Scannell Wealth Report
September 6, 2011

The Markets

Two four-letter words -- "debt" and "jobs" -- are hanging over the economy like a noose that keeps tightening.

This is not news; we've known for several years that debt is too high and jobs too scarce. Unfortunately, they've become intractable problems with no solution in sight.

Last week, the government reported the U.S. economy had a net gain of zero new jobs in August. On top of that, the unemployment rate remained stuck at a disappointingly high 9.1 percent and the number of unemployed people rose to 14 million -- including more than 6 million workers who have been out of work for 27 weeks or longer, according to *MarketWatch*.

With jobs hard to come by, consumer confidence is suffering, too. The Conference Board reported its consumer-confidence index for August fell to the lowest level since April 2009, according to *MarketWatch*.

The weak economy and uncertain outlook have led to a dramatic decline in interest rates. The yield on the 10-year Treasury dropped to 2.0 percent last week and the 30-year Treasury yielded just 3.3 percent, according to *Bloomberg*. This decline in longer-term interest rates is, "a sign of heightened fears about a recession in the U.S. and more actions from the Fed," according to *The Wall Street Journal*.

When you put the pieces of the economic puzzle together, it starts to paint a picture that a new recession may be looming. While we're not in the business of making projections like that, we do monitor the economy and, right now, it's sending unsettling signals.

Whether a new recession is coming or not, we continue to do our job of helping you reach your financial goals regardless of what the market and economy may put in our way.

Data as of 9/2/11	1-Week	Y-T-D	1-Year	3-Year	5-Year	10-Year
Standard & Poor's 500 (Domestic Stocks)	-0.2%	-6.7%	6.3%	-2.8%	-2.2%	0.4%
DJ Global ex US (Foreign Stocks)	2.9	-9.9	3.1	-2.6	-2.0	5.0
10-year Treasury Note (Yield Only)	2.0	N/A	2.6	3.8	4.8	5.0
Gold (per ounce)	4.9	33.0	50.2	32.9	24.5	21.2
DJ-UBS Commodity Index	0.9	0.1	21.7	-4.0	-1.0	4.8
DJ Equity All REIT TR Index	0.5	0.6	7.9	0.0	-0.5	9.6

Notes: S&P 500, DJ Global ex US, Gold, DJ-UBS Commodity Index returns exclude reinvested dividends (gold does not pay a dividend) and the three-, five-, and 10-year returns are annualized; the DJ Equity All REIT TR Index does include reinvested dividends and the three-, five-, and 10-year returns are annualized; and the 10-year Treasury Note is simply the yield at the close of the day on each of the historical time periods.
Sources: Yahoo! Finance, Barron's, djindexes.com, London Bullion Market Association.
Past performance is no guarantee of future results. Indices are unmanaged and cannot be invested into directly. N/A means not applicable or not available.

THERE'S THIS PESKY LITTLE THING CALLED THE P/E RATIO and changes in this number could have a big effect on whether stock prices rise or fall. Normally, stock prices are driven by earnings. As earnings rise, stock prices tend to rise and vice versa. Granted, it's not a straight-line relationship. Instead, it tends to come in sync over time -- even though "over time" could mean several years.

We now have some great examples of how changes in the P/E ratio can dramatically affect the returns on certain stocks.

First, a definition. The P/E ratio is simply the price of a stock divided by its previous 12 months earnings per share. For example, if XYZ Company earned $1 per share in the past 12 months and its stock is selling for $15 per share, then it has a P/E ratio of 15.

For a real example, let's look at Microsoft. Ten years ago, on August 23, 2001, Microsoft stock traded at $26.60 per share. Ten years later, on August 23, 2011, Microsoft stock traded at $24.72 per share. As you can see, the stock price actually *declined* over that 10-year period. However, during those 10 years, Microsoft's earnings per share actually *skyrocketed* by 193.33 percent, according to a September 3 *Barron's* article.

The obvious question is, "How can Microsoft's earnings nearly triple in 10 years while the stock price drops during that period?" The answer is… the P/E ratio declined dramatically.

The next obvious question is, "What causes the P/E ratio to change?" Ah, that's the million-dollar question. *Barron's* pointed out that back in 2001, companies like Microsoft were viewed as exciting growth companies and investors were willing to pay a higher than normal premium for each dollar of earnings. Flash forward 10 years and Microsoft did indeed grow its earnings dramatically. But today, Microsoft is viewed more as a "steady Eddie" and the multiple on each dollar of earnings that investors are willing to pay is less, hence, the slight decline in its stock price over the past 10 years.

There are a couple lessons here for investors.

First, when you buy a stock, it's important to know the P/E ratio. If it's higher than the market average, then you need to be extra careful. You could run into a Microsoft situation where the earnings actually rise, but the stock price doesn't.

Second, buying a stock with a low P/E ratio is not necessarily a bad thing. Using Microsoft again as an example, its P/E ratio is currently low relative to 10 years ago. If the ratio starts to expand, then the stock price could actually rise faster than its earnings over the next few years. Microsoft is mentioned as an example and not meant as a buy or sell recommendation.

Nobody said investing was easy and figuring out the direction of a stock's P/E ratio is one reason why.

Weekly Focus – Remembering 9/11

"Time is passing. Yet, for the United States of America, there will be no forgetting September the 11th. We will remember every rescuer who died in honor. We will remember every family that lives in grief. We will remember the fire and ash, the last phone calls, the funerals of the children."

--President George W. Bush

Best regards,

Scannell Wealth Management Group

* The Standard & Poor's 500 (S&P 500) is an unmanaged group of securities considered to be representative of the stock market in general.
* The Dow Jones Industrial Average is a price-weighted index of 30 actively traded blue-chip stocks.
* The NASDAQ Composite Index is an unmanaged, market-weighted index of all over-the-counter common stocks traded on the National Association of Securities Dealers Automated Quotation System.
* The Dow Jones World (Ex. U.S.) is an unmanaged group of securities considered to be representative of the non-U.S. stock market in general.
* The NASDAQ Composite Index is an unmanaged, market-weighted index of all over-the-counter common stocks traded on the National Association of Securities Dealers Automated Quotation System.
* The Dow Jones World (Ex. U.S.) is an unmanaged group of securities considered to be representative of the non-U.S. stock market in general.
* Yahoo! Finance is the source for any reference to the performance of an index between two specific periods.
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