Macroeconomic Update

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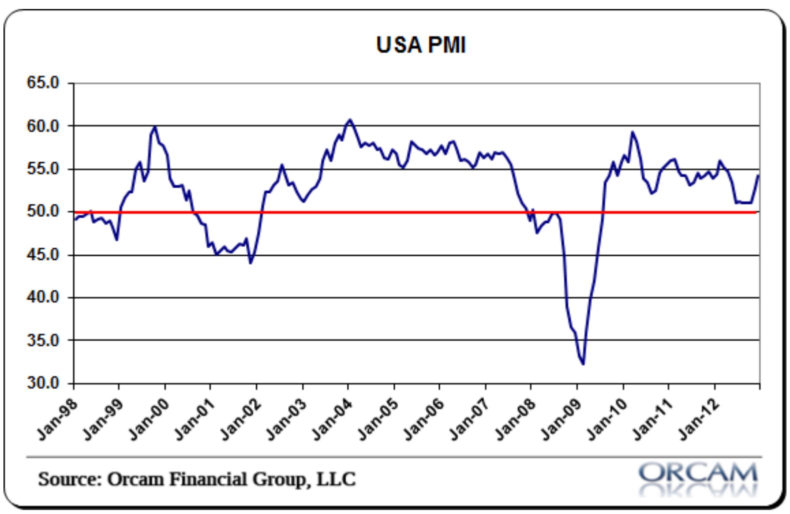
The Big Picture

There's been quite a bit of economic data in recent weeks that has provided great clarity on the current macroeconomic picture and the likely path forward.

The Flash PMI for December showed considerable strength at 54.2, up from 52.8 in November. Markit reports that the improvement is consistent with a "turning point" in the economy and likely points to better growth in manufacturing ahead.

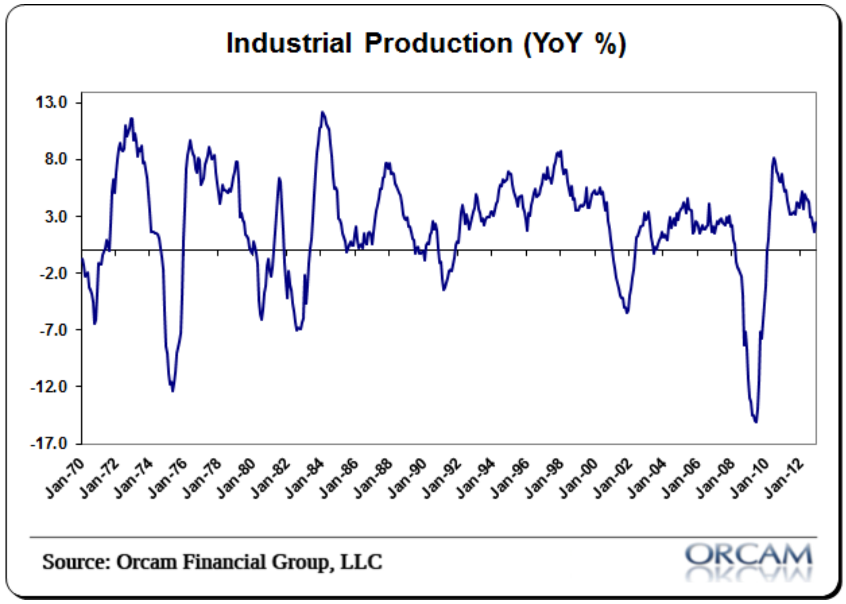


This morning's reading on industrial production is telling a similar story. Industrial production is showing a 2.5% year over year increase which is consistent with an economy growing modestly.

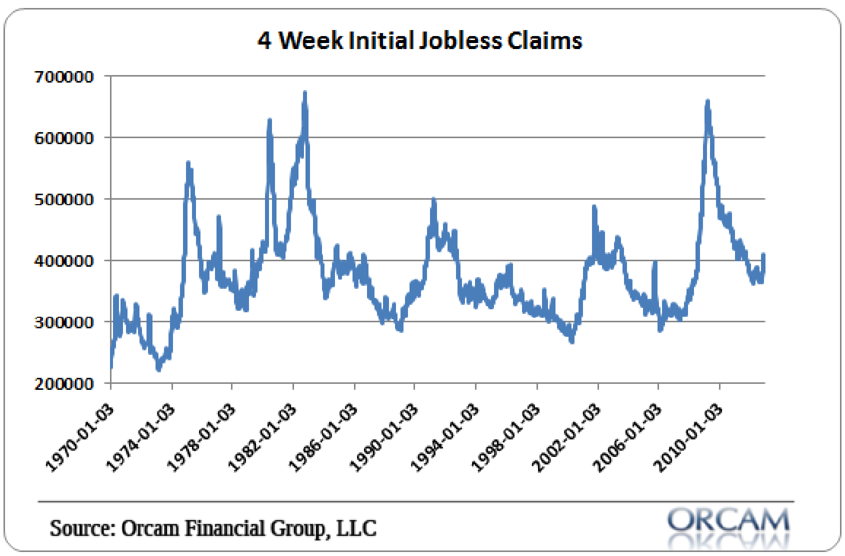
(continued...)

Long story short—The Economic Picture Appears to be Stabilizing….

The report on industrial production also showed an improvement in total capacity utilization from last month's reading of 77.7 to 78.4. This is consistent with the pre-hurricane readings in the mid-78 area. Historically, the economy has averaged a substantially higher level of capacity utilization with an average reading of 81 since 1965. The current readings are still a sign that the US economy is operating well below it potential.

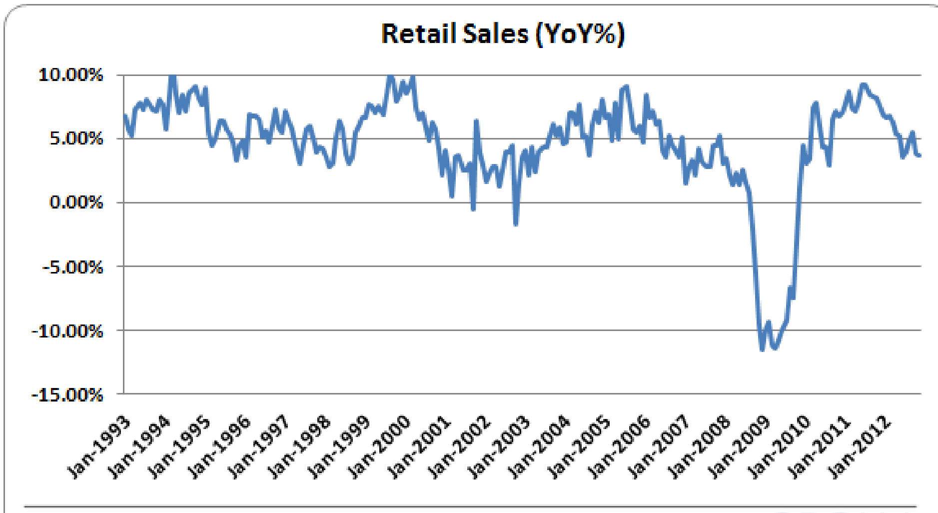


This reading also shows an economy that is unlikely to experience high inflation. The continued lack of output is consistent with an economy that will continue to put very little upward pressure on wages and overall prices.



One of the best real-time economic indicators, weekly jobless claims showed a considerable improvement in this week's reading. Claims fell to 343K after spiking in recent weeks due to the hurricane. This brings the 4 week average in claims down to 381K, but this should correct substantially in the coming weeks. Weekly jobless claims have correlated (inversely) well with the S&P 500 in recent years and continues to be consistent with a market that is not at a risk of substantial decline.

This week's retail sales report tells a very similar story to the previously discussed indicators. According to the Census Bureau retail sales in the USA rose by 3.65% on a year over year basis in November. This is down quite substantially from the 2011 highs, but still growing modestly.



Source: Orcam Financial Group, LLC

Connecting the Dots

Overall, this data appears to confirm my macro perspective that the US economy is "muddling through", but is not contracting. Our historical research has found that the most devastating market downturns occur within recession so it's important to be able to measure the risk of recession if portfolios are going to be properly allocated in advance. The current environment is not consistent with a recessionary environment and therefore likely points to a market environment in which downturns are likely to be relatively shallow buying opportunities as was evidenced in the November downturn.

Looking ahead to 2013 I think we're likely to see similarly stagnant data, but no recession. Of course, that could change if the fiscal cliff decision proves to be more negative than expected, but the outlook now is essentially "more of the same". I'll be updating you regularly on the macro and micro outlook as we move into the near year.

If you ever have questions or comments on research or Orcam's services please contact us directly.

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