



How Weak is the Recovery?

Market sentiment is always a tricky indicator. Like so many facets of the markets, there are layers upon later of elements that impact the way we think about things. Sentiment is an indicator without a specific time frame. You might feel depressed today, but you could be euphoric tomorrow. It's all relative, highly cyclical and frankly, rather manic.

When I think of sentiment I like to think of it the same way I think about risk management within a portfolio. And that means we have to account for the possibility that sentiment will vary over different durations. For instance, would you bet against growth in the USA over a period of 30 years? My guess is that most of you would not. Therefore, you're optimistic about the long-term. But what about the next 30 months? I'll bet that many more of you would be pessimistic about guaranteeing growth in the next 30 months. So our perspectives and sentiments change with duration.

When we confront a particular environment we have to consider this reality as we try to navigate a certain environment. For my cyclical view of things we're looking at a rather intermediate timeframe. Therefore, sentiment can be quite uncertain over this period.

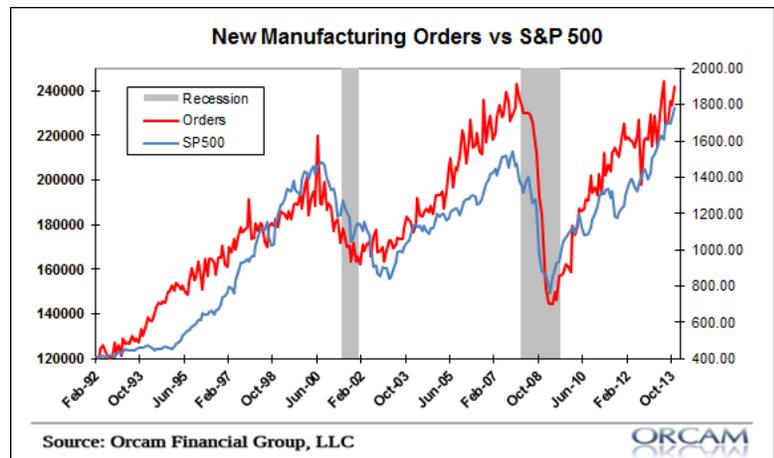
In recent months we've seen a bit of a sentiment change towards a more optimistic perspective of the overall economy. But how justified is this view? In my view, it remains highly

Cullen O. Roche

Founder

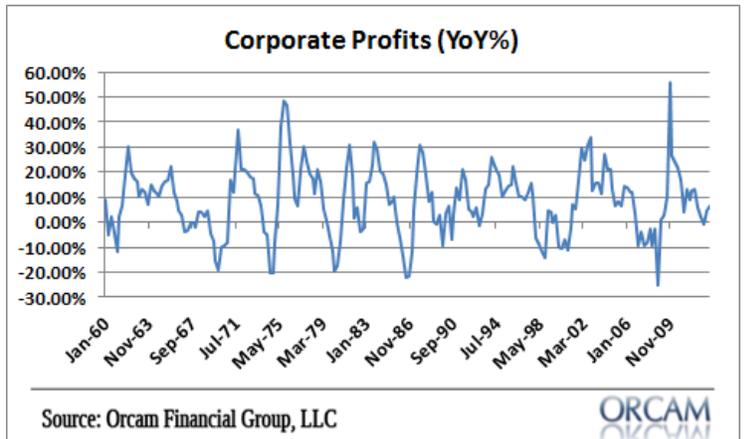
Orcam Financial Group, LLC
cullenroche@orcamgroup.com

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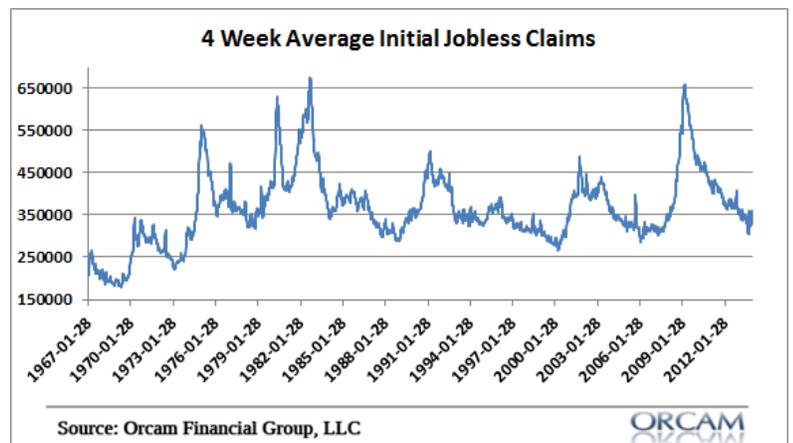
justified. On the previous page there's a chart of the S&P 500 relative to durable goods orders. These indices have tended to correlate highly over the last 20 years and the recent highs in new orders appears to confirm the new highs in the S&P 500.

What about corporate profits? Although growth in corporate profits has slowed substantially the latest reading of about 5% year over year is still a moderately healthy reading. I would argue that there's potential downside in profits in the coming 6 months, but the longer-term trend does not appear all that alarming at present.

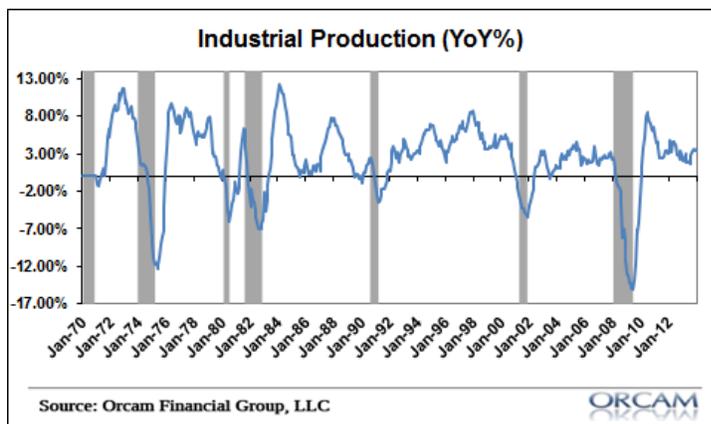


What about the consumer? The latest reading on retail sales from this week showed a continued steady growth trend. At 4.1% I think the consumer is showing a good deal more strength than many in the mainstream media give them credit for. And this isn't anything new. Retail sales have been holding steady at over 4% growth since the recovery started in 2009.

What about the labor market? The best real-time indicator of the health of the labor market is initial jobless claims. The latest 4 week moving average of 335K is up slightly from recent lows, but still showing a very clear longer-term downtrend. I would also note that the weakness in last Friday's NFP report was not consistent with this data or any of the other private sector readings. Although there's a lot of work to be done on the unemployment front, I think the labor market is holding up better than many give it credit for.



What about American Manufacturing? One of the perennial “weaknesses” in the American economy is the oft-cited state of the manufacturing industry. But the latest reading on industrial production show an all-time high. In addition, year over year growth clocked in at 3.7%. The average rate of change since 2011 has been just 3.2% so we’re growing above trend on the manufacturing front.



I am hesitant to point too rosy of a picture here because there are some concerns about the state of the middle through US economy at present and I still think markets have a somewhat frothy appearance in the short-term, but I would be very hesitant about falling victim to some of the excessively negative presentations of the cyclical view. In my opinion, the most reliable indicators confirm a rather optimistic outlook for the US economy at present.

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