ORCAM
ALTERNATIVE PERSPECTIVES

Macro Strategy & Research

November 20, 2013

The Macro View

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

There's been quite a bit of "bubble talk" in the mainstream media in recent weeks. This is important to discuss because a "bubble" implies a severe disconnect in the markets. I define a bubble as follows:

"A bubble is an environment in which the market price of an asset has deviated from the underlying asset's fundamentals to an extent that renders the current market price unstable relative to the underlying asset's ability to deliver the expected result."

I think there's a potential disconnect growing in the markets, but "bubble" talk is probably overdone. There are two very clear drivers in market dynamics: 1) fundamentals; and 2) how market participants perceive the markets at any given time.

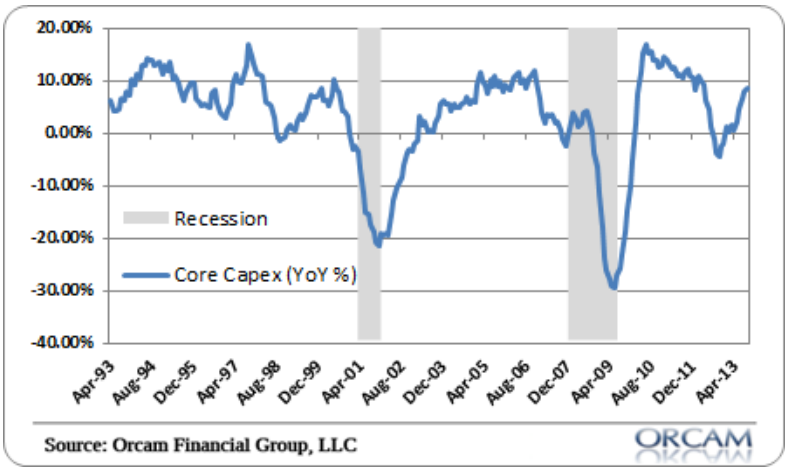
Part of what makes markets so difficult to decipher is that we can, to some degree, analyze #1, but analyzing #2 is extremely difficult. At times, Mr. Market is manic and misinterpreting the data. Trying to rationalize what Mr. Market does on a daily basis is a lot like trying to decipher why a schizophrenic does what he/she does on a daily basis. This requires a good deal of second level thinking and trying to decipher what others are deciphering. This puts us in a position which requires us to analyze #1 as best we can and position ourselves with the understanding that even a schizophrenic is likely to see reality for what it is on occasion.

That said—what's the reality of the economy telling us at this juncture? To me, it is continuing to tell the same basic story I've been forecasting all year—this is an environment that's not exactly robust, but it's strong enough to generate some growth and

(continued…)

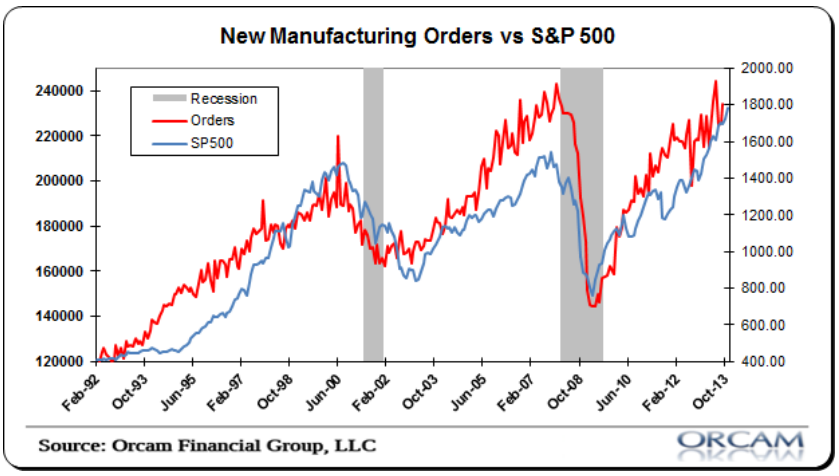
Long story short— There seems to be a bubble in bubble talk.

certainly strong enough to maintain some profit growth.



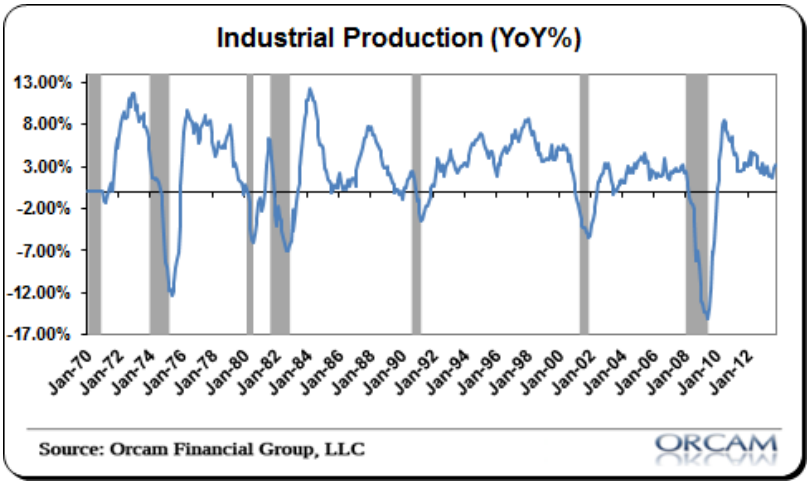
Let's review a bit of the data here to see if we can't begin to put together a better picture of the future.

First of all, the big drag in the last 5 years has come specifically from private investment. Business investment cratered in the Great Recession in a nearly unprecedented fashion. And businesses have been very slow to pick up the slack mainly because their customers have been too weak to really provide them with any confidence. But we've seen some positive signs in recent months. Core capex spending, which is a leading indicator of domestic business spending has been very strong in recent months and recorded its highest reading of 8.6% in over a year.



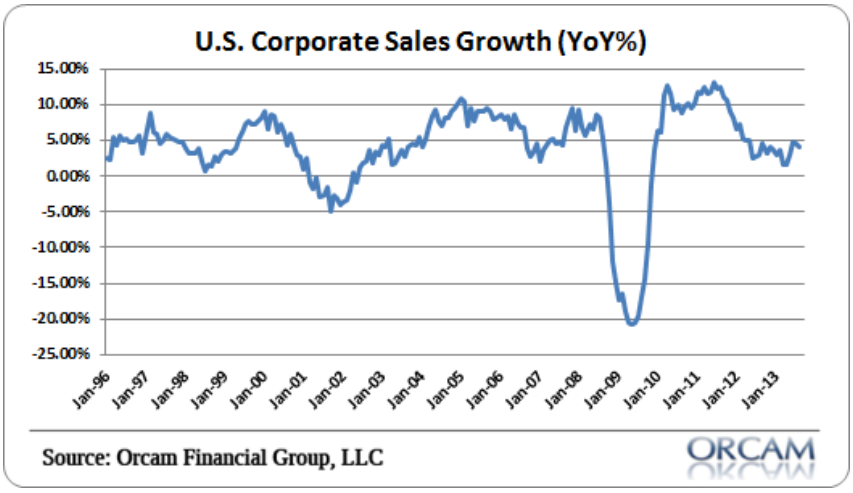
New manufacturing orders, as seen in the figure to above, have remained very strong and tend to correlate with the S&P 500.

Industrial production while not robust at 3.2% growth is certainly not sending off any alarm bells at this point in the business cycle.

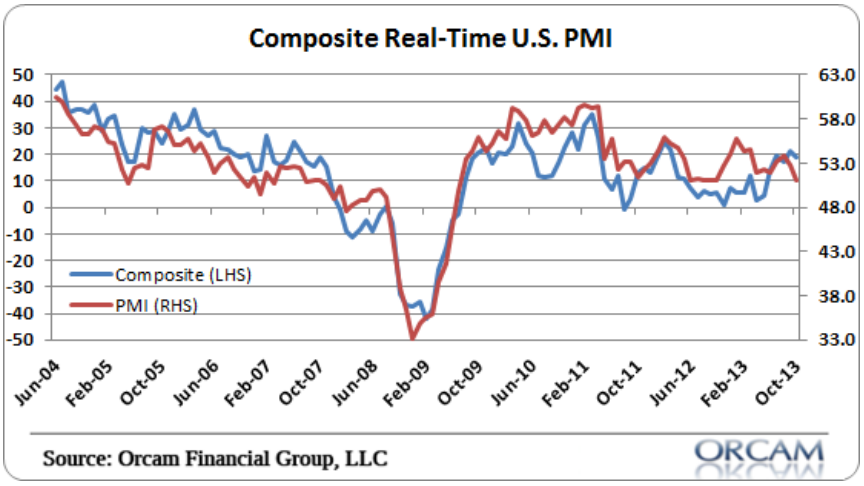


ORCAM

US corporate sales growth clocked in at 4.2% September which is nothing to write home about, but also certainly nothing to panic about.

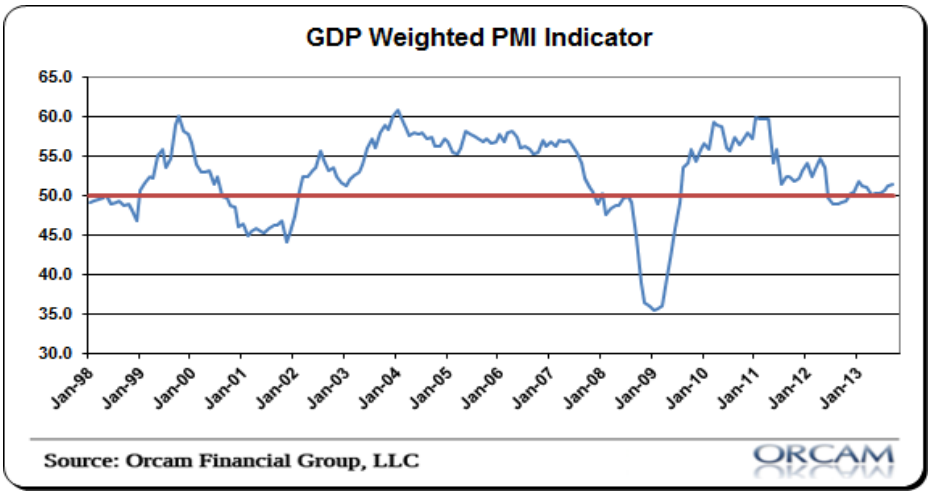


The composite Real-Time US PMI index, which tracks the regional ISM surveys on manufacturing growth have tracked a bit stronger than the PMI itself. The latest reading, at 19.24 is consistent with a modestly expanding manufacturing sector.



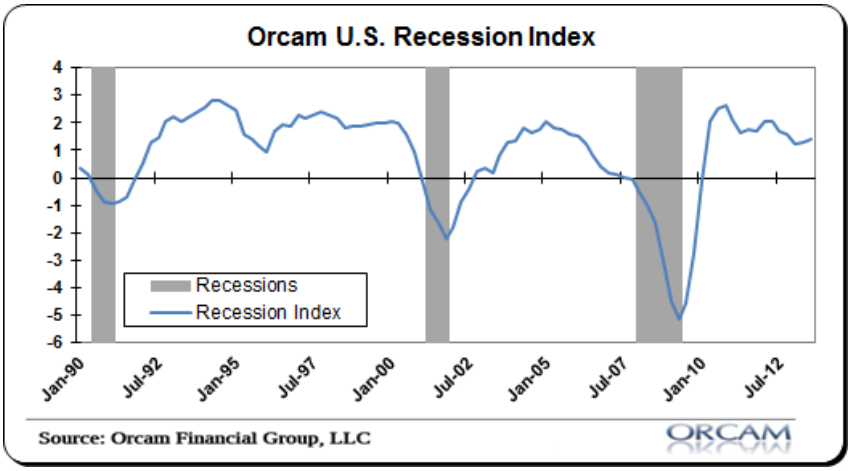
The GDP weighted PMI indicator, as seen below, is telling a similar story. The global economy isn't strong, but it seems to be expanding just modestly. The latest reading of 51.4 is consistent with the modest growth we seem to be seeing around the globe. Again, nothing to write home about, but nothing work panicking about.

And perhaps most importantly, the Orcam Recession Index continues to tell a rather benign story. In fact, the latest reading showed a slight uptick.



ORCAM

Given all of these macro positives, I have to say that the fundamental picture at least somewhat confirms what we're seeing in the equity market. In the next note I'll explore how exactly this all relates to the behavioral side, but I'll leave the reader reiterating with how I started the note—if this were truly a bubble or an environment at risk of a substantial disequilibrium then I think we'd be seeing a fundamental picture that was much worse than it actually is. There is growing risk of a disconnect here, but I hesitate to use language that implies we should turn extremely negative on the markets from a strategic perspective.



Orcam Financial Group, LLC

Orcam Financial Group, LLC is a fee only financial services firm offering macro research, personal advisory, institutional consulting and educational services.

Important Disclaimer

ORCAM