Earnings reports key to market rally



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Traders Richard Cohen, left, Brittany Wayne and Peter Tuchman work on the floor of the New York Stock Exchange.

Companies need to show profit, sales growth to keep bears at bay

By Adam Shell
USA TODAY

NEW YORK — The fate of the monster stock rally may hinge on how CEOs in coming weeks answer two key questions: How much money did your company make in the final three months of 2009? Do you think it can earn a lot more dough in 2010?

After the bell Monday, aluminum giant Alcoa (AA) kicked off the fourth-quarter 2009 earnings reporting season, which Wall Street views as a huge test to determine if early signs of an economic recovery point to a sustainable rebound.

Investment strategists in search of the next catalyst to propel stocks higher, after a hefty 70 percent gain since the March 9 low, say the bottom line is simple: Companies must start showing better top-line profit growth from stronger sales. Investors want to see proof that profits are rising because people are actually buying products and paying for services.

Despite beating analyst profit estimates the past two quarters, most of the "beats" were due to cost cutting, layoffs and gains in worker productivity.

Stronger sales and big boosts to revenue will be needed to give investors the courage and confidence to buy stocks on the belief the economy is healthy enough to keep growing. The cost cuts have created massive earnings leverage for companies, as their cost structures are much lower, which means stronger sales will result in big profit gains.

"This earnings season is very, very important," says Jim Paulsen, chief investment strategist at Wells Capital Management. "Improving sales are important. What it does, just like the return of jobs, is it makes profits a sustainable story, not just a short-term cyclical story."

Analysts are expecting revenue growth of 7 percent in the fourth quarter, ending a streak of four quarters of no growth. Alcoa's report was mixed, as it topped revenue estimates but still earned less money than expected.