



POTOMAC
STRATEGIC INVESTMENT SYSTEM

CAPITOL MARKET REVIEW

In This Issue: Eurozone News Benign...Global Markets Turn Attention to US Earnings Season

At Mid day: 1215 US10Y 2.13% Gold \$ 1654 Oil \$88.21 Oct. 18, 2011

In spite of ongoing political, social and financial market carnage, Eurozone markets continue to hold current valuations. This relative calm has shifted the focus of investors to US earnings season, where, as predicted, the news has been spotty.

On a day when German Chancellor Merkel described the pace Eurozone crisis talks to be advancing by a “*millimeter*,” apparently that’s enough to stop the selling of European assets. It’s been the US earnings news that is moving markets.

Last night, IBM “*beat The Street*,” on reported earnings, but disappointed on its revenue projections. The stock slumped in after-hours trading and has been lower throughout the day. Earlier, Google reported a solid quarter and gapped-up some 30 points, (5%.) on the news. Later today, Apple will report. And even if its numbers do not meet Wall Street “whispers,” (whispers being the most aggressive analyst projections,) traders expect that Apple will retain its leadership position as the leading global technology company.

Beyond technology, negative earnings news continues to hit the financial sector as the leading global financial stock, Goldman Sachs, reported a loss for the quarter. This is only the second time in its public history Goldman Sachs has reported a quarterly loss. The news was already in the stock and valuations did not change for GS. It continues to sell below \$100/share and below what many believe is the only real book value for a Wall Street bank.

CMR does not dwell on earnings announcements as there are far better ways politicians can track public financial news. However, the Goldman story is important for Washington in that no other Wall Street institution has Washington connections like Goldman. GS maintains a large and effective federal liaison service. Its data and analysis on political events are tracked closely by global investors. Its clout in the halls of Congress, The White House, Federal Reserve, Treasury and other DC based entities knows no equal.

If Goldman is sustaining losses in its operations, other firms are also suffering through a difficult market cycle. In numerous posts over the previous quarter, CMR repeatedly warned that the carnage in global markets was impacting many banks, funds and traders. In the days ahead there will be a number of surprises. Some positive, some negative. Last quarter Goldman’s main rival, Morgan Stanley, beat-out Goldman. However, in recent market action, Morgan has been pegged as having too much Eurozone exposure. Many believe Morgan Stanley’s shares have been shorted due to the inability of aggressive traders to short any of the leading Eurozone banks. Another quarter where Morgan beats Goldman will set-off a strong short-covering rally in MS shares.

In past quarters, stocks have been supported by artificial lending via the Fed. Quantitative easing has ended and so has the predictability of bank earnings.