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Economic Commentary

Gluskin Sheff

MARKET MUSINGS & DATA DECIPHERING

Breakfast with Dave

MARKET COMMENT

The Dow very briefly breached its April 26 interim high yesterday but 11,205 seems to be posing some serious resistance to the upside. It may well be the case that hopes that QE2 will work have established a firm near-term floor for Mr. Market, but hope is still not much of a strategy. Somehow there is a view that the economy is out of the sickbay, but below we attempt to dispel that myth and one has to wonder what the message is out of the fixed-income market from a -0.55% yield emanating from yesterday's TIPS auction. Talk about a new form of risk aversion. And what's this about newspaper circulation going down 5% year-over-year (see page B4 of the NYT).

While over 80% of the S&P 500 universe are beating their beaten-down Q3 estimates, as the 'Ahead of the Tape' section of today's WSJ poignantly points out (see page C1), excluding financial, profits have moderated to (a still-solid, however) 21% YoY trend, but that slows even more dramatically based on consensus estimates to just 11% in Q4. Let's keep in mind that with the U.S. dollar heading down to 15-year lows, this equity market "rally" in the U.S. has been far less than impressive for a global investor (a good take on this in the "Short View" on page 15 of today's FT).

TRADING DOWN

Every man's dream (not woman's!) today is to go back and buy back the last house he sold. In other words, we all regret that decision to trade-up during the bubble years as everyone made the fatal mistake of linearly extrapolating years of double-digit price appreciation into the future.

So, while the media types loved the fact that residential re-sale activity jumped 10% in September, the real story is that homeowners are in the process of trading down. The move-up buyer has become a very rare breed, if not D.O.A.

While September existing home sales in the U.S. rose 10.0% to 4.53M, which far surpassed consensus forecasts, median house prices fell 3.3% MoM, the steepest monthly drop since January 2010 and the third decline in as many months (all regions were down too). Over that three-month span, resale home prices have tumbled at a 22.5% annualized rate — the largest drop on this basis since February 2009 when the economy was in the abyss.

Deflation remains the dominant intermediate-term risk, particularly in the realm of residential real estate. And, the backlog of active listings for sale remains massive at 10.2 months' supply for single-family homes and 14 months for condos.

IN THIS ISSUE

CHICAGO INDEX CONFIRMS STALL-SPEED ECONOMY

Both the U.S. Chicago Fed National Activity Index and our measure of the 'real economy' LEI point to an economy that is slowing down meaningfully into Q4 and early next year

One of the most comprehensive measures of the economy is the Chicago Fed National Activity Index and for all the talk of how the economy has turned around, this broad barometer weakened to -0.58% in September (versus -0.3% expected). This was the second negative reading in a row.

The key three-month moving average metric dipped to -0.33%, from -0.32% and has been negative now for four months in a row, signalling below-potential growth.

We ran some regressions and found that the Chicago Fed index is pointing to sub 1% real GDP growth in Q4. That is not a contraction but it is too close for comfort.

'REAL ECONOMY' LEI POINTS TO ANEMIC GROWTH

Last Friday, we mentioned that we stripped out the S&P 500 and the yield curve out of the Conference Board's index of Leading Economic Indicators (LEI) to get a sense of what the 'real economy' was doing. We also ran some simple regressions versus real GDP and found that the real economy LEI has a better correlation than the official LEI — r-squared was 70% versus 60%.

This is worrisome as on this basis, the real economy LEI has fallen four months in a row, and suggests that real GDP could slow meaningfully into this quarter and early next year (we currently expected Q4 real GDP to be sub 1%). Not only that, but the coincident-to-lagging indictor fell 0.4% MoM in September, the third decline in as many months and also points to weaker growth ahead.

Gluskin Sheff

Gluskin Sheff at a Glance

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$1 million invested in our Canadian Value Portfolio in 1991 (its inception date) would have grown to $10.9 million[2] on June 30, 2010 versus $5.4 million for the S&P/TSX Total Return Index over the same period.

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$1 million invested in our Canadian Value Portfolio in 1991 (its inception date) would have grown to $10.9 million[2] on June 30, 2010 versus $5.4 million for the S&P/TSX Total Return Index over the same period.

For further information, please contact questions@gluskinsheff.com

Notes:

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