

CONSUMER CONFIDENCE AND US STOCKS

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In their Workingman's Dead album, the Grateful Dead sing in "New Speedway Boogie":
"I spent a little time on the mountain, I spent a little time on the hill
I heard someone say better run away, others say better stand still."

PRELUDE

As Labor Day weekend has ended, as American unemployment remains lofty, and as stock benchmarks such as the S+P 500 have faded from their springtime heights, let's revisit key consumer confidence measures.

After the first quarter of 2009, both the S+P 500 and the Conference Board's Consumer Confidence Index ("CCI") rose sharply. The S+P 500's race to its 5/2/11 peak at 1371 more than doubled its 3/6/09 low at 667. At this 5/2/11 altitude, it was about 87 percent of its 10/11/07 major high, and just 4.8pc beneath its final pre-crisis top at 1440 on 5/19/08.

The CCI's February 2011 high at 72.0 indeed represents a steep ascent from its February 2009 25.3 valley. Yet it nevertheless fell well short of the 111.9 July 2007 top. Moreover, this winter 2011 CCI elevation was only modestly above the 61.4 level of March 2003- when the S+P 500 achieved a major low at 789 (3/12/03) miles underneath 2011's various S+P 500 heights. In addition, since February 2011- when the S+P 500 made an initial top at 1344 on 2/18/11, the CCI has ebbed lower. It fell under 60 in June (57.6) and July (59.2) and tumbled to 44.5 in August.

Thus, since February 2011, and until its collapse from its July 2011 highs (1357 on 7/7 and 1347 on 7/21), the S+P 500 painted a rosy picture while the CCI increasingly drew a fairly gloomy one.

CONCLUSION

However, given the sharp fall in the S+P 500 from its February, May, and July 2011 highs (8/9/11 low at 1101 is almost a twenty percent drop from 1371; 9/2/11 close about 1173), the S+P 500 and CCI now are confirming each other in a bearish path.

The level and trend of the Conference Board's Consumer Confidence Index alongside this nosedive in the S+P 500 indicates that the US economy and the S+P 500 probably will slump further over the next several months. If so, then the worldwide economy will slow alongside America's, as will many other equity arenas. Given the close links between the S+P 500 and overall commodity marketplace trends in recent years, commodity players should monitor the Consumer Confidence Index.

BACKGROUND

Many believe that from a "general, overall perspective", US equity levels and trends are a key weathervane for the US economy- and the extent and depth of confidence in it. Some marketplace generals proclaim that the business of America is business. In any event, consumers are an important implicit part of that aphorism. The Conference Board heralds that its "Consumer Confidence Index ® (CCI) is a barometer of the health of the U.S. economy from the perspective of the consumer." ("Technical Note- February 2011").

We all know that many interrelated factors influence economic and stock marketplace levels and direction. American equity marketplace supply/demand considerations vary to some extent from those affecting US consumer confidence. The S+P 500 and the CCI are not duplicates.

Nevertheless, analysis of the Conference Board’s Consumer Confidence Index over the past four decades reveals that this measure sometimes provides guidance in the identification (confirmation) of major highs, lows and trends in US equity benchmarks such as the S+P 500. In general, don’t happy and confident consumers tend to spend more money (even if many of them have to borrow it)? Since United States consumer spending represents about 70 percent of American GDP, their attitudes and actions greatly influence United States economic growth. This affects US corporate profits and therefore equity marketplace levels and trends. In the intertwined global economy, US consumer confidence and spending influence overseas economies and marketplaces.

The Conference Board releases the CCI monthly. The next one is 9/27/11. In addition to the S+P 500 and the CCI, there of course are numerous other “confidence” measures (indicators) for business and consumers, including purchasing manager surveys, retail sales, industrial production, and interest rate levels and trends.

HISTORY: CONSUMER CONFIDENCE AND THE S+P 500

“It was the best of times, it was the worst of times, it was the age of wisdom, it was the age of foolishness, it was the epoch of belief, it was the epoch of incredulity, it was the season of Light, it was the season of Darkness, it was the spring of hope, it was the winter of despair, we had everything before us, we had nothing before us...” Charles Dickens, “A Tale of Two Cities”

<u>High (time)</u>		<u>Low (time)</u>	
<u>Consumer Con. Index</u>	<u>S+P 500</u>	<u>Consumer Con. Index</u>	<u>S+P 500</u>
142.3 (Oct 1968)	109 (12/2/68)	75.7 (Dec 1970)	69 (5/26/70)
		75.2 (Apr 1971)	
116.1 (Dec 1972)	122 (1/11/73)	43.2 (Dec 1974)	61 (10/4/74)
			[DJIA 570; 12/9/74]
		56.7 (June 1982)	
		56.9 (Aug 1982)	102 (8/9/82)
		47.3 (Feb 1992)	371 (12/2/91 take-off point)
		100.1 (notable rise from this June 1996 level)	606 (7/16/96)
144.7 (Jan+May 2000)	1553 (3/24/00) [DJIA 11910; 1/14/00]	61.4 (Mar 2003)	789 (3/12/03 final bottom)
111.9 (July 2007)	1556 (initial high 7/16/07) 1576 (major peak 10/11/07) (Final top 1440 on 5/19/08)	25.3 (Feb 2009)	667 (3/6/09)
72.0 (February 2011)	1371 (5/2/11) (initial high at 1344 on 2/18/11) (note also 1357 on 7/7/11 + 1347 on 7/21/11)		

In this table, the Consumer Confidence Index date is for the given month. For stocks, the high or low is for the day indicated. The S+P 500 and Dow Jones Industrial Average often achieve key

highs (lows) around the same day, but not always. The timing of the DJIA's important peak (trough) occasionally ties even more closely than the S+P 500 to that in the Confidence Index. Consequently the table includes a couple of references to the Dow. S+P 500 and DJIA numbers are rounded.

Note the S+P 500 plateau on 3/24/00 at 1553 was not far from the October 2007 summit (Dow Jones Industrial Average high 1/14/00 around 11,910). In contrast, the February 2011 Confidence Index level lurks far beneath (only 50 percent of) the 144.7 achieved in January 2000. This underscores the current weakness of consumer net worth and the related mournful consumer attitude.

PROFITS...PROBLEMS...PROPHECY

Admittedly, various current measures of US corporate profits have been remarkably strong. Look at after tax profits (without inventory valuation and capital consumption adjustments; Bureau of Economic Analysis). In both 1Q11 and 2Q11, after tax profits (annualized) were almost \$1.5 trillion. Second quarter 2011 soared over the low of full (calendar) year 2008 by 39.6 percent. Both 1Q and 2Q11 thus accelerated past the peak profit years of the blissful Goldilocks Era (2006's over \$1.3 trillion, 2007's almost \$1.3tr), as well as individual calendar quarters during that happy and exciting epoch. Thus there's been a good argument for bull moves in US stocks and confidence in the American economy "in general".

Some of this striking profitability in recent quarters is more than a "mere rebound" from the worst and most dangerous times of the financial crisis. Efficiency (productivity) gains have sparked and sustained much of these profit jumps. Some demand from overseas for American goods and services probably has helped. And for money earned outside the US by American firms, dollar depreciation arguably boosts reported earnings.

Observers nevertheless should ask how much of this profit run up and the high levels of 2011 (and of several prior quarters) derive from the Fed's money printing extravaganza (quantitative easing) and massive federal deficit spending. For now, quantitative easing essentially has ceased. For now, some fiscal stimulus is winding down. Moreover, nowadays fiscal deficits in the US and overseas ignite more fear than joy. The recent shakiness in stocks hints that the weak dollar, as well as the subsidy from low policy interest rates (Federal Funds), probably will be less helpful to corporate profits going forward.

Why else might have rallied American stocks despite the relatively feeble Consumer Confidence Index? Share buybacks are probably a factor. Federal Reserve data (Z.1; "Flow of Funds"; 6/9/11) showed massive buybacks by nonfinancial corporate business in 2006 (about \$565 billion) and 2007 (\$787bb). This 2006 and 2007 buyback volume probably helped to propel equity benchmarks to their peaks. They fell to under \$65bb in 2009. However, though below the 2006-07 levels, the nonfinancial corporate business category showed accelerating buybacks in recent quarters (annual rates). Third quarter 2010 were \$338bb, 4Q10 \$363bb, and 1Q11 \$332bb. Corporate share buyback programs in general apparently were substantial even more recently than 1Q11, thus helping to rally stocks. (Financial Times, 8/19/11, p11).

Also, there's always a lot of money around that readily can switch between financial racetracks. Though inflation supposedly is low, so have been US government interest rates. Especially at the short end of the curve, they've hovered close to rock bottom. So many yield ("return") chasers migrate into the wonderful world of stocks (and commodities). Those struggling to get by (many consumers) do not have this luxury.

History is not destiny for the S+P 500, the CCI, and their relationship. Also, a dramatic equity marketplace move can occur without a similarly gigantic corresponding shift in confidence. Not long after equities peaked in late August 1987 came a fearsome equity price crash. But after climbing from 85.8 in October 1986 to its September (and October) 1987 height over 115, the Confidence Index fell only modestly to its 100.8 November 1987 level. It then resumed its advance alongside stocks.

But also keep in mind that an equity price rally does not prove that the world is (or will remain) wonderful for consumers (or business and sovereigns). Recall the demise of the Goldilocks economy. The S+P 500 made its major high in October 2007 and a final one in May 2008 at 1440. However, the Confidence Index commenced a precipitous downtrend after July 2007.

A perspective that sees bearishness in and for the economy, the S+P 500, and the Consumer Confidence Index relies on more than the associations detailed above between the S+P 500 and the CCI. Let's highlight a handful.

Even with the joyful equity marketplace rally from March 2009 to spring 2011, US consumer net worth has never recovered from the terrifying financial crisis and horrible recession. The household balance sheet, despite the devoted and sustained repair efforts of Federal Reserve engineers and fervent politicians, remains severely damaged. (Federal Reserve, Z.1; statistics include nonprofit organizations).

Household net worth crashed about \$15.4 trillion dollars- around twenty-four percent- from the end 2007 level of about \$64.2 trillion to 1Q09's floor. Another way to assess that carnage- that loss exceeds current year 2011 US nominal GDP of about \$15.0 trillion (2Q11 annualized; Bureau of Economic Analysis). By end 2010, with net worth at \$57.1tr, almost \$8.4tr of the disappearance had been reversed. A substantial amount of this was due to the explosive stock rally, which added about \$5.6tr to consumer net worth from end 2008 to end 2010. Yet the balance sheet still remained badly wounded.

What about now? Although more is on the books than stocks and housing, it probably remains badly injured. Let's concentrate on the 2011 moves in stocks and home prices.

The current level of the S+P 500 at 1174 is down about 6.7pc from its end 2010 level of 1258. At end 2010, equity shares at market value were about \$18.0tr. Thus roughly \$1.2tr (18.0*6.7pc) evaporated from the household balance sheet from this source relative to year end 2010. Prices for US existing home sales as of end July 2011 were up about three percent versus end 2010 (average prices, not seasonally adjusted; National Association of Realtors). Adjusting end 2010 real estate assets for this increase adds around \$550bb to consumer net worth, not nearly enough to compensate for the equity decline relative to year end 2010.

Housing inventory (existing homes) remains significant. Delinquency and foreclosure rates have declined a bit, but they remain high. But focus further on another Fed statistic that underlines reasons for low American consumer morale. Everyone knows that housing prices matter a great deal to consumers (and many businesses). Owners' equity in household real estate fell off the cliff in the worldwide economic crisis. It was about \$13.2 trillion in 2005; that year, owners' equity as a percentage of household real estate was 59.7 percent. The 2006 levels were about \$12.9tr and 56.6pc. By end 1Q11, they were \$6.1tr (about a seven trillion dollar loss) and 38.0pc. Why wouldn't many consumers be somewhat pessimistic and reluctant to spend freely?

Another real estate question- have most of the real estate loans (residential and commercial) on the books of US banks been marked to market?

Some other nerve-wracking considerations for consumers (and politicians and equity bulls) include the US federal fiscal/debt disaster (both short run and long run). Marketplace watchers surely are not pleased by past and upcoming Washington squabbling. Let's also remember the similar troubles of many state and local governments. Severe European deficit problems, and not just on the periphery with Greece, persist. Incidentally, the European Union consumer confidence indicator fell in August 2011 to -16.8 (negative number), down from July's -12.4.

US unemployment remains stubbornly high; the August 2011 headline level of 9.1pc is troubling, a broader measure of 16.2pc even more so (Bureau of Labor Statistics, Table A-15). Despite Federal Reserve squawking that inflation is low and well contained, inflation has been creeping upward by as much as 2.5pc in first half 2011 (see the Bureau of Economic Analysis GDP release Table 4, 8/26/11). Real earnings (income) for most of Americans have been sluggish. For example, real average hourly earnings fell 1.3pc from July 2010 to July 2011 (seasonally adjusted; Bureau of Labor Statistics, 8/18/11).

Recent productivity information also warns that high US corporate profitability should not be taken for granted. US nonfarm productivity fell at an annual rate of .7pc during 2Q11 (Bureau of Labor Statistics, 9/1/11).

There's another reason to think the CCI and S+P 500 now are moving in a downward (bearish) tandem. The fearless financial firefighter, the Fed, though perhaps not frantic, is showing more and more fretfulness. Note its recent policy decision (8/9/11); the Fed Funds rate will be kept low "at least through mid-2013". Scan the FOMC Minutes (8/9/11): "the projection for real GDP growth in the second half of 2011 and 2012 was marked down notably." Finally the Chairman's Jackson Hole speech (8/26/11) confessed: "it is clear that the recovery from the crisis has been much less robust than we had hoped."

Federal Reserve gardeners, no doubt anxious to preserve or create economic green shoots, remind audiences that its toolkit remains ready. These include money printing theatrics (QE3) and a shift in the composition of its portfolio (own relatively more long-dated debt securities). The Federal Reserve meets 9/20-21/11.

What levels in the S+P 500 might inspire Fed guardians to leave their starting gate and engage in further action? The May 2010 high in the Consumer Confidence Index at 62.7 barely reached above the March 2003 low of 61.4. And the 44.5 level of August 2011 is well below the March 2003 one. That spring 2010 CCI high occurred around the time (4/26/10) of the interim top in the S+P 500 around 1220. With the CCI currently at a very low level, the failure of the S+P 500 to sustain an advance above the spring 2010 top would be a gloomy sign for the US economy. The S+P 500's nearly 20pc fall to its summer 2010 lows (1011 on 7/1/10, 1040 on 8/27/10), inspired the Fed to vigorously plant seeds of growth via a second quantitative easing round. **A challenge by the S+P 500 of its 1000/1050 support probably would induce more rescue efforts.**

A review of the S+P's financial sector equity index in the context of the Consumer Confidence Index warns of potential for further US economic weakness and declines in the S+P 500 itself. This underlines that the "financial" crisis that erupted in 2007 remains ongoing and significant.

The S+P financial sector stock index attained its major highs in 2007 on 2/20/07 and 5/23/07 around 510. This was several months before the S+P 500's peak in October 2007. The S+P financial equity index made a major low on 3/6/09 at 78.5, the same day as the S+P 500. Like the Consumer Confidence Index, the S+P financial sector stock index has never come close to its

2007 peak. The financial sector's rally high (231.2 on 2/16/11) was less than half its 2007 summit. The S+P financial equity index, unlike the S+P 500, never marched above its April 2010 high (230.5).

Recall that the 2011 high in the CCI at 72.0 was in February- the same time as the high for the S+P financial stock index. As in 2007, the S+P financial group's high in 2011 preceded the S+P 500's peak. Like the S+P 500, the financial sector plummeted in early July 2011 (from 207.6 on 7/7/11).