



MCAG MACRO: The Lost Summer

September 1st, 2010

It's hard to tell whether today's rally is an explosion of return to risk that investors have been waiting for or just a technical bounce and short cover coming off month-end selling that ended the worst August in nine years. I tend to lean toward the latter. Initially, today's equity rally was fueled, in part, by positive data out of Asia, where the Chinese PMI snapped a three months losing streak with a rise from 51.2 to 51.7 pts. The Australian GDP rose by 1.2% in the Q2, beating the market consensus of +0.9%. A solid performance of the Asian economies provides optimism about the global economy, should the conditions in the US economy still wane, which also offers a realistic reason for yields to rise, other than just based on a transfer into equities. Then the real catalyst came when the August ISM Manufacturing Index beat expectations, clocking 56.3 versus market expectations for 52.8.

Either way, today's rally, if not completely decimated by the close of trade tomorrow, sets us up for a pull-back if NFP disappoints or even doesn't beat expectations with the rigor that ISM did today. You all know I don't use equity markets as a gage of anything, let alone the state of recovery, so I'm going to turn your focus back onto the grander macro-economic picture. This is in spite of the chatter going on that today's rally signals the reversal of the short equity, long treasury trade that has worked all summer. I'm not saying that's not the case but as I've said before, one day does not a recovery make.

It was easy to poke holes in the hope that yesterday's better than expected data. S&P Case-Schiller Home Price Index rose 1.0% in June after a 1.3% rise in May but that was dismissed as having been masked by the home buyer tax credit, which I agree with. The surprise rise in the Conference Board's Consumer Confidence Index which unexpectedly rose to 53.5 in August from 51.0 in July can be dismissed as it remains at more depressed levels than previous recoveries. Any hope given the markets by either data piece yesterday was shot down after the release of the FOMC minutes, which generally speaking, clued us in to both the reality that growth had softened somewhat more than members had anticipated and that members would only consider large scale asset purchases if the economy weakened "appreciably."

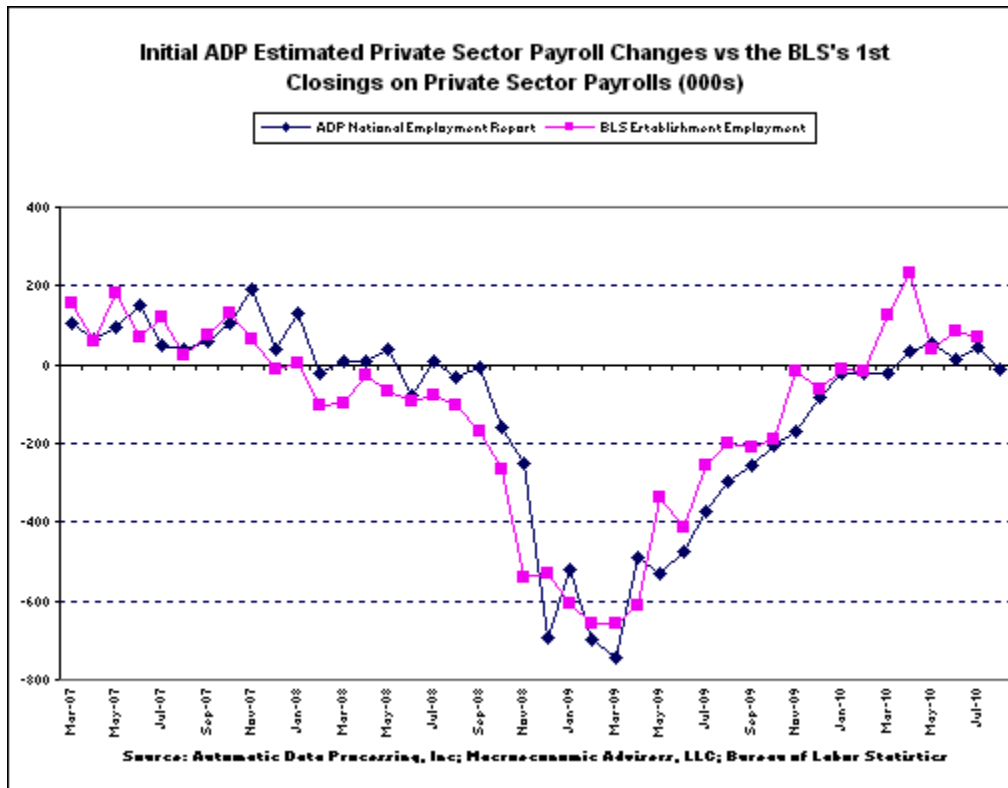
Regardless, those looking for clues of a Japanese lost decade rerun coming off the Jackson Hole meeting, mixed but unpleasant data, dismal Fed Minutes, and the worst August in nine years got a bit of a

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reprieve in today's rally and data. Even if those doomsayers are right about deflation they still might be wrong. As "hindsight is 20/20" sounding as it may be, I like James Mackintosh's point this morning in FT's Short View that "Japan's experience suggests economies can function perfectly well with entrenched deflation." (This statement must be footnoted with his insert that economist Andrew Smithers points out that ageing population effects data and Japanese GDP per person of working age rose at more than double the rate of Germany, faster than that of the UK, and close to that of the US while on paper GDP rose only half the level of the US in the 2000's.) I would never imply that a deflationary scenario is imminent; I just think market disappointment coming off the minutes that more government intervention is unlikely is misplaced.

We may very well get some more confirmation that we're not in such bad shape by Friday's non-farm payrolls number. I think it will be short-lived though. My crystal ball tells me we'll continue to see a mixed bag of data, we're not out of the woods yet, and equities will continue to get gitty every chance they get. Either way, it's September now, the excuse of quiet, low-volume, unpredictability is in the rearview, and now it's time to step it up and go back to work.

The August ADP National Employment report showed a 10,000 decline in private sector payrolls. According to Stone and McCarthy Research, this is consistent with expectation of a 50K increase in the Bureau of Labor's private sector measure. However, they point out that we must remain mindful that in recent months the ADP reading has been weaker than BLS. Stay tuned.



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A bit silly, but interesting view:

<http://www.zerohedge.com/article/michael-pento-says-fed-will-buy-stocks-and-real-estate-its-next-attempt-create-inflation>

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