

Does the stock market have legs?

• As earnings season approaches, there will be profits, but will sales improve?

ON BUSINESS NEAL ST. ANTHONY

Is there more upside to the stock market this year?

Much depends on the next two weeks as large companies report third-quarter earnings. The solid second-quarter earnings, which sparked the summer rally, came mainly from cost cutting. Will third-quarter results show some indication of sustained revenue growth? That's the wild card in the early stages of a so-far tepid economic recovery.

The stock market rose last week on better-than-expected earnings and revenue in the third quarter for aluminum maker Alcoa, topped off by news that retailers were getting their first sales uptick in sales in 16 months.

Minnesota companies such as Fastenal, UnitedHealth Group, U.S. Bancorp, Tennant and Supervalu will be watched closely as they post third-quarter results over the next 10 days.

"The third-quarter performance of the Standard & Poor's 500 was the best quarter since 1998," said Greg Kulka, a veteran broker and money manager who is president of Guardian Wealth Advisors. "Institutional investor psychology has seen a positive change since 2008. They seem to be buying on the dips instead of selling on the rallies."

Optimistic forecasters, such as Brian Belski, chief investment strategist at Oppenheimer Asset Management, predict operating earnings of the S&P 500 will rise to \$60 per share over the next four quarters, indicating the market sells today for about 17.5 times those earnings. That's above the average of about 15 times earnings, but less than the price-earnings multiple top of most bull market runs in their last stretch. Belski predicts an additional 10 percent increase to 1,180 for the S&P 500 by October 2010.

Moreover, the S&P 500 dividend yield is about 2.7 percent compared with an average of 2.1 percent since 1990, Kulka said last week. That indicates stocks may have a bit more to run as the yield declines to normal levels.

"If you focus on forward earnings, stocks are not overvalued," said David Joy, chief market strategist at RiverSource Invest-

ments, the mutual fund subsidiary of Ameriprise Financial. "But for this market to move higher we need to see some evidence of increased revenue and some reason to believe that the revenue growth can be sustained.

"There's still skepticism. That's good. This rally has been fueled by institutional investors. How long does it take for retail investors to be convinced there's an opportunity? I don't think it's too late yet. But I think the upside is far more modest than what we've gotten since March."

Pension funds, trust companies and insurers have moved more money into the stock market this year. But wary individual investors have withdrawn more from stock mutual funds than they've invested through retirement accounts or otherwise.

Rallies usually peak amid buying frenzies, as the last buyers jump in for fear they're missing out and prices rise to levels not justified by earnings projections.

Meanwhile, credible naysayers believe we've rebounded too much, too soon.

George Soros, the hedge fund operator who's been right more often than not, calls the U.S. banking system "basically bankrupt," in sharp contrast to the Goldman Sachs upgrade of the large banks last week. Nouriel Roubini, the pessimistic Columbia University business professor who called the subprime crisis and its devastation, says the stock market is way overvalued and will retreat when economic news refutes sentiment that we are in the early stages of recovery.

Channeling Alan Greenspan, Joseph Stiglitz, the Nobel Prize-winning economist, told Bloomberg News that investors have become "irrationally exuberant" about prospects for a recovery.

Even optimists about the long-term future of the U.S. economy don't believe the S&P 500, which closed at 1,071.49 Friday, will top its 2007 high of 1,565 anytime soon.

"I think the market will continue to be solid as [third-quarter] earnings come in as expected or better and that there are signs that revenues are starting to improve as well," concluded Keith Tufte, founder of Longview Wealth Management of Eden Prairie. "The news will be improving revenues and strong incremental profit margins over the next few quarters of earnings. I think, at the current valuation, the market is now about fairly priced ... but there is a lot of positive momentum right now."