A funny thing happened in the 2nd quarter of 2010. Most companies made more money than expected. Anyone reading the newspaper headlines in May and June would have been justified in believing that the wheels were coming off the economies of all the leading countries. European nations were threatening default on their debt, putting stress on already weakened banks. Unemployment remained so high in the U.S. that "double dip" appeared in the headlines almost every day. China was said to be stomping on the economic brakes, threatening to kill commodity prices. And yet, three out of four of the largest companies in the world reported earnings that were higher than forecast. How can that be?

Let's begin with the premise that the news media have a bias towards the bad. Headlines like "things are okay, no need to worry" are not likely to garner much attention in a very crowded and competitive industry. The internet demands fresh content on an hourly basis, and if it is not interesting, one click takes the viewer to a different site. High unemployment, falling house prices and failing banks are inherently sexier and more likely to capture attention than the news that companies are going about their business, making money and raising dividends. The same, of course, is true of market commentators. Getting a great nickname such as "Dr. Doom" or the "Perma-bear" is good branding, but demands that the commentator stick to his or her thesis, even if the evidence no longer supports it. We don't like flip-floppers.

In fact, the economy is doing pretty well. Certain sectors such as new home construction in the US remain depressed, but for a good reason – there are still too many houses left over from the bubble days. Once the excess inventory is gone, new home sales will pick up. Retail sales are sluggish but again for a good reason – consumers are winding down the excessive debt they incurred in the pre-recession years, a necessary step to a more stable economy. Unemployment is stubbornly high, but showing gradual improvement in the U.S., and Canada has now regained every job lost in the recession. Commodity prices are not at the boom levels of 2007 when oil hit $140 per barrel, but they are high enough to allow companies to do very well indeed. Bell-weathers sectors are showing increased activity – from truckers, to freight forwarders to railroads.

Secondly, what is bad for the economy may be good for a company. Investors must always remember that behind every stock there is a company, and that we invest in that company, not in the economy.

One of the things that happened in the first half of the year is that companies made more profits on lower sales. In other words, their margins went up. In part, this is because they carried on business with fewer workers. The U.S. economy shed over 5,000,000 jobs during the recession. This was terrible for the laid off workers and terrible for the economy as a whole, but it forced companies to do more with less. Obviously if a company can produce the same revenue with a smaller workforce, it will make more money. This is called raising productivity, something every Government claims to want.

Finally, very low interest rates and government stimulus spending continued to have a positive impact on corporate earnings. Companies were able to raise capital at record low costs. Banks paid almost nothing on deposits, raising their margins. Construction and infrastructure companies are still benefitting from projects which were approved in the depths of the recession.

Stock prices, in the end, are driven by corporate profits, not by headlines about the economy. The rising profits we saw in the 2nd quarter bode well for stock prices for the balance of the year. Better earnings lead to increased investor confidence, and we may finally be seeing some of the huge stockpile of cash which has been sitting in money market and bank accounts coming back into the market. All in all, a much sunnier picture than has been presented in your morning newspaper.