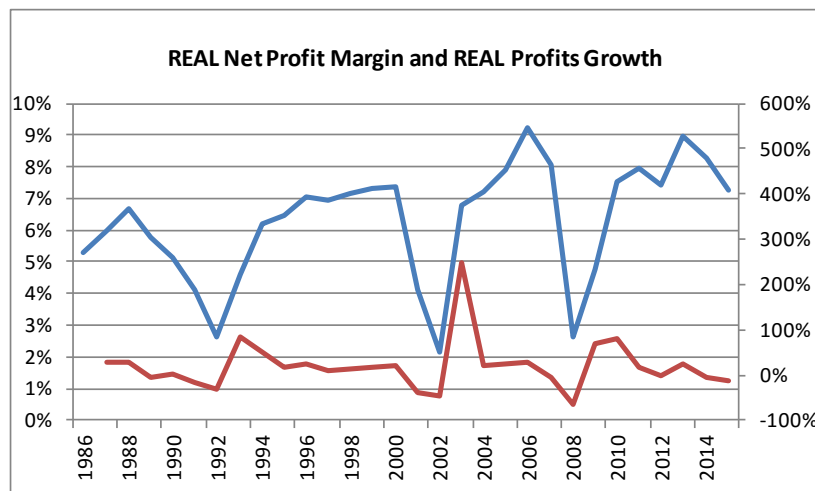


# Profits and Sense

August 10, 2016

## REAL profits have declined for 2+ years while valuation has risen. Let's rally!

What if I said that profits (real profits) have declined for over two years (not a typo) - and real sales even dropped -3% in 2015. What if I further said this has NOT been just an energy sector phenomenon, and the current profit margin is now close to the median profit margin set for whatever time period you wish? What if I finally said that PE multiples have expanded +25% in the last three years as this profit deterioration occurred? Would you now buy at stock price highs?

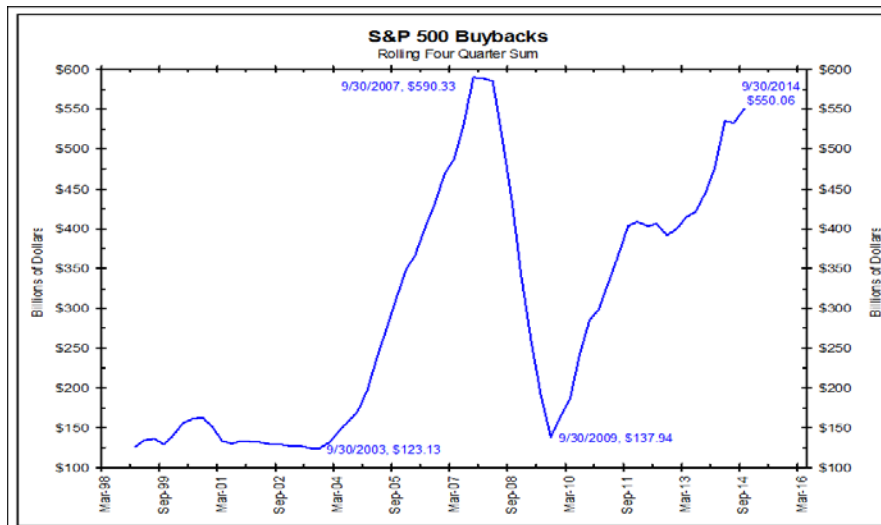


The market has rallied though - on "hope" for a later 2016 and early 2017 earnings growth turn-around. That's a boatload of hope in 2016 of all years - especially with already rapidly rising inventories and accelerating yoy quarterly net losses in 2016. FYI - I'm leaving analysis of the fantastically opaque Federal Reserve money pump out for now. No, in the short-term the market is a popularity contest; in the long-term, it's an REAL earnings scale.

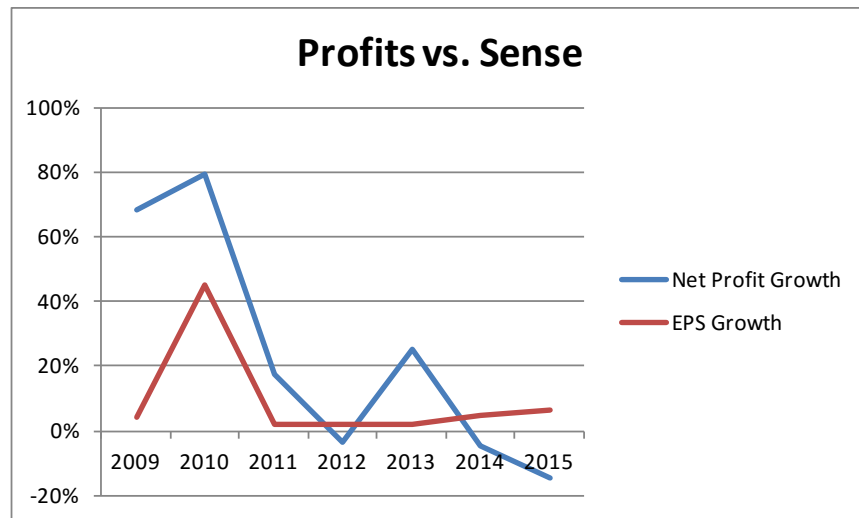
**REAL profits whistling past the Graveyard.**

## EPS is increasing or at least holding its own, right? How? Debt-financed buybacks.

The difference between REAL profits and EPS is that one is the total amount of net earnings (INCLUDING non-restated extraordinary items and restructurings) whereas EPS usually measure operating earnings excluding these things (don't get me started on "adjusted operating earnings"). Oh yeah, one more thing: share buybacks. When debt is free, why not borrow to repurchase your own shares? We'll see in the next credit crunch.



That's approaching a rolling +3% to EPS growth each year. Think buybacks have gone down since 2014? Doubtful.



And this pitiful performance (either way you slice it, but especially without share repurchase manipulation) is on top of a 25% premium market PE valuation to historical median. Low interest rates can't explain all of that premium away.

**Prepare for a Fall 2016 real correction or worse.**

Kind regards,

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