TFC Financial Management

TFC Market Update
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Forecasters Sharply Reducing Future Economic Growth Rate Projections (Slower Growth or "Growth-recession," or "Double dip"?)

Like lemmings, most economists tend to follow their compatriots, run with the crowd and revise their forecasts as often as they dare by shifting degrees of probability and expectation. The media picks up where economists leave it and extract sound-bites crafted to create attention and concern. Meanwhile, the financial markets make their own news these days and contribute to the generally dismal investor psychology which predominates (JP Morgan reports that fully 63% of Americans recently polled still think the economy is mired in recession). Weakening consumer sentiment and flagging investor confidence are a definite drag on the current recovery. Deleveraging throughout seems a burden the economy will need to adjust to for the foreseeable future.

No doubt today, worldwide, the developed economies (i.e., U.S., Japan, and Euro-zone) are at significant tipping points. The question emerges whether the equity markets have already fully discounted these changes in the economic outlook, and if globally corporate earnings projections will need to be adjusted downward to reflect diminished underlying revenue growth expectations? Although admittedly with less conviction than a few months ago, our sources for macro-economic research continue to look for weak, but nevertheless positive, improvement in U.S. Gross Domestic Product (GDP) numbers in the coming 18 months. For the average American company, profit margin maintenance and earnings per share improvement should continue well into 2012. On 2012 projected earnings, at current market valuations, equities in the U.S. remain at very reasonable levels. Outside the U.S., similarly attractive valuations appear available.

All Eyes on Jackson Hole (To QE3 or Not to QE3? Does It Really Matter?)

The commentariat during the past few weeks has been focusing on what U.S. Federal Reserve Bank Chairman, Ben Bernanke, might announce during his speech last Friday morning during the annual conference of central bankers at Jackson Hole, Wyoming. You might remember it was a year ago at the last Jackson Hole conclave that Bernanke declared quantitative easing would be extended (QE2). The Fed would print even more money, provide the banking system with increased liquidity, buy long-dated Treasuries, and add up to $600 billion to its balance sheet. All this was intended to lower long maturity interest rates and provide added lending resources for our commercial banks.

Trouble is/was that during the last 12 months all this artificial liquidity went into emerging market stocks, and through their U.S. subsidiaries, into large foreign bank home office capital reserve accounts. In essence, the Fed inflated the U.S. monetary base to shore up foreign banks' required capital reserves. Although, possibly an unintended consequence, the effect is that U.S. taxpayers are by implication now sub-guarantors to many of the Euro-zone's larger banks; an embarrassing outcome to say the least, which understandably may not be publicized widely.

So the financial markets must now parse the Chairman's vague remarks made just prior to Irene's appearance and await further clarification, possibly to be negotiated at September's next two-day meeting of the Fed's governors; precisely the very result Bernanke may have wished to generate. If he had proposed some sort of pro-active remedial policy shift at Jackson Hole, investors might have sensed panic. Leaving his constituent markets uncertain about the Fed's next step buys time and allows investors to come to their own conclusions; a communications strategy often practiced by Bernanke's predecessor.

Should you have any questions or comments, please let us know.

Best,

Jim

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