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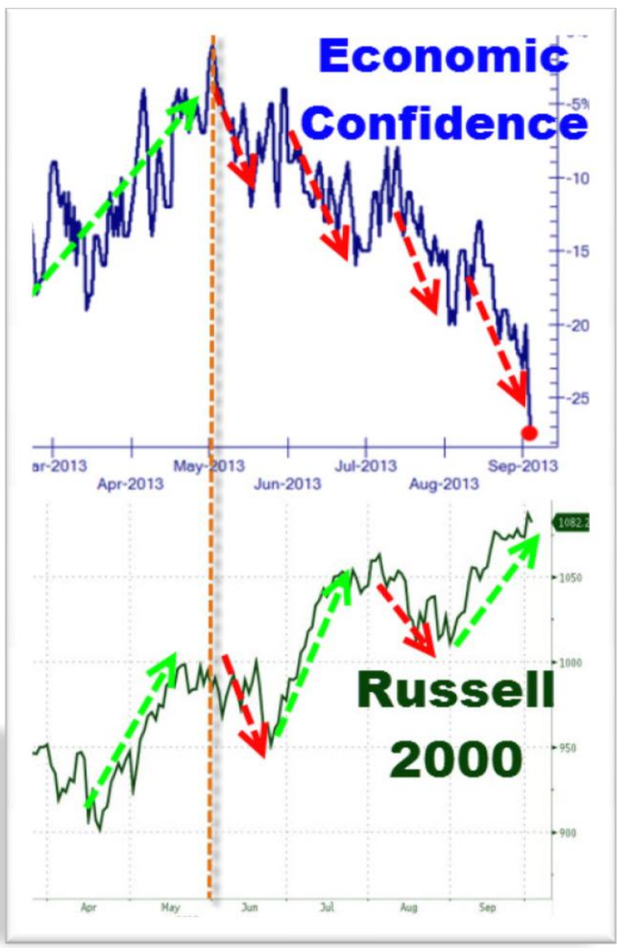
CONFUSING CROSS CURRENTS

ANALYTIC INSIGHTS - NOVEMBER 2013



Gordon T Long
10/27/2013

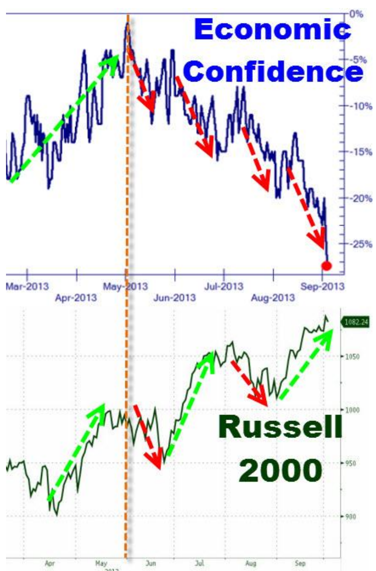
CONFUSING CROSS CURRENTS

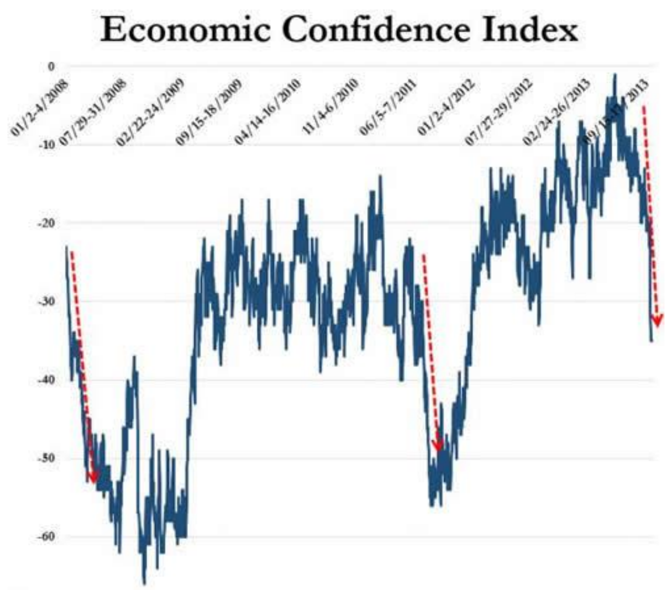
Let’s take a quick walk through some of the blatant cross currents and divergences being caused by what can only be termed Monetary Malpractice.

The Gallup economic confidence index shown here has collapsed. In fact, this is the worst 3-week plunge since Lehman Bros. It is worse than during the 2011 Debt Ceiling debacle**.**

It is hardly a surprise that the most recent University of Michigan consumer confidence slumped to its lowest since January, having fallen 3 months in a row. This is the 2nd monthly miss in a row and the biggest 3-month drop in 25 months. Both appear to confirm the cyclical turn we have been discussing for a few months.

However, compare this to the relentless rise in the Russell 2000 index. Remember, the exuberance of PE multiple expansions relies on an ever-rising confidence of investors to continue to lift it.

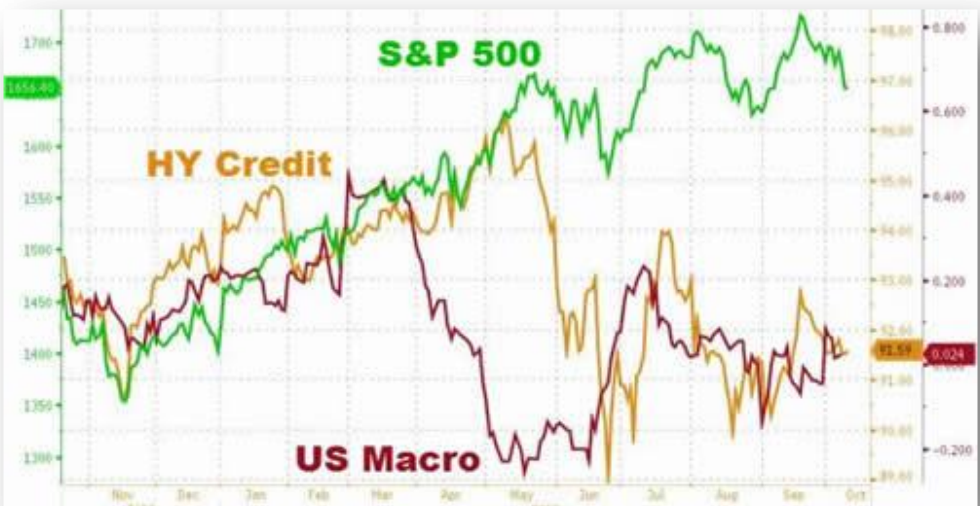




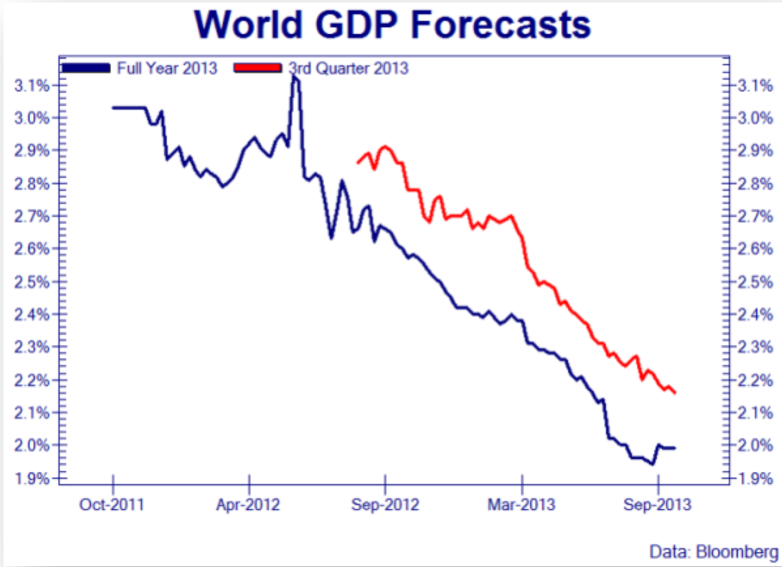
The University of Michigan consumer sentiment is more reflective of the lack of employment opportunities and the pressures on real disposable incomes even by those who do have full time jobs.

It is a completely different picture for corporate profits which are off the scale from an historical perspective as labor has been squeezed through benefit reduction, labor arbitrage and ever expanding automation processes.

But things are not as rosy as the corporate profit picture would indicate. Credit markets, specifically in high yield (HY) are diverging from the S&P 500, as is the US Macro index. This has been going on for awhile and usually is well correlated. They are signaling that the fundamental underpinnings of the market are weak.



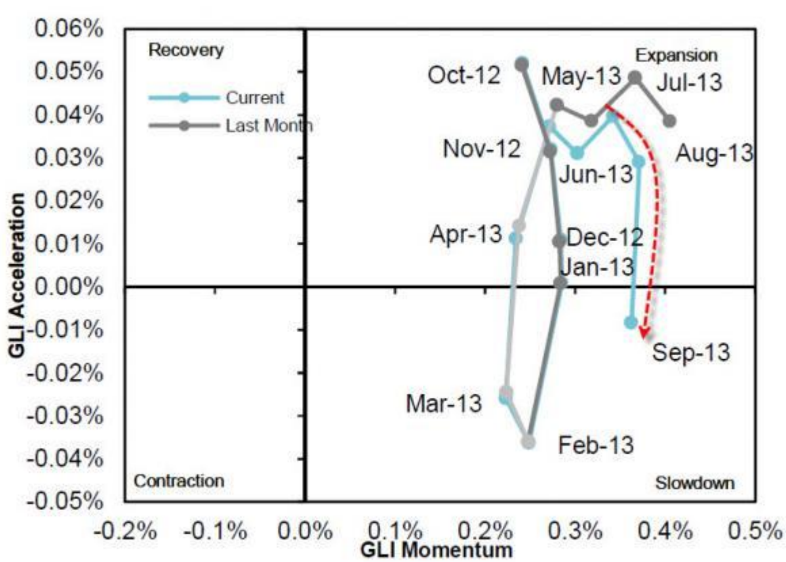
The confusing cross currents are by no means unique to the US economy. The Global GDP forecasts continue to be reduced which implies revenue and earnings pressures on the DOW and S&P 500 corporations**.** These pressures have been temporarily camouflaged by cost cutting and creative accounting, but corporate CFO's are quickly running out of runway**.**



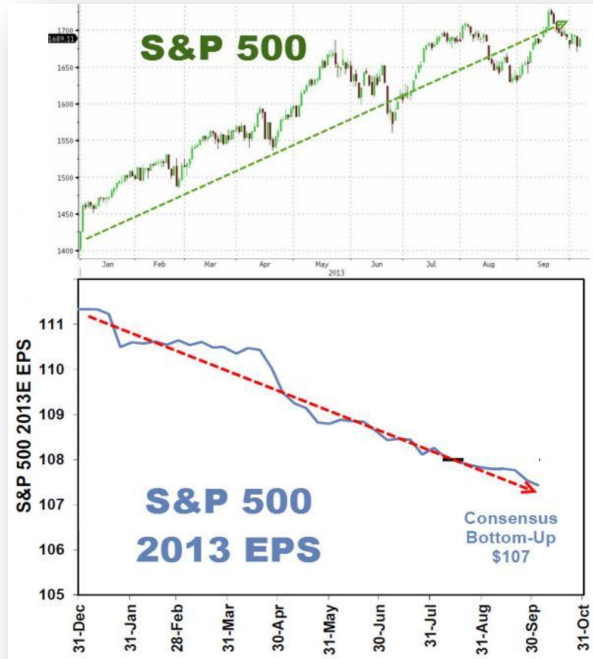
Everything apparently looked good in August when Goldman's global leading indicator (GLI) "swirlogram" had recovered quickly from a 'growth scare' in Q1 and was holding firmly in "expansion" territory. Then reality hit as:

- New-orders-less-inventories worsened,
- Global manufacturing & PMI surveys rolled over,
- Industrial metals gave up gains, and
- Korean exports provided no help.

Global Leading Indicator Swirlogram



Source: Goldman Sachs Global Investment Research



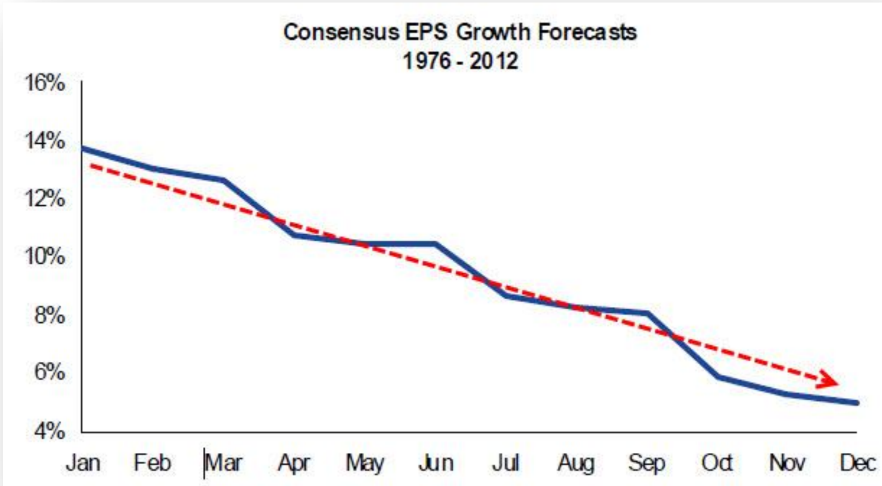
Among the few factors holding up the index from already plunging levels was the Baltic Dry Index (which has subsequently collapsed) and Consumer Confidence (which as we just discussed appears to also be rolling over).

September's plunge into "slowdown" for the GLI is the biggest drop in 8 months**.**

As you would surmise from all of this that the consensus earnings estimates must be witnessing pressures to reflect all of this. With little attention they have. Like a thief in the night they have been steadily reduced.

Recently however they have noticeably increased their rate of reduction as the obscene year end 'hockey stick' must now be removed quietly under the media glares of debt ceiling and budget wrangling coverage.

This is nothing new. It is the way of Wall Street as can be seen on the historical patterns of consensus earnings growth forecasts, but it has become even more distorted recently, if that is possible?



We have been warnings of an earnings recession and if you turn off CNBS, you will be able to see it quite visibly!

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