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First Trust

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Monday Morning Outlook

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# Is it the Economy or the Policies?

Stocks just had one of the worst months since the 1930s and economic data was ugly, too. Real GDP was revised down sharply in Q4, home sales fell further, business investment was weak, and unemployment claims jumped again.

First quarter GDP, so far, doesn't look any better than it did in the fourth quarter. Yet, there are signs that the primary cause of the recession – a sudden and sharp decline in the velocity of money – is starting to reverse, eventually paving the way for recovery later this year.

Retail sales were up on a widespread basis in January and we expect auto sales (reported Tuesday) to show gains in February. Meanwhile, oil prices appear to have bottomed, while used car prices jumped 3.8% in January and the Baltic Freight index has risen this year. Moreover, the money multiplier measured as a ratio of the M2 measure of the money supply to demand deposits (checking accounts) stopped contracting in December and is up in both January and February. This last item is very good news.

Usually, stocks move up before a recovery begins, so what's going on? Are stocks saying that there is no recovery on the horizon, or is it something else? And here there are two things to worry about. First, some say the Fed is too tight. And second, policies coming from Washington, DC are certainly damaging to the economy. We do not agree that money is too tight. Every measure of money is rising, not falling and gold is up, not down. This leaves fiscal policy as the explanation.

Despite naming the new budget "a new era of responsibility," the budget deficit in the *last* year of the president's term (2012) is forecasted by the administration to be a higher share of GDP than in 14 of the previous 15 years. Moreover, government spending (even subtracting bailout money) will be a much larger share of GDP than in almost any years since WWII. Every dollar the federal government takes from the private sector reduces potential future growth.

Moreover, every federal resource (time, money, or political capital) that is focused on national health insurance, income redistribution, and climate change is a resource that is not focused on financial market problems. And even though he was misguided, at least FDR's first two years in office were focused on trying to save the economy. That was his goal. Social Security did not get implemented until the late 1930's.

So, where do we go from here? Is the market in a freefall that will never end? We don't think so. With money easy, and velocity stabilizing, recent declines in stocks are most likely a reaction to intrusive fiscal policy. The good news is that these policies, while negative, are unlikely to harm the economy dramatically until 2010 or later. With the potential for a change in mark-to-market accounting rising, and easy money in place, we are still looking for a sharp rally in stocks this year, just like the US experienced in 1975-1976 despite stagflationary policy mistakes.

| Date/Time (CST) | U.S. Economic Data | Consensus | First Trust | Actual | Previous |
|---|---|---|---|---|---|
| 3-2 / 7:30 am | Personal Income - Jan | -0.2% | **-0.3%** | +0.4% | -0.2% |
| 7:30 am | Personal Spending - Jan | +0.4% | **+0.7%** | +0.6% | -1.0% |
| 9:00 am | ISM Index - Feb | 33.8 | **34.4** | 35.8 | 35.6 |
| 9:00 am | Construction Spending - Jan | -1.5% | **-1.5%** | -3.3% | -1.4% |
| *3-3 / sometime* | Domestic Auto Sales - Feb | 3.0 Mil | **3.2 Mil** | | 2.9 Mil |
| *during the day* | Domestic Truck Sales - Feb | 4.0 Mil | **4.0 Mil** | | 4.0 Mil |
| 3-4 / 9:00 am | ISM Non-Man. - Feb | 41.0 | **40.5** | | 42.9 |
| 3-5 / 7:30 am | Q4 Non-Farm Productivity | +1.4% | **+0.2%** | | +3.2% |
| 7:30 am | Q4 Unit Labor Costs | +3.5% | **+4.7%** | | +1.8% |
| 7:30 am | Initial Claims - Feb 28 | 650K | **664K** | | 667K |
| 9:00 am | Factory Orders - Jan | -3.5% | **-2.9%** | | -3.9% |
| 3-6 / 7:30 am | Non-Farm Payrolls - Feb | -650K | **-535K** | | -598K |
| 7:30 am | Unemployment Rate - Feb | 7.9% | **7.9%** | | 7.6% |
| 7:30 am | Average Hourly Earnings - Feb | +0.2% | **+0.3%** | | +0.3% |
| 7:30 am | Average Weekly Hours - Feb | 33.3 | **33.3** | | 33.3 |
| 7:30 am | Manufacturing Payrolls - Feb | -198K | **-175K** | | -207K |