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ECONOMY HUMMING, BUT ARE WE GETTING AHEAD OF OURSELVES?

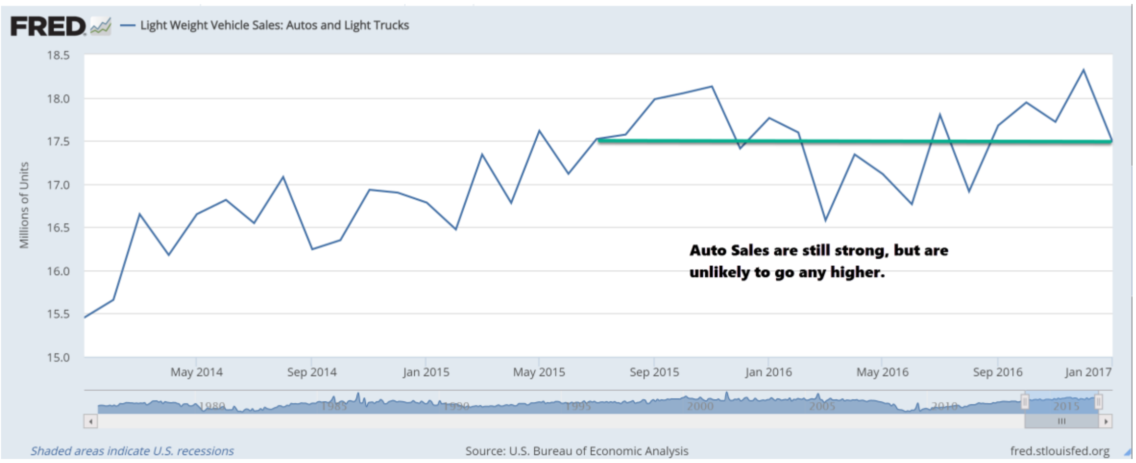
SUMMARY

- The strength in MACROCAST™ is being driven by economic data, which remains constructive. Counterintuitively, the biggest concern with the economy is that the data has come in better than expected for some time. When data comes in better than expected, economists raise their targets, and future data often disappoints.
- Consumer and business confidence has spiked since the election. But "hard" data (what is actually happening) has yet to follow this new-found optimism. If the economy is going to really pick up, we would expect this confidence to translate in to actual gains soon.

ECONOMIC DATA REMAINS FIRM, WITH SOME WEAKNESS IN AUTOS

The economy is on sound footing, with many critical indicators showing strength. Real retail sales are at an all-time high. Initial Claims, a key leading indicator for employment, have been below the important 300,000 level for 103 consecutive weeks. Existing home sales are the best they have been in over ten years.

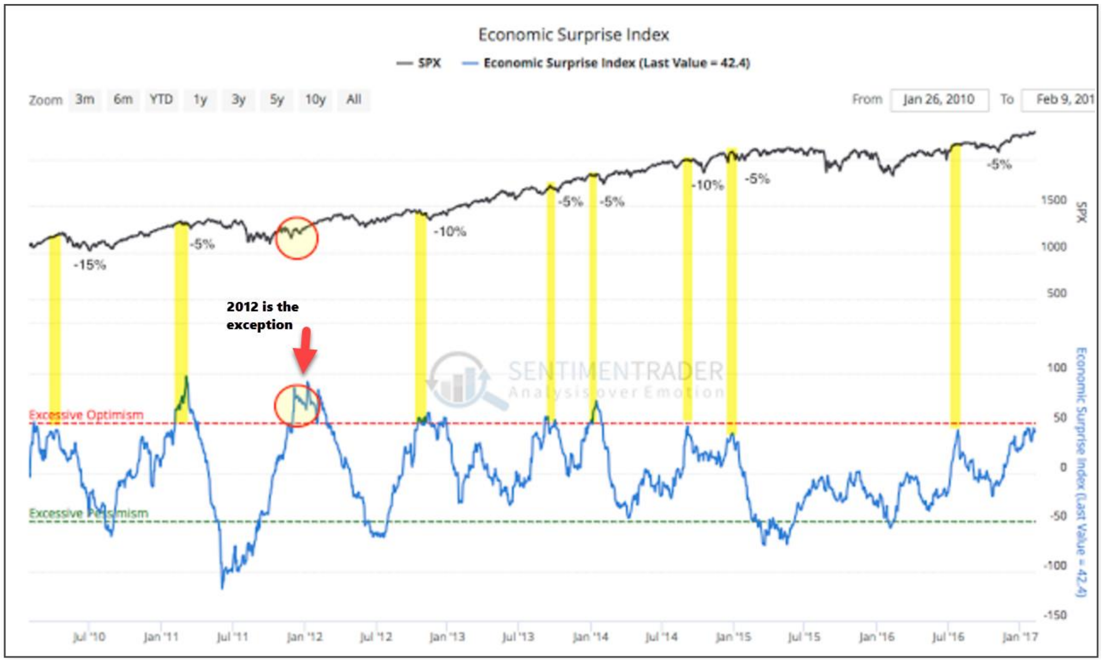
In a dynamic economy like we have in the United States, not all data is rosy of course. While auto sales are still high, they appear to have topped out and are at the same annual level they were in 2015:



RELATIVE TO EXPECTATIONS, DATA MAY BE SETTING UP TO DISAPPOINT

Markets are often moved by how that data comes in relative to expectations. In this regard, economic data has been coming in better than expected since February 2016. This is not surprising, as oil prices and the stock market also bottomed that month. The following chart shows the Citigroup U.S. Economic Surprise Index (orange line). It measures how various parts of the economy are doing relative to expectations.

More recently, the Citigroup Economic Surprise index bottomed in late October. Over the past several years, the index has not been able to rise much higher than current levels. This is important because peaks in the index have often coincided with the beginning of a pullback:

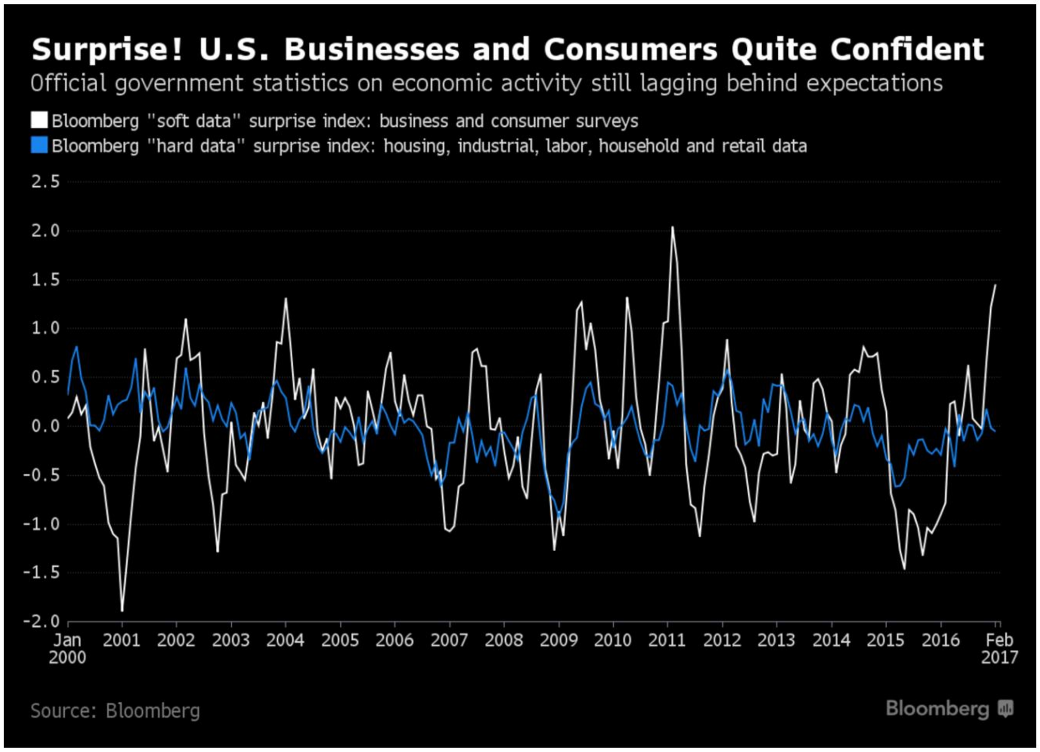


Source: Sentiment Trader, Fat Pitch Blog

To be clear, we are not worried about a major market top here. MACROCAST™ is +9 and there is little sign of a recession this year, which is typically when you get the worst market performance. But a decline of 5%-10% occurs almost every calendar year, so it would not be surprising to see that occur over the next couple of quarters.

DATA IS GOOD, YET NOT MATCHING THE JUMP IN CONFIDENCE

Although overall economic data is solid, there is a concern that expectations are getting too high. A recent Bloomberg article suggest that the difference between "soft" data (how everyone feels), and "hard" data (what is actually happening) is at the widest gap since 2011:



This is not a bad thing in and of itself, but we would like to see confidence translate to actual continued improvement. If surveys don't result in more spending by consumers and businesses, then the economy will likely perform similar to what it has the past several years, which can be summed up as good, not great.

ECONOMY WILL NEED TO GO TO THE NEXT LEVEL TO MATCH EXPECATIONS

To summarize, while the data remains constructive, expectations are now getting a little hot. With the market making large gains the past year and since the election, we believe further major gains would require a higher correlation between the optimism shown by the market and the real economic data to support the gains.