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Economic Commentary

Gluskin Sheff

MARKET MUSINGS & DATA DECIPHERING

Deep Dish with Dave

Chicago, the city of bulls, bears and cubs — how perfect.

What hasn't been is the weather, which calls for pinot noir at the hotel bar.

And some market and macro musings, vacation notwithstanding.

I see once again that the S&P500 is at a crossroad, but this time after a huge bounce. The market is having as much trouble now with resistance levels as it was encountering difficulty breaking below support levels just a short month ago.

Once again that the S&P500 is at a crossroad, but this time after a huge bounce

Currently, the S&P 500 is a lock between 1,000 and 1,200 and we are now right at the midpoint. This range-trade pattern will break at some point and my sense is that it will be to the downside, and at that time we will see who has the cash (to put to work) and who's left with the trash (and about to be trashed).

The level of complacency over the economic outlook is palpable and so reminiscent of the fall of 2007 when everyone believed the Fed could navigate us into a soft landing in the face of a credit collapse. Now the pundits have all but abandoned the ECRI index as a leading indicator (even the architects have) of economic activity. The ISM is dipping, but still above 50, didn't you know. Corporate earnings were stellar in the second quarter — who cares if the results were skewed more to April than June? The savings rate has spiked to 6.4% in June, and many pundits see this as a valve for the U.S. consumer to reload the spending gun as opposed to a new secular theme of frugality.

So, many market commentators and prognosticators still see this cycle as a classic post-war correction in GDP than what it really is — the aftershocks of a post-bubble credit collapse. A double-dip recession may well be averted, but the risks are not trivial and the major point here is that the statistical recovery that was underpinned by the arithmetic contributions to GDP growth from inventories and the massive support from unprecedented fiscal and monetary ease is proving to be extremely fragile. Why else would Democratic senators now be voicing opposition to allowing the Bush tax cuts to end (the ones they criticized vehemently in the 2008 election) and why else would the Fed be hinting strongly at extending its quantitative easing strategies if the consensus view of 2.75% real GDP growth, was realistic? The odds of something closer to zero are higher than many think.

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After all, after yesterday's economic data, there is almost no growth "built in" for consumer spending as far as Q3 is concerned. In Japan-like fashion, the only thing that is preventing U.S. consumer spending from contracting outright at the current time is a negative price deflator, which is helping to flatten the data in "real terms". (As an aside, anyone notice that the yield on the 10-year JGB just dipped below 1% for the first time in seven years? Just in case you thought 3% in the U.S. and Canada was too low — they may in fact be as much a bargain today as they were at 4% earlier this year and 5% in the summer of 2007.) Consumer prices in the U.S. have now fallen three months in a row (as measured by the PCE price deflator) and the last time we had a three-peat of deflator declines was when the economy was plumbing the depths back in the opening months of 2009. It is against this deflationary backdrop that "yield themes" shine as far as investment strategies are concerned.

Going into the third quarter, there is almost no growth "built in" for consumer spending

Moreover, the sharp and unexpected 2.6% decline in pending home sales points to a huge reversal in housing this quarter as well. Recall that the tax incentive induced housing boost in Q2 added six-tenths of a percent to that already lukewarm 2.4% GDP growth rate last quarter.

We also now have to contend with the end of the mini inventory cycle that was responsible for nearly two-thirds of the GDP rebound from last year's depressed lows. The ISM may well be above 50, but it has still declined for three months in a row — slipping to 55.5 in July from 56.2 in June. And, out of the 18 industries polled in the ISM, only 10 reported growth, which was down from 13 in June and the lowest tally since December 2009, while 4 actually contracted. Inventories jumped to 50.2 from 45.8 and it would seem as though this sudden re-stocking looks to be unintended — after all, production and orders slid to their lowest levels since June/09. Had inventories been flat, ISM would have been down to 54.6. What really stood out was the new orders component — down 12.2 points in the last two months. The last time this happened was October 2008 and in fact is a 1-in-25 event. The 4% of the time this does occur is in or near recessions but rest assured, like the ECRI, this is nothing more than a relic… Right.

The ISM may well be above 50, but it has still declined for three months in a row

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Gluskin Sheff at a Glance

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For further information, please contact questions@gluskinsheff.com

Notes:

Unless otherwise noted, all values are in Canadian dollars.

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3. *Returns are based on the composite of segregated Value and U.S. Equity portfolios, as applicable, and are presented net of fees and expenses.*

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