Macroeconomic Update

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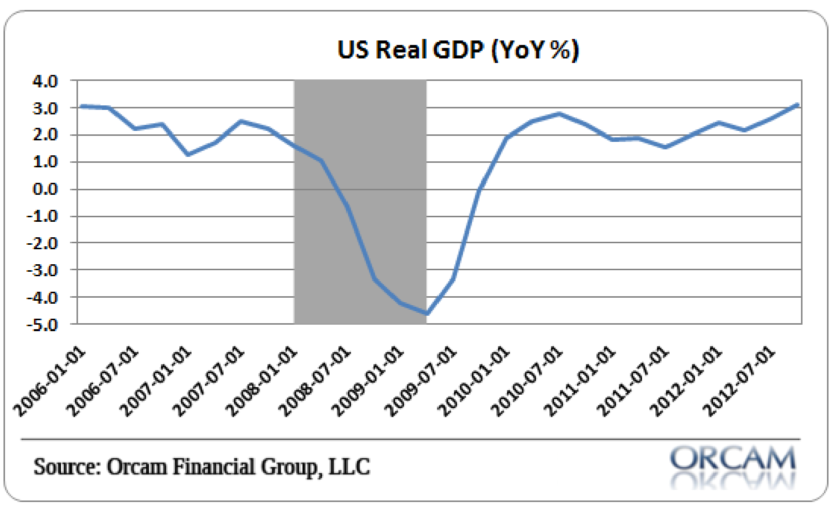
There was a big data dump this morning providing us with even greater clarity on the overall economic picture.

Real GDP

The most important piece of the puzzle was the big upgrade in Q3 GDP in the USA. Real GDP grew at 3.1% which was a substantial revision from the previous estimate of 2.8%. The upgrade was primarily due to higher estimates for personal consumption expenditures.

Obviously this is a backward looking indicator, but it's a sign that the economy has been a bit stronger than most presume. Looking ahead, the consensus is calling for Q4 GDP of 1.2%. Clearly, it's still a "muddle through" environment.



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

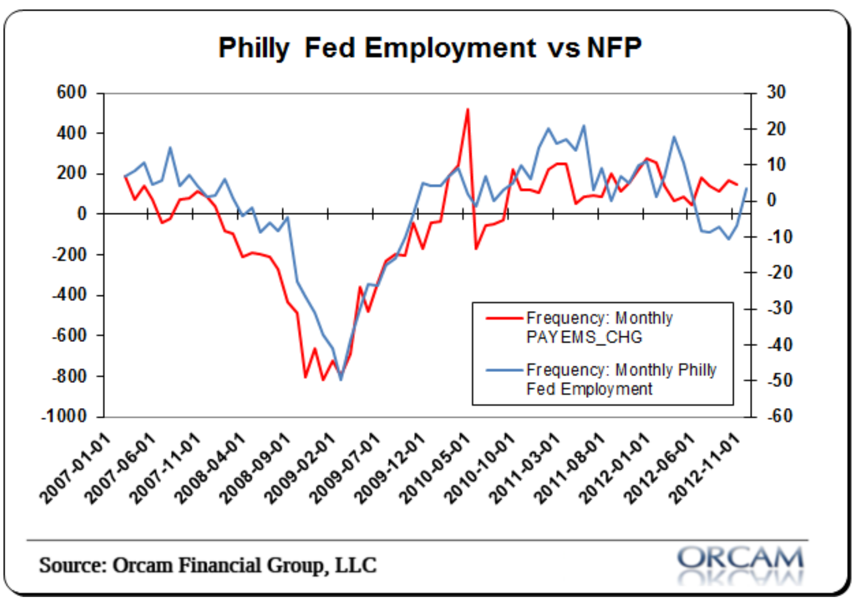
Initial Jobless Claims

The 4 week moving average in initial jobless claims dipped substantially this week to 367,750. The blip from Hurricane Sandy was only temporary. We should see this average dip further in the coming weeks as the hurricane correction completely unwinds.

This is one of the best real-time economic indicators around and it clearly points to an economy that is still shy of operating at its peak potential, but the good news in this data is that we're not seeing signs of deterioration.

Philadelphia Fed Survey

This morning's Philadelphia Fed Survey showed continued economic improvement. This is a narrow slice of the US economy, but does add some clarity to the overall picture. The index improved to 8.1 from last month's negative reading of –10.7. This too appears to have been hurt by the hurricane.

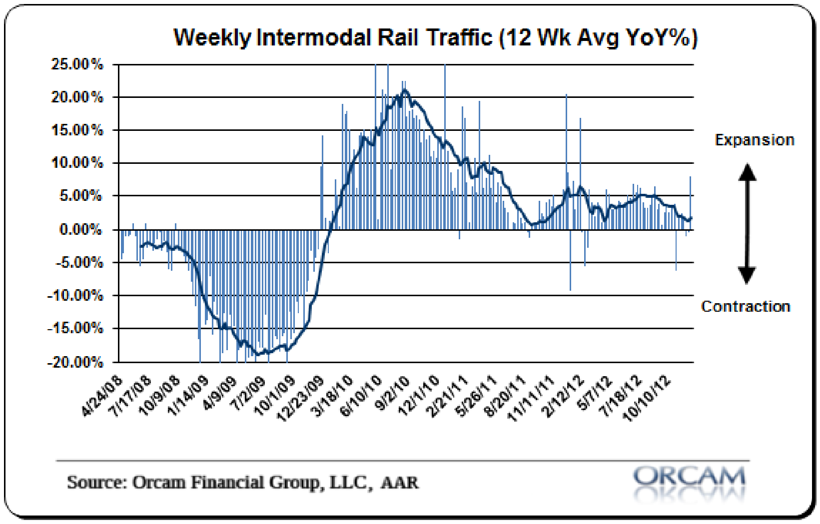


Notable improvement in the number of employees bodes well for future non-farm payroll reports and is generally consistent with readings in the mid-150K range.

Rail Traffic Surges

Rail traffic made a big rebound this week as intermodal traffic surged 8%. This was the best reading since February. This brought the 3 month moving average to 1.91%.

Like claims, this is one of the better real-time economic indicators we track. Clearly, it's still consistent with the "muddle through" theme.



Connecting the Dots

From a macro risk management perspective it's imperative that we attempt to gauge the risks to the macro trend of the economy. As I've shown before, the most substantial equity market losses tend to occur inside of a recession. So, from a cyclical forecasting perspective we must always keep our ear to the ground.

The recent economic data has added a great deal of clarity to the overall economic picture following the uncertainty of the election, this fiscal cliff charade and the hurricane. It all points to a continued "muddle through" environment. This means corporate profits should continue to expand modestly and the economy should grow fast enough to generate modest job growth. From a cyclical (longer-term) perspective this leads me to conclude that investors should position their portfolios with the understanding that downturns are likely to be relatively shallow (i.e., less than 20% losses consistent with secular bear markets and recession).

Of course, we'll keep you updated on the tactical positioning as well, but from a more cyclical positioning I think this data generally bodes well looking forward.

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