concerning public policy we have ever had. I was wrong, the last item below is a composite picture of the new winners.



IBM Reports 22nd Consecutive Quarter Of Declining Sales, "Beats" EPS On Drop In Effective Tax Rate

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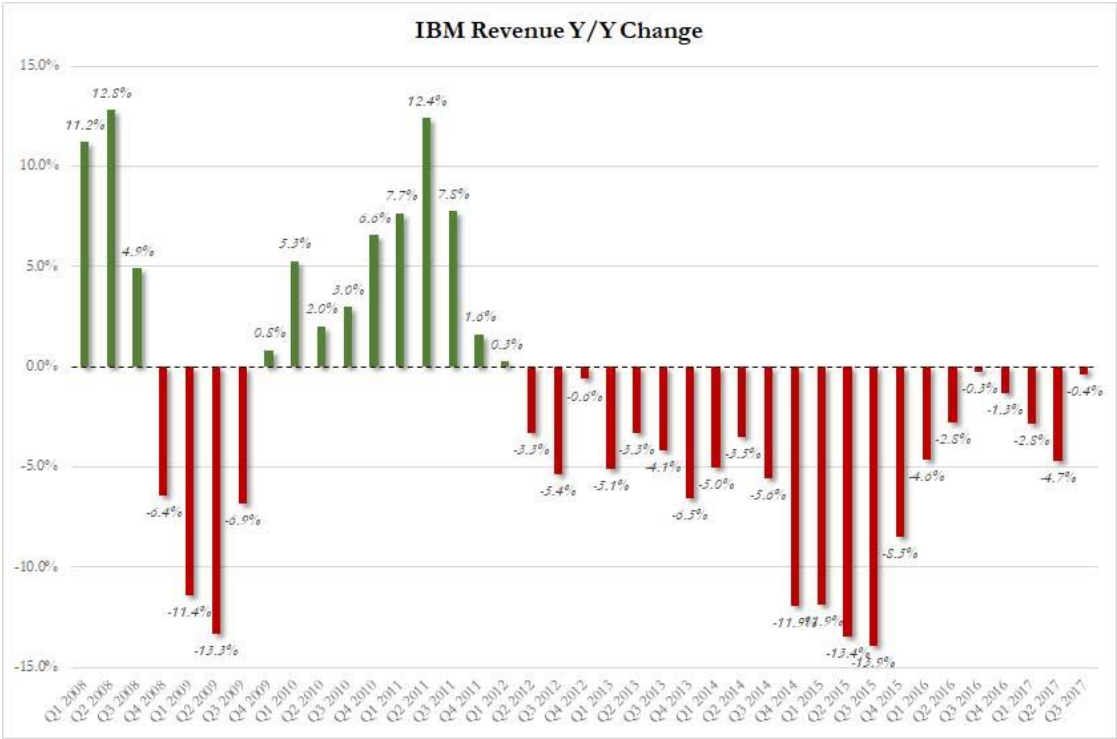




Chart 2: Cumulative flows (\$bn) by client type, YTD 2017

