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Coming Week: Now Come Earnings

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NEW YORK (TheStreet) -- Earnings reports from blue-chip companies in the coming week will provide investors with the first real indication of how the European debt crisis and continued economic stress have affected Corporate America's bottom line.

Stocks lost a good deal of value over the second quarter, but the start of July has indicated a sharp about-face in sentiment. The **Dow Jones Industrial Average** rallied more than 400 points this week alone. The question is whether the bulls will be disappointed next week, further the rally or sell the good news. With recent volatility -- at times inexplicable -- it's been hard to predict.

"An important thing to take away from this is that we have to get used to continued volatility," said Curvin Miller, a vice president at Russell & Co. a wealth-management firm for seniors in Fairborn, Ohio. "It's not going anywhere; it's here to stay."

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Five Dow components will be reporting next week, starting with **Alcoa** (AA) on Monday, **Intel**(INTC) on Tuesday, **JPMorgan Chase** (JPM) on Thursday and **General Electric**(GE) and **Bank of America**(BAC) on Friday.

Wall Street believes Alcoa earned 12 cents per share last quarter, a reversal from the aluminum-maker's year-ago loss of 26 cents per share, according to *Thomson-Reuters*. Analysts expect GE to say it added a penny to EPS over the past year, pegging the second quarter at 27 cents.

Estimates for JPMorgan and Bank of America represent a tale of two companies, muddled by special factors related to the government's bailout program. The Street is bullish on JPMorgan, believing the firm more than doubled EPS performance -- from 28 cents a year ago to 72 cents last quarter. Analysts are less optimistic about Bank of America's results, estimating the firm's EPS declined 39% to 20 cents per share. The changes are affected by JPMorgan's TARP payback a year ago, as well as Bank of America's stock offering to repay TARP at the end of 2009.

"Their earnings reports are all a mess anyway, because it's all fictional accounting at this point," said James Dailey, portfolio manager of the TEAM Asset Strategy Fund. "It's all about how the market reacts to it rather than the numbers."

The momentum of this week could carry into next, as long as earnings reports and a retail sales report on Wednesday aren't completely abysmal. Investors will be scrutinizing the reports to figure out how companies have been handling economic difficulties: Accepting lower margins to woo customers? Raising prices and accepting lower revenue due to the price-sensitive environment? And will consumers keep spending if they do?

Still, after months of convulsive action that repeatedly ended on the downside -- the flash crash of May 6, ongoing euro woes, financial-reform concerns, weak home sales and consumer sentiment -- Miller believes that the market has shifted because there was too much negativity for too long.

"The market is in need of some good news," said Miller, "and less bad news is going to translate into good news."

Dailey agreed. "A lot of the sentiment technical factors had reached extreme down parameters," he said.

Dailey looks forward to volatility as a chance to boost returns. One of his firm's funds gained 12% in 2008 by capturing gains from rallies and avoiding selloffs. He said the recent volatility recalls corrections in August 2007, when investors first started noticing subprime problems -- which reversed to reach a market high just two months later. Similarly, in March 2008, after Bear

Stearns collapsed, "fundamentals went to hell in a handbasket, but we still had a rally," Dailey pointed out.

Dailey believes the second-quarter reports will be far ahead of bearish estimates, especially Intel, on which his fund holds call options. He suggests investors use any strength as "a gift" to either cash out of positions or reallocate funds. Dailey thinks small- and mid-cap stocks are overvalued and "vulnerable to get crushed," while large- and mega-cap firms are trading at more reasonable multiples with better dividend yields.

"My advice would be to sell Russell 2000 small-cap/mid-cap space and raise cash or rotate into things like the Dow Jones," said Dailey.

Christian Wagner, chief investment officer and CEO of Longview Capital Management, took another view: He's avoiding the U.S. space altogether right now.

"I've heard the term 'sucker's rally' about five times this week," said Wagner.

Instead, he's put money into emerging-market ETFs that focus on specific countries: Chile, Malaysia and Indonesia, as well as the **Wisdom Tree Small Cap Value International Fund**(DGS). Wagner believes emerging markets as a whole have held up better than other areas. Additionally, he said emerging-market stocks are still attractively valued because they have more room to grow than mature markets.

"We're sitting here in the U.S. with our goggles on like the only things that happen are here in the U.S.," said Wagner. "To be a successful investor, you've got to go out and find those opportunities."

As a general rule of thumb, even for those wearing goggles, Wagner suggests investors look to the most resilient firms: "If the market's going down 10%, we're looking for something that's only gone down 5%."

-- Written by Lauren Tara LaCapra in New York.

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