NAVELLIER
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Despite Washington's Budget Crisis, Earnings Season Should Lift Stocks
By Louis Navellier

Despite the contentious federal debt ceiling debate and the end of the Fed's Quantitative Easing last month, yields on Treasury securities have fallen this month. In fact, PIMCO, the world's largest bond manager, has actually increased its holdings of U.S. government debt. Stocks fell 2% last week but they have risen 4% in the last three weeks. With earnings season reaching a peak by late July, we could see a strong summer stock rally, despite all the frustrating political debates in Washington, DC.

Is a U.S. Budget Deficit Deal in the Works This Week?

Last week, both Moody's and Standard & Poor's threatened to lower America's AAA credit rating if the U.S. government defaults on its interest payments. After President Obama walked out of last week's budget talks, S&P commented that the U.S. debt crisis has "become more entangled." Last Thursday, S&P placed U.S. sovereign debt on "watch" for a possible downgrade, meaning that there is at least a one-in-two (50%+) likelihood that S&P could lower its long-term rating on U.S. debt within 90 days.

The President says that 80% of Americans are in favor of higher taxes - despite the fact that the tax-cutting "hawks" virtually swept last November's Congressional and State elections. To his credit, however, President Obama urged the House and Senate leaders to present their "final offers," indicating that he may be willing to accept some sort of deal this week. Meanwhile, Wall Street seems to be rooting for a spending cap (or a short-term government shutdown), since if the federal government is capped or constrained, it will help unleash the private sector and ultimately help stocks outperform Treasury bonds.

Frankly, I suspect that a debt ceiling deal will get done in late July, even if it is a Band-Aid. Worst case, even if there is a brief federal government shutdown, most economists and Fed watchers expect that interest will be paid on Treasury securities, preventing any technical default. Additionally, since many members of Congress believe that Social Security checks will also go out, some GOP members want to force a government shutdown to embarrass President Obama, who implied that Social Security checks would cease in the event of a federal government shutdown.

As I have been saying all along, I believe the stock market will rally in the event of a short-term federal government shutdown, but all bets are off in the event of a longer-term federal government shutdown.

Bernanke: Anti-Gold & Pro-Quantitative Easing

The other big news last week was Fed Chairman Ben Bernanke's Congressional testimony. The highlight of his testimony was when he told veteran Representative Ron Paul (R-Texas) that gold was "not money." Ironically, gold soared to a new record high of $1595 the next day and $1605 this morning! Congressman Paul also asked Bernanke why central banks hold gold instead of, say, diamonds. In the best tradition of Tevye in "Fiddler on the Roof," Bernanke answered Ron Paul in one word: "Tradition."

Technically, Bernanke is correct. If he had called gold money, then the U.S. would have been obligated to deliver the gold in Fort Knox to anyone who presented their paper dollars in exchange for that gold. In the meantime, gold is becoming legal tender in some smaller jurisdictions. Utah has declared gold as legal tender. Other states are considering doing the same, and the Swiss are planning a golden Swiss franc.

Turning to the U.S. economy, Bernanke said "the possibility remains that the recent economic weakness may prove more persistent than expected, and that deflationary risks might re-emerge, implying a need for additional policy support." Hinting at a new round of Quantitative Easing (QE-3), Bernanke said that "we have a number of ways in which we could act to ease financial conditions further." When asked if that means the Fed could engage in a third round of quantitative easing, Bernanke clearly said "yes."

Then, the Fed Chairman accidentally pushed the panic button when he said "We don't know where the economy is going to go and if we get to a point where the recovery is faltering and we're looking at inflation dropping down towards zero ... then we have to look at all the options." With this crystal clear signal that the Fed was ready to prime the monetary pump to help the U.S. economy, financial markets responded positively, gold rose and the dollar fell. Then, on Thursday, before the Senate, Bernanke tried to undo his Wednesday statements by implying that the Fed had no intention of easing any time soon!

Stat of the Week: "Core" Inflation vs. Overall Deflation

Last week, the stock market recovered a bit late in the week, mostly responding to three favorable price indexes: (1) On Wednesday, the Labor Department announced that the prices for imported goods declined in June by 0.5%, the first decline in a year. This decline was mostly due to lower crude oil prices. (2) On Thursday, the Labor Department reported that the Producer Price Index (PPI) declined 0.4% in June, while the "core" rate (excluding food and energy), rose 0.3%. (3) Then on Friday, the Labor Department reported that the Consumer Price Index (CPI) fell by 0.2% in June, even though the core rate rose 0.3%. In summary, underlying (core) inflation is rising moderately while lower food and energy prices bring the overall price indexes down. Still, these very low rates of price changes are basically good for the market.

The other economic news last week was mostly positive: On Thursday, the Commerce Department said that June retail sales rose 0.1%, but this was significantly better than economists' consensus expectation of a 0.2% decline. Excluding gasoline, retail sales rose 0.3%, implying that overall consumer spending was steady. Vehicle sales rose by a more robust 0.8% in June, so consumers are finally buying more big ticket items, a clear sign that consumer confidence is slowly improving. And on Friday, we learned that industrial production rose 0.2% in June, so economic growth continues, but at a maddeningly slow rate.

The best economic news last week was that China's official GDP growth came in at a 9.5% annual pace in the second quarter, down only slightly from a 9.7% rate in the first quarter. This is good news, since it shows that the pessimists' fears about China "slowing down" are unfounded. In addition, on Tuesday, the Bank of Japan turned out a surprisingly upbeat report, which bodes well for Asian and global growth.

In conclusion, despite all the political distractions, Wall Street remains focused on earnings and mergers. Google's blowout earnings on Thursday helped to improve investor sentiment, as did Carl Icahn's bid for Clorox on Friday. The global economy is humming along nicely and U.S. economic growth should improve in the second half. Since the stock market reflects private sector profits, not government sector debts, all of the news about rising global interest rates, credit agency downgrades in Greece, Italy, Ireland (and maybe the U.S.) should not impact second quarter corporate sales and earnings announcements. This week, we will see a series of major tech-stock earnings reports, so technology stocks could rally soonest.

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