INVESTOR ALERT

TOP DOWN INSIGHTS...BOTTOM LINE RESULTS

Uneven Recoveries (Like the Current One) are Normal

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Many top economists and strategists continue to fret about the state of the U.S. economy – about whether it's still mired in recession – or why, if there's a recovery, it seems to be weakening – or whether the weakening foretells *another* recession (a "double-dip").[1] The broader population now echoes these fears. In one recent poll of likely American voters,[2] an amazing 88% of them said they believe the U.S. economy is *still in a recession* – even though, as we demonstrated last April,[3] the latest U.S. recession actually ended *more than a year ago* (June 2009).[4]

Every economic recovery in modern history seems riddled with complaints about how tentative and prolonged it is, and with so little job creation — even though that's the norm.

We first refuted such "gloom and doom" outlooks in late January 2009, only two months before *stock prices* reached a bottom (in March 2009) and just five months before the *economy* bottomed (in June 2009).[5] Since we issued those "anti-gloom" reports, U.S. stock prices have jumped 28%, while industrial output has risen 4.6% (and +8.2% since its trough in June 2009). Today's jobless rate remains high (9.5%), but it has *fallen steadily* from its peak of 10.1% last October. Media sensationalism again makes it necessary to refresh our prior refutations of gloom.[6]

Like the scores of clueless Keynesian economists who now dominate public debate – the ones who obsess about the almighty "consumer," "consumer confidence," and anemic job growth – most American today look *not* into what *truly* drives the economy (businessmen, savers and investors) but into the economy's *rear-view* mirror. Trained by Keynesians, they don't realize that measures of consumer well-being *always trail* economic measures by *at least* a year or so, precisely because *production* is always and everywhere the *source* of consumption, never the *effect* of it. Additionally, regardless of how pessimistic (or optimistic) consumers might be, history shows that their emotional-psychological state has *no predictive power* – *except* in a *contrarian* way: *peaks* in consumer optimism typically appear *just prior to cyclical declines*, while *troughs* in pessimism appear *prior to strong cyclical advances*.[7]

Another myth is also widely assumed: that unless an economic recovery resembles a *one-way rocket launch to the moon*, with nary a set-back or side-ways move, the chances are high that *another* recession will ensue. In fact,

[1] See, for example, Jeff Sommer, "Double Dip? A Tipping Point May Be Near," *The New York Times*, August 15, 2010; Annalyn Censky, "Double-Dip Recession: What are the Odds?" *CNN/Money Magazine*, June 9, 2010; Christopher Wood, "Don't Rule Out a Double-Dip Recession," *The Wall Street Journal,* May 24, 2010; and Nouriel Roubini, "Beware of a Double-Dip Recession," *Forbes*, March 11, 2010.

[2] See question #23 in the Fox News / Opinion Dynamics Poll of 900 registered voters nationwide, which was conducted August 10-11, 2010 and published on August 12, 2010. Source: http://www.foxnews.com/projects/pdf/081210_ObamaEconomyPoll.pdf. The poll results were not materially different among Republicans, Democrats and Independents, who comprised 42%, 40% and 18% of the 900 voters polled. In another recent poll, "nearly two-thirds of Americans believe the economy has yet to hit bottom, a sharply higher percentage than the 53% who felt that way in January." See Peter Wallsten and Eliza Gray "Grim Voter Mood Turns Grimmer: Pessimism Rises on Economy and War," *The Wall Street Journal*, August 11, 2010.

[3] "Yes, the Recession Ended Last Summer – and Don't Expect a 'Double Dip,'" *Investor Alert*, InterMarket Forecasting, Inc., April 15, 2010.

[4] In the days prior to our April report, the organization that assigns "official" dates to the beginnings and ends of U.S. recessions specifically refused to name June-July 2010 as the trough (end) of the recession that began in December 2007. We suspect it'll do so sometime before the November election. See "NBER Committee Confers: No Trough Announced," National Bureau of Economic Research, April 12, 2010 (http://www.nber.org/cycles/april2010.html).

[5] See "Debating Doctor Doom," *The Capitalist Advisor*, InterMarket Forecasting, Inc., Part I (January 27, 2009) and Part II (January 31, 2009). See also "Doctor Doom Revisited," *The Capitalist Advisor*, InterMarket Forecasting, Inc., February 28, 2010.

[6] See "The Silver Lining in Job Destruction," *The Capitalist Advisor*, March 9, 2009; "Is the Worst of Public Policy Already Priced In?" *The Capitalist Advisor*, May 11, 2009; "Don't Be So Defensive," *Investor Alert*, July 8, 2009; "The One Saving Grace," *The Capitalist Advisor*, August 31, 2009; "The Revival of Corporate Profitability," *Investor Alert*, November 6, 2009; "Yes, the Recession Ended Last Summer – and Don't Expect a 'Double Dip,'" *Investor Alert*, April 15, 2010; "Latest 'Crisis' is Much Ado About (Almost) Nothing," *Investor Alert*, May 21, 2010.

[7] See "The Almighty Consumer is Depressed – and That's *Bullish*," *Investment Focus*, InterMarket Forecasting, Inc., November 6, 2002.

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Table One
Growth in Output, Jobs, Profits & Stock Prices After U.S. Recessions
U.S., 1948-2010

	Real GDP Growth Quarterly AFTER Recessions Ended							1-Yr Post-Recession Changes in		
Recessions	1st qtr.	2nd qtr.	3rd qtr.	4th qtr.	Avg, 1-4	5th qtr.	6th qtr.	Jobs	Pre-Tax Profits	S&P 500
1948-49	4.6%	-3.7%	17.2%	12.7%	7.7%	16.6%	7.2%	4.4%	29.2%	25.0%
1953-54	0.5%	4.6%	8.3%	12.0%	6.3%	6.8%	5.4%	2.9%	32.3%	30.9%
1957-58	2.5%	9.7%	9.7%	8.3%	7.5%	10.5%	-0.5%	3.4%	37.0%	34.9%
1960-61	7.7%	6.6%	8.4%	7.4%	7.5%	4.5%	3.7%	1.4%	26.2%	12.9%
1969-70	0.7%	3.6%	-4.2%	11.5%	2.9%	2.3%	3.2%	2.1%	24.6%	10.1%
1973-75	3.1%	6.9%	5.3%	9.4%	6.2%	3.0%	2.0%	3.3%	47.5%	20.7%
1980	7.6%	8.6%	-3.2%	5.0%	4.5%	-4.9%	-6.4%	1.9%	16.6%	7.8%
1981-82	0.3%	5.1%	9.3%	8.1%	5.7%	8.5%	8.0%	3.6%	39.6%	19.6%
1990-91	2.7%	1.7%	1.6%	4.5%	2.6%	4.3%	4.2%	0.4%	6.2%	9.4%
2001	3.5%	2.1%	2.0%	0.1%	1.9%	1.6%	3.2%	0.2%	20.6%	-19.5%
Averages:	**3.3%**	**4.5%**	**5.4%**	**7.9%**	**5.3%**	**5.3%**	**3.0%**	**2.4%**	**28.0%**	**15.2%**
2007-2009	1.6%	5.0%	3.7%	2.4%	3.2%	na	na	-0.7%	38.7%	17.0%

as we illustrate in Table One, it's perfectly *normal* for economic recoveries – including the current one – to proceed unevenly. We examine the aftermath of ten U.S. recessions from 1948 to 2001 and compare it to the aftermath of the *latest* one (December 2007-June 2009). Real GDP has grown by an *average* of 3.3%, 4.5%, 5.4% and 7.9% in the first, second, third and fourth quarters following each recession, but there's *considerable variation* within these averages. Indeed, there have been *three* cases when real GDP *contracted* for a quarter – and *fifteen* cases (*half* the time) when the growth rate *decelerated* from one quarter to the next – even though these are still classified as year-long, post-recession economic *recoveries*.

The economic recovery of the *past* year compares favorably to the ten prior ones Real GDP has grown by 1.6%, 5.0%, 3.7% and 2.4% in the first, second, third and fourth quarters since the recession ended in June 2009. Unlike past cases, there have been *no quarterly contractions in the past year* – and while there have been two *decelerations* in the growth rate (from 5.0% in 4Q09 to 3.7% in 1Q10, then down to 2.4% in 2Q10), that too isn't so rare, since it happened after the recessions of 1957-58, 1990-91, and 2001. *Neither quarterly contractions nor temporary decelerations impeded the ten prior U.S. recoveries.*
We also document, in Table One, growth rates for employment, corporate profits and the S&P 500 price index in the same recovery periods. On average, jobs have grown 2.4%, but job-growth rates have declined over the decades, from 4.4% after the 1948-49 recession, to 2.1% after 1969-70, to just 0.4% after 1990-91 and 0.2% after the 2001 recession. This is due partly to productivity gains, partly to increasingly-punitive labor laws (make it too costly for business to actively re-hire) and partly to Washington's increasingly liberal extensions of jobless benefits, which discourages job-seeking.[8] In the past year, employment has declined slightly (-0.7%), but it's not materially different from last two recessions; moreover, today's jobless rate (9.5%) is down from its peak of 10.1% last October, and should keep falling in 2011.

As we've shown,[9] a slow re-hiring rate, while widely condemned, can be a *good thing* when it permits firms to keep costs down, productivity up, and profits booming;. That's *bullish* for *stocks*. Table One shows how profits have jumped 39% in this recovery, well *above* the average gain of 28% in prior ones – and how the S&P 500's 17% gain since the end of the latest recession is *also* above the average gain of 15% amid prior recoveries. In time, greater profitability will justify more job creation, but the latter is *by no means* a prerequisite for economic recovery. Consumption, *per se*, is not only irrelevant to the future rate of production, but a direct *inhibitor* of it.

We conclude with a reminder of the predictive importance of the shape of the Treasury yield curve – or alternatively, the width of the "yield-curve spread," or the spread between the T-Bond yield and the T-Bill rate.[10]

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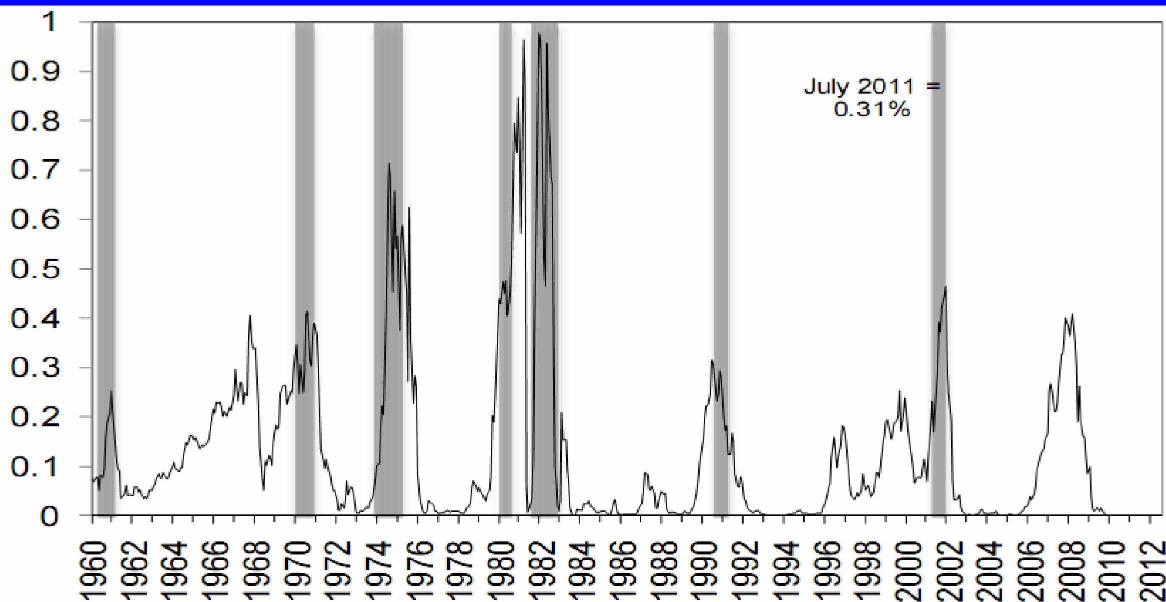
[8] See "Ominous Trends in the Burden of the Jobless on Taxpayers," *The Capitalist Advisor*, InterMarket Forecasting, Inc., March 31, 2010.
[9] See "The Silver Lining in Job Destruction," *The Capitalist Advisor*, March 9, 2009 and "The Revival of Corporate Profitability," *Investor Alert*, November 6, 2009. Another widespread Keynesian fear – that a rising *savings rate* will cause a "leakage" of aggregate spending and thus inhibit an economic recovery – is equally unfounded: see our study, "The One Saving Grace," *The Capitalist Advisor*, August 31, 2009.

Figure One
Probability of a U.S. Recession 1-Year Ahead – Using the Treasury Yield-Curve Spread
Shaded Areas = Recessions (excepting the recession of Dec 2007–June 2009)
U.S., 1960-2012



There's only a *single case* of "double-dip recession" in modern U.S. history – when the 16-month recession of 1981-1982 arrived only a year after the 7-month recession of 1980. But as usual, in the lead-up to every *other* U.S. recession since 1961, *both* ends of that "double dip" were preceded by a *deliberate inversion of the yield curve* by the Fed. Monetary policy brought short-term interest rates *above* long-term rates, which effectively reduces or eliminates the profit margin on financial intermediation, or the business of "borrowing short to lend long."

The "double-dip" recession of the early 1980s was a rarity *only* because it's rare for the Fed to *invert the Treasury yield curve twice in so short a span of time*. This only *confirms* the amazing forecasting power of the yield curve. Of course, Fed researchers (and policymakers) know full well that its yield-curve inversions invariably cause credit crunches and recessions; that's why they now periodically publish a chart (see Figure One) plotting the probability of U.S. recession, one-year ahead, relying exclusively on signals from the yield-curve spread (the 10-year T-Bond yield minus the 3-month T-Bill rate).[11]

Whereas the yield-curve spread (being negative) showed *high* probabilities of a year-ahead recession before prior contractions (shaded in gray), including the last one (not shaded) the current probability of recession, looking a year ahead (into 2011), is now a mere 0.31% (below 1%). Today's yield-curve spread is quite wide (roughly 275 basis points), and although it is much *narrower* than it was just four months ago, it's certainly *not negative* – the *prerequisite* for recession. There won't be a U.S. recession in 2011, no matter *how* uneven is the journey to then.

The "double-dip" recession of the early 1980s was a rarity *only* because it's rare for the Fed to *invert the yield curve twice in so short a period.* This only *confirms* the amazing forecasting power of the yield curve.

[10] See our reports: "The Fed Wants a Recession," *Investor Alert*, January 6, 2006; "Global Yield Curves and Economic Growth," *The Capitalist Advisor*, February 24, 2006; "Global Yield Curves and Equity Performance," *Investment Focus*, February 17, 2006; "The Policy Mix Index: Yield-Curve Inversion Signals Trouble Ahead," *The Capitalist Advisor*, September 25, 2006; "The Recession of 2007," *Investor Alert*, December 7, 2006; "Inverted Yield Curves as Bull Market Killers – and Bear Market Predictors," *Investment Focus*, February 7, 2007; "When 'Corrections' Degenerate Into 'Bear Markets,'" *Investment Focus*, September 18, 2007; "The U.S. Yield Curve as a Predictor of the Business Cycle," *Investment Focus*, December 15, 2008.
[11] See "The Yield Curve as a Leading Indicator," Federal Reserve Bank of New York, at http://www.newyorkfed.org/research/capital_markets/ycfaq.html.