## The Markets

What's more important to the U.S. stock market, economic growth or the value of the U.S. dollar?

On the surface, economic growth would seem to be the logical answer since as the economy grows, earnings should grow, too. But, digging a little deeper, the answer is not so clear cut.

What muddles the answer is that large U.S. multinational companies generate about 47 percent of their revenue from outside the U.S. When that revenue is translated back into U.S. dollars, the revenue could vary significantly depending on whether the dollar is strong, weak, or neutral.

For example, if the dollar is strong, then foreign revenue translates into ***fewer*** dollars which ***reduces*** a U.S. company's reported revenue. Lower revenue could lead to lower profits and possibly lower stock prices. The reverse is also true. If the dollar is weak, then foreign revenue translates into ***more*** dollars which ***increases*** a U.S. company's reported revenue and could lead to higher profits.

We're talking about the value of the dollar today because of the uncertainty surrounding numerous world currencies. The euro, in particular, is on the radar because it might soar or plunge depending on how Europe cleans up its sovereign debt problem. And, with Europe accounting for 22 percent of our total exports so far this year, any major change in the value of the euro could affect U.S. corporate revenue and profits.

That's why Christopher Wood, strategist for CLSA Asia-Pacific Markets says, "The key variable for the U.S. stock market is not the U.S. economy, but the U.S. dollar."

In a globally based economy, the value of the dollar matters. It's an important variable that impacts how much a company reports as earnings, and as a result, affects stock prices.

**IT'S NOT JUST HOW MUCH A COMPANY EARNS THAT MATTERS,** but how much of an earnings multiple investors apply to those earnings that helps determine stock prices. To illustrate this, let's assume it's your lucky day and you have the ability to be given one of the following five companies. Based on the data given in the following chart, which of the five companies would you choose to inherit?

| Company | 2010 Annual Revenue | 2010 Operating Profit |
|---|---|---|
| Ford (car company) | $128,954,000,000 | 6,658,000,000 |
| DuPont (chemicals) | 32,733,000,000 | 3,711,000,000 |
| Honeywell (manufacturer) | 33,370,000,000 | 3,134,000,000 |
| eBay (e-commerce) | 9,156,000,000 | 2,054,000,000 |
| VMware (software | 2,857,000,000 | 428,000,000 |

Source: Morningstar

Just looking at the numbers, you might think Ford would be the obvious choice. Its revenue was nearly four times the next closest company and its operating profit last year was nearly 80 percent higher than the next closest company.

Interestingly, the stock market can tell us how it thinks these five companies stack up against one another. It turns out that as of last week, the market value of these five companies (stock price times shares outstanding) was between $40.5 billion and $41.9 billion. In other words, the stock market valued these companies at basically the same price.

That may seem strange since the financial metrics of these five companies differs significantly. How can Ford, with $129 billion in annual revenue and $6.7 billion in operating profit be worth about the same as VMware, a company with just $2.9 billion in annual revenue and an operating profit of only $0.4 billion?

This highlights the point that in the long run, earnings do drive stock prices; however, the value that investors place on those earnings can vary significantly from one company to the next at any point in time. So, what causes investors to value a small company like VMware at about the same market value as the much larger Ford? Ah, that's the million-dollar question which keeps investment analysts gainfully employed!

We mention these five stocks not as a buy or sell recommendation, but simply to point out that numerous factors affect the valuation of stock prices. It's not as simple as saying those with the most profits win.

**Weekly Focus – Shuffling Cards**

Playing cards is about as American as baseball, hot dogs, and apple pie. So here's a trivia question for you. How many times must you shuffle a deck of 52 playing cards in order to ensure it is truly scrambled?

Mathematicians have studied this problem and determined that even after six shuffles you can still find patches of non-random sequences. It's the seventh shuffle that does the trick. At seven shuffles you reach a tipping point and the deck turns into chaos, according to the book Magical Mathematics by Persi Diaconis and Ron Graham. So, if you are concerned that one of your table mates is a skilled card shark, make sure you shuffle at least seven times!

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***Notes***

*The Standard & Poor's 500 (S&P 500) is an unmanaged group of securities considered to be representative of the stock market in general.*

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*Past performance does not guarantee future results.*

*You cannot invest directly in an index.*

*Consult your financial professional before making any investment decisions.*