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Economic Commentary

MARKET MUSINGS & DATA DECIPHERING

Breakfast Lite with Dave

IN TODAY'S ISSUE OF BREAKFAST WITH DAVE

- While you were sleeping: global equity markets are up sharply to start off the week and in turn, the safe-haven sphere of government bonds are selling off
- The good and the bad. The good: the Nasdaq is the first major U.S. stock market to reclaim its 200-day moving average; the bad: the rally was on extremely low volume
- Gold may be near-term overbought: we remain long-term bullish on gold, but there is a herd mentality now that is a little disconcerting
- Why the U.S. States are not PIIGS: the comparison of the U.S. State and local government with the nanny states in Europe is unfair
- U.S. consumer sentiment up a tad
- Double-dip, anyone? The latest figure on the smooth ECRI weekly leading index has now turned negative, which is now signaling an 80% chance of a double-dip recession
- No sails in retail sales: U.S. retail sales came in far weaker than expected in May

THE GOOD AND THE BAD

Let's start with the good. The Nasdaq became the first major average to reclaim its 200-day moving average level to close out the week (the small-cap S&P 600 index did so on Thursday). According to the Investor's Business Daily, new highs outnumbered new lows for just the second time in the past two weeks; and, the market closed near the highs of the day for the second straight session. But … the rally last Friday was on extremely low volume — for the Nasdaq, it was actually the low-water mark of the year. The market is still devoid of follow-throughs on big volume — that is a problem for the bulls.

GOLD MAY BE NEAR-TERM OVERBOUGHT

Don't get me wrong, I'm still very bullish on a long-term basis; however, there is a herd mentality now that is a little disconcerting. Far too many front-page headlines like *Growing Demand for Bullion Hands Banks Golden Opportunity in Storage* in the weekend FT (another article on this topic surfaced on page 15 — *Demand For Bullion Puts Strain on Vaults*) and *Financial Uncertainty Restores Glitter to an Old Refuge* in the Sunday NYT.

WHY THE U.S. STATES ARE NOT PIIGS

There are several reasons why the comparisons of the State and local governments to the nanny states in Europe are unfair. For one, the U.S. does have a central government that has already been directing large blocks of cash to the lower levels. Second, as we have seen in the latest round of GDP and employment data, the State governments are cutting spending and jobs aggressively. Third, unlike the Club Med nations, the State governments are also taking action towards restructuring their expensive social contracts: see *State Pension Cuts Face Test* on page B3 of the weekend WSJ (state pension funds are reducing their payouts to retirees … facing the knife that private sector workers have already endured) and *Taking on the Unions in California--and Winning* on page 15 of today's Investor's Business Daily.

CONSUMER SENTIMENT UP A TAD

It's a little strange that the equity market would be looking more at a survey than in the actual spending data. Maybe Mr. Market was looking at neither — but consumer confidence (University of Michigan) did rise 1.9 points to 75.5 in June (the consensus was at 74.5) — the best tally since December 2007. But to put 75.5 into perspective, it is just about in line with the average levels we have endured in past recessions.

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DOUBLE DIP, ANYONE?

The smoothed ECRI leading economic index fell in the opening week in June for the fifth week in a row and now down in nine of the past ten. The index, went from +0.3% to -3.5%, the weakest it has been in a year. After predicting the V-shaped recovery we got briefly in the inventory-led GDP data when the index soared off the bottom in late 2008, at -3.5%, we can safely say that this barometer is now signalling an 80% chance of a double-dip recession. It is one thing to slip to or fractionally below the zero line, but a -3.5% reading has only sent off two head-fakes in the past, while accurately foreshadowing seven recessions — with a three month lag. Keep your eye on the -10 threshold, for at that level, the economy has gone into recession … only 100% of the time (42 years of data).

Double-dip watch: The ECRI weekly leading index has now swung from +0.3% to -3.5% for the week ending June 11

Suffice it to say, when the ECRI was drifting lower in 2007, it got to -3.5%, where are we are now, in November and unbeknownst to the consensus at the time that a recession was only one month away. Remember that the economics community did not call for recession until after Lehman collapsed — nine months after it started; and go back to 2001, and the consensus did not call for recession until after 9/11 and again the economy had been in recession for a good six months). We should probably point out here that real M3 has contracted at the fastest rate since the early 1930s, as John Williams has published, and declines in the broad money measured has foreshadowed every recession in the past seven decades.

NO SAILS IN RETAIL

U.S. retail sales came in far weaker than expected in May with a 1.2% MoM decline, the worst print since last September. As we had warned, much of the pickup in unit auto sales last month that got everyone excited was in fleet sales (government buying) so we actually saw a hefty 1.7% decline in motor vehicle receipts (could have been some deflation as well).

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As bad as the data was, the "core" number (retail sales excluding autos, building supplies and gasoline station sales) that goes into the consumer spending part of the GDP data did manage to eke out a 0.1% MoM gain — soft, but hardly a disaster. There were a few bright spots that held this metric up, including furniture/appliances (+0.8% MoM); food and pharmacies were both up 0.3% too — steady-as-she-goes sectors.

But overall, it was clearly a disappointment to see that in a month when households spent 3.3% less filling up their cars and posted a nice (though less than expected) 431k gain in employment that the rest of the retail spending pie was trimmed 1%. Maybe frugality is back in, and the savings rate is heading back up. When the economy is not in recession, declines in gas station receipts coincide with gains in ex-gas retail sales more than 80% of the time. Maybe something funky is starting to go down here.

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Gluskin Sheff at a Glance

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