



AQUILA  
GROUP OF FUNDS®

# AQUILA INVESTMENT MANAGEMENT

## U.S. EQUITY MARKET COMMENTARY

November 10, 2009

### The Outlook for Earnings

Volatility in the stock market over the past few weeks has created the type of chatter among investors and traders that usually accompanies such movements in the popular indexes. However, it is doubtful that this is the beginning of the prototypical correction which usually occurs in post-recession bull markets. Major corrections at these times almost invariably occur as a result of an increase in interest rates, especially short-term rates, and we don't expect to see that happen in the near-term. In fact, bonds have been relatively stable and short-term Treasury bill rates are near their lows. The favorable performance of the fixed-income markets reflects changing expectations for the economy and inflation.

In recent weeks, economic data have supported the case for a moderate recovery in output and profits, but have not supported what the stock market may have been anticipating – namely a robust recovery. Last week's report of 3.5% GDP growth in the third quarter confirmed what stock and credit markets have been signaling for weeks – the recession has finally ended. The question now becomes whether this recovery has legs and can potentially turn into a durable expansion. Still, a recovery is underway. The yield spread between short and long-term bonds and the relatively high valuation of the stock market is a good indication that investors were looking and hoping for more growth than they got. The numbers being reported indicate slow or moderate growth ahead.

Having taken advantage of a run-up in stock prices that approaches 60% since the March 2009 lows, investors have recently been engaged in portfolio adjustment and profit taking. The third quarter marked a return to growth for the overall economy but not a return to profit growth for most companies. Overall, corporate earnings in the third quarter fell for the ninth straight quarter; a record losing streak. Corporate results for many firms exceeded Wall Street's lowered expectations but we may not see a year-over-year increase in corporate earnings until the end of the fourth quarter. The fourth quarter of 2008 was a money-losing quarter and earnings comparisons should be easy.

In order to drive stock prices significantly higher, at some point the economy must improve sufficiently so that increased earnings would justify the prices of stocks. Then investors will want to jump on board to take advantage of the boost to financial assets which should accompany an economic recovery. The stock market may have been expecting a robust recovery a few weeks ago but the continuing evidence is that we are getting something less than what the market anticipated, leading to a reduction of those expectations.

The volatility can be unnerving. It appears likely that stock prices will begin to stabilize as investors shift their focus to earnings prospects beyond the fourth quarter. The economy is in recovery mode with analysts looking for a 20-30% rise in 2010 earnings for the Standard & Poor's 500. Profits have been hit hard by the recession but tend to bounce back quickly during recoveries. If the recovery is sustained, earnings could surge and bring investors a pleasant surprise next year.

Lynn Yturri

*For Internal / Broker-Dealer Use Only*

*Information contained herein has been obtained from sources we consider reliable, but its accuracy is not guaranteed. Any opinions expressed are based on the interpretation of data available to Aquila Investment Management, and are subject to change at any time without notice. This report is for informational purposes only and is not intended as an offer or solicitation for the purchase or sale of a security. The S&P 500 is an unmanaged index that includes 500 leading companies in leading industries of the U.S. economy therefore, its performance does not reflect management fees and expenses like those associated with the Fund. One cannot invest directly in an index. Aquila Investment Management, LLC, as well as certain of its Investment Companies or Investment Advisory accounts, may own the Securities being reviewed or recommended in this report. Aquila Investment Management LLC and others associated with it may from time to time have long or short positions and effect transactions in the securities of companies mentioned in this report.*