Zachary
Karabell

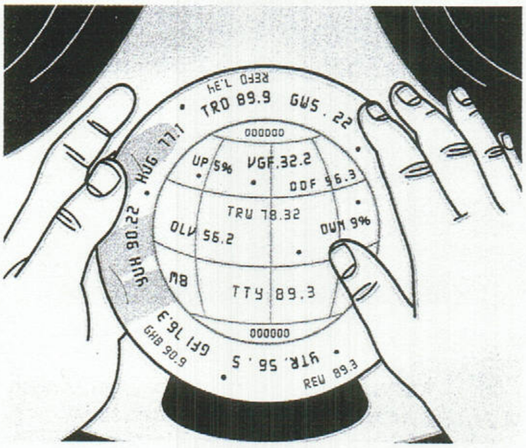
With Stocks, It's Not the Economy. Companies are no longer tied to their home GDPs. Yet we still invest that way

FROM THE BEGINNING OF MAY UNTIL LATE June, stock markets worldwide declined sharply, with losses surpassing 10%. The first weeks of July brought only marginal relief. Ominous voices began to warn that the weakness of stocks was a direct response to the stalling of an economic recovery that has lasted barely a year. Anxiety over debt-laden European countries—most notably Greece—combined with stubbornly high unemployment in the U.S. to create a toxic but fertile mix that allowed concern to blossom into full-bloom fear.

The most common refrain was that stocks are weak because global economic activity is sagging. A July 12 report by investment bank Credit Suisse was titled *Are the Markets Forecasting Recession?* With no more stimulus spending on the horizon in the U.S., Europeans on austerity budgets and consumer sentiment best characterized as surly, the sell-off in stocks was explained as a simple response to an economy on the ropes.

It's a good story and a logical one. But it distorts reality. Stocks are no longer mirrors of national economies; they are not—as is so commonly said—magical forecasting mechanisms. They are small slices of ownership in specific companies, and today, those companies have less connection to any one national economy than ever before.

As a result, stocks are not proxies for the U.S. economy, or that of the European Union or China, and markets are deeply unreliable gauges of anything but the underlying strength of the companies they represent and the schizophrenic mind-set of the traders who buy and sell the shares. There has always been a question about just how much of a forecasting mechanism markets are. Hence the saying that stocks have correctly predicted 15 of the past nine recessions. At times, stocks soar as the economy sours (in 1975, for instance) or sour when the economy soars (as with China's stock market, the Shanghai stock exchange, in the past year).



At other times, stocks have tracked or even anticipated a nation's economic strength—but that happened in an era when a strong relationship existed between the companies that traded on a particular exchange (American companies on the New York Stock Exchange, British companies in London) and the country in which they traded. For many years, American companies did most of their business in the U.S., so their results could be expected to parallel the larger economy.

But since the turn of the millennium, business and capital have gone truly global. The companies of the S&P 500 now make about half of their sales outside the U.S., and if you remove geography-bound utilities and railroads, regional banks and a fair number of retailers, the percentage is higher. Tech and industrial firms such as 3M, Hewlett-Packard and Intel derive two-thirds or more of their sales beyond the U.S. That means that even if the U.S. economy is a total wash, they can access other markets to maintain their growth. The same might be said of a German conglomerate like Siemens, a Dutch powerhouse like Philips or a Korean company like Samsung.

This is known within companies, though CEOs are often susceptible to the false story—which makes some sense, given that most CEOs are older than 50 and once operated in a world where what was good for GM was indeed good for America. But look at the actual balance sheets of thousands of global companies, large and small, and you'll find that their fortunes have diverged from those of their national economies.

Over the past two years, as unemployment in the U.S. has soared and GDP has stumbled, companies have been minting money. Tons of it. The Shaw Group, an engineering firm that makes things like nuclear power plants in Saudi Arabia, trades at about $32 a share and has $19 per share in cash. It would be as if you owned outright a $500,000 home and had $300,000 in the bank. That is the case for most companies. Their position is almost the opposite of governments' and consumers': lots of growth, little debt and mounds of money.

They have amassed that hoard of cash, and are now growing on average 20% a year, at a time when the economies of Europe, the U.S. and Japan are flat. But you'd never know that from the continued drumbeat about how markets reflect economies. Every time Apple unveils a new product and millions rush to buy it, we should pause for a moment and wonder which jobs report—the one released by the U.S. government every month or the Steve Jobs report on Apple's health—tells us more about the world.

As companies report their earnings for the second quarter of 2010, it will be harder than ever to escape the fact that corporations now inhabit their own thriving economy, unencumbered by many of the ills of nation-states. That may be exhilarating (if you're an investor) or troubling (if you're a citizen), but either way, it's time to let go of the false belief that as goes the economy, so go companies and their stocks. ■

Over the past two years, as unemployment in the U.S. has soared and GDP has stumbled, companies have been minting money