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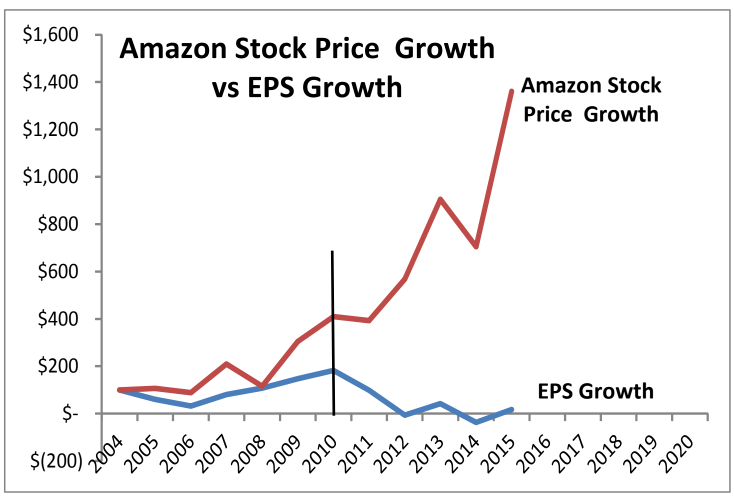
Amazon Keeps 'Em Fooled

Amazon had a great week. Earnings were..... not great, but better than how bad the consensus expected, so the stock shot up.

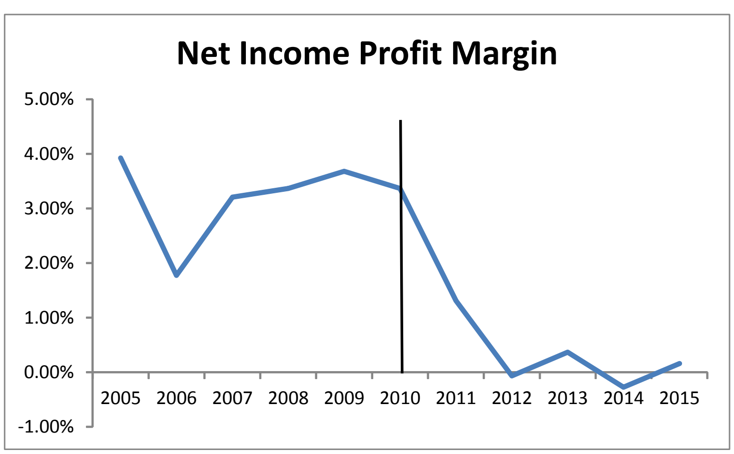
In our opinion, Amazon is the perfect example of what is wrong with the stock market.

There is supposed to be some sort of relationship between the stock price and EPS (Earnings Per Share). There is none with Amazon. We created a chart to show just how far off the price is compared the EPS. We normalized both EPS and stock price at $100 in 2003, and then applied annual EPS growth and annual stock price growth. There should be somewhat parallel movement. Prior to 2010, there is. But since 2010, Amazon's EPS has been declining while the stock is skyrocketing.



Source: Yahoo, NASDAQ; Format: CIS

2015 is for the 1st 9 months in both charts



Source: S&P Marketscope; Format: CIS

To our understanding of fundamental research, this makes no sense.

Amazon is no different than any other mass retailer. Other retailers have gone through the same cycle. As soon as the uniqueness wears off, revenues start to drift. When that happens they slash prices, (and profits), to bring people back. Revenues go back up, but profits slide. Once you get shoppers used to low prices, there is no going back. You cannot raise prices. You lose customers if you try to raise prices.

This scenario has been done over an over again by retailers in the past. Ask Sears, K Mart, and Montgomery Wards how it worked for them. They each at one time dominated retail.

Amazon saw sales growth slow in 2008. Revenues came back in 2009, but profit margins collapsed in 2010. Now the question is, how do they get profit margins back up? As the previous mass merchant failures have shown, it is very difficult to do.

To celebrate the minuscule increase in profit margins for the first 9 months of 2015 seems a bit premature. Yet this is what investors clamor for. They buy the "darlings" regardless of fundamentals.

And this is why Amazon is the perfect example of what is wrong with the market. Eventually, you have to show earnings, *and* earnings growth. When investors realize they have been fooled again, it will not likely be pretty, for Amazon and the market.

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