



Scannell Wealth Report
October 26, 2009

The Markets

What do Caterpillar, Netflix, Apple and Microsoft have in common? They all posted quarterly earnings last week that exceeded analyst expectations—and they are not alone.

We are about one-third of the way into the quarterly earnings season and a remarkable 78% of the S&P 500 companies have delivered a positive earnings surprise, according to HSBC as reported in *Financial Times*. Only 12% have missed to the downside. The huge stock market surge since March has foreshadowed these strong results and companies are delivering.

Generally speaking, the better-than-expected earnings are still being driven by lower expenses rather than higher revenue. For the stock market to continue its meteoric rise, investors want to see year-over-year revenue growth—not just more cost cutting.

The next big test for the markets may be the upcoming Holiday shopping season. If consumers shake off their frugality and spend freely, that could pump up corporate earnings into next year and keep this rally roaring. So this year, your gift purchases may deliver a double benefit—a big smile to the gift recipient and a big smile to you in the form of higher stock prices.

Data as of 10/23/09	1-Week	Y-T-D	1-Year	3-Year	5-Year	10-Year
Standard & Poor's 500 (Domestic Stocks)	-0.7%	19.5%	23.1%	-7.8%	-0.3%	-1.8%
DJ Global ex US (Foreign Stocks)	0.1	39.7	44.3	-3.5	5.9	2.1
10-year Treasury Note (Yield Only)	3.5	N/A	3.5	4.8	4.0	6.2
Gold (per ounce)	1.3	22.0	47.4	22.1	19.9	13.4
DJ-UBS Commodity Index	2.2	17.1	6.0	-6.2	-2.7	4.2
DJ Equity All REIT TR Index	0.3	16.1	15.2	-13.9	0.7	10.1

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.

PRETEND YOU ARE ON A GAME SHOW WITH MONTY HALL and he offers you the following scenario as described in a 2003 article from the *Journal of Experimental Psychology*.

You face three doors and behind one door is a car, while the other two hide goats. Your goal is to pick the door that hides the car. Here are the rules. First, the car and the goats were placed

randomly behind the doors. Second, after you choose a door, the door remains closed for now. Third, Monty knows what is behind each door. Fourth, he has to open one of the two remaining doors. Fifth, the door he opens must have a goat behind it. Sixth, if both remaining doors have goats behind them, he chooses one randomly.

After Monty opens a door with a goat, he will ask you to decide whether you want to stay with your first choice or switch to the last remaining door. Pretend you chose Door 1 and Monty opens Door 3 containing a goat. With only Doors 1 and 2 remaining—one of which contains a car—he asks you, “Do you want to switch to Door 2?”

From a probability standpoint, are you more likely to win the car by staying with your original choice of Door 1, switching to Door 2, or does it make any difference at all if you stay or switch? Before reading further, think of your answer then return to the next paragraph.

As you contemplated your answer, you may have reasoned that since one of the two remaining doors contains the car, you have a 50/50 chance of winning, so there is no need to switch. That may sound reasonable, but it is not correct. Presented with this three-door scenario, you should always switch, in fact, by switching, you have a 2/3 probability of picking the car.

Here’s the explanation, according to Michael Shermer writing in the February 2009 issue of *Scientific American*.

At the beginning of the game you have a 1/3 chance of picking the car and a 2/3 chance of picking a goat. Switching doors is bad only if you initially chose the car, which happens only 1/3 of the time. Switching doors is good if you initially chose a goat, which happens 2/3 of the time. Thus, the probability of winning by switching is 2/3, or double the odds of not switching.

Over countless studies using this “Monty Hall” problem, the vast majority of participants think that staying and switching are equally good alternatives. So, if you are in that camp, you have lots of company.

For investors, the fact that the majority of people who take the “Monty Hall Challenge” get it wrong suggests that there may be times when the majority of investors are “wrong,” too. At crucial turning points in the stock market, when there is evidence to support two opposite directions for the major averages, the majority of investors may “misread” the data (as in the Monty Hall Challenge) and draw a conclusion that subsequently turns out to be incorrect. While we will not always be “smarter” than the crowd, we do realize that, like the Monty Hall problem, the crowd is not always right. And because of our open mind, our willingness to think differently, we are constantly scanning for opportunities or turning points that may be overlooked by the crowd.

Sidebar: Are you still shaking your head about the answer to the “Monty Hall” problem? Here’s another way to look at it from mathforum.org.

What if there were 1,000 doors? You would initially have a 1/1,000 chance of picking the correct door. If Monty opens 998 doors, all of them with goats behind them, the door that you chose first will still have a 1/1,000 chance of being the one that conceals the car, but the other remaining door will have a 999/1,000 probability of being the door that is concealing the car. Here switching sounds like a pretty good idea.

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This newsletter was prepared by PEAK

Weekly Focus – Think About It

“How wonderful that we have met with a paradox. Now we have some hope of making progress.”
--Niels Bohr

Best regards,
Scannell Wealth Management Group

P.S. Please feel free to forward this commentary to family, friends, or colleagues. If you would like us to add them to the list, please reply to this email with their email address and we'll ask for their permission to be added.

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* 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*

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