ALTERNATIVE PERSPECTIVES

Macro Strategy & Research

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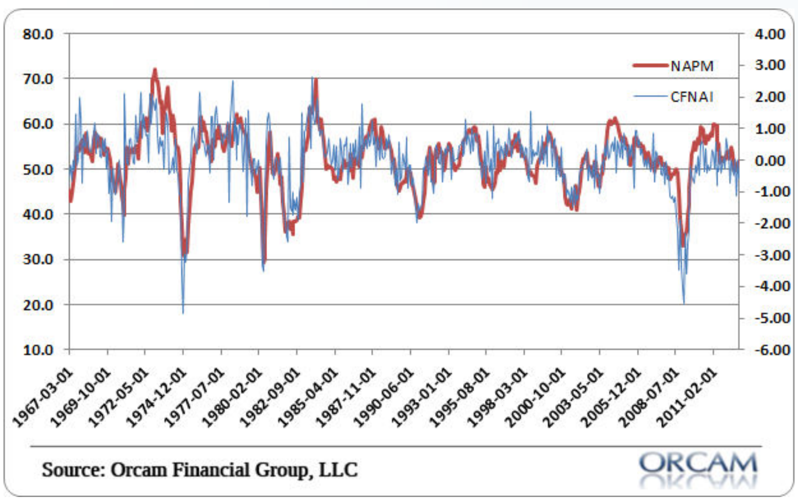
U.S. Equity & Economic Update—Still Looking at Muddle Through

Cullen O. Roche
Founder
Orcam Financial Group, LLC
cullenroche@orcamgroup.com

Recession chatter is ramping up again as uncertainty lingers with the fiscal cliff talks in progress. But we still don't see the economic contraction in the USA.

Growth is Weak, but it's Growth

This morning's data showed more signs of weakness at the macro level as both the Dallas Fed Manufacturing and Chicago Fed National Activity Index came in at contraction levels. The Chicago



(Chicago Fed National Activity Index vs Nation ISM)

Fed National Activity Index is of particular interest due to its very high correlation with the national ISM Manufacturing Index. Many of the other regional Fed Manufacturing Indices are highly volatile and less consistent. The CFNAI gives us a much better idea of the state of national manufacturing.

Long story short—Some growth is better than no growth.

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The current reading of -0.56 is generally consistent with meager growth. According to the Chicago Fed:

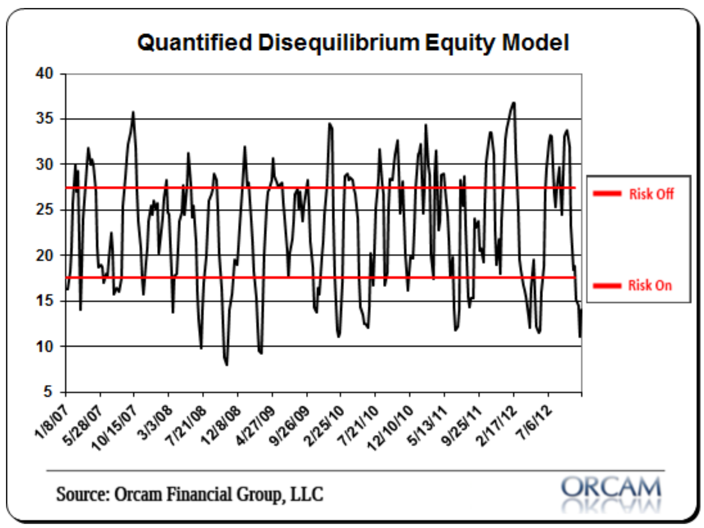
> "A CFNAI-MA3 value below –0.70 following a period of economic expansion indicates an increasing likelihood that a recession has begun."

It's no fun to declare victory in what is obviously a very weak period of economic growth, but growth in this environment is indeed a victory.

This week we will see the Q3 GDP likely revised up to 2.8%, but early estimates for Q4 GDP are in the mid 1% range. I would add that the risks to 2013 growth are presently to the downside, but that's assuming Washington doesn't get its act together. I think this ultimate uncertainty is likely to wane in the coming weeks as an agreement is pieced together.

Still Expecting a Year-End Rally

I still maintain that we're in the midst of a year-end rally as recession fears will wane, the fiscal cliff will get resolved and investment managers will chase the equity markets higher into the year-end.



Source: Orcam Financial Group, LLC

We're transitioning from a period of policy uncertainty to the strong likelihood of policy resolution. As this unfolds in the coming weeks the market is likely to remain relatively buoyant and frustrate the bears. It's a "buy the rumor, sell the news" sort of trading environment. We're at a point where we all know the fiscal cliff is going to get resolved, but it's a matter of when and what the consequences will be. My guess has been a resolution by the middle of December and something in the ~$150B cut range. That's not raging bullish, but it's also not a "cliff". So it's bullish to the extent that it's not terribly bearish.

As expected, our primary equity model has bottomed and is signaling a continued bullish risk/reward scenario. With the market up 4.5% since the recent bottom we've seen a nice bounce and I wouldn't be surprised to see the equity markets bounce sideways to higher into the end of the year.

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