Introducing the C6 Real Misery Index™

MEASURING REAL MISERY IN THE REAL ECONOMY

Tom Cammack, CFA March 8, 2016

This article is Part 1 of a three part series.

According to the United States Misery Index website (www.miseryindex.us), the misery index was created by economist Arthur Okun, an advisor to President Lyndon Johnson in the 1960's. He used it to characterize current economic conditions. The index was defined as the sum of the unemployment rate plus the inflation rate. A rising index indicated a worsening of economic conditions and vice versa. Misery index results have been linked to various presidents' term in office (a rather dubious use of the index, in my opinion).

The misery index used in the 1960's and 1970's worked fine for traditional business cycles, including periods of stag-inflation (stagflation). However, as the country (and the world) has moved increasingly to credit-driven asset bubble cycles over the past twenty years, the old formula no longer works as effectively as it once did.

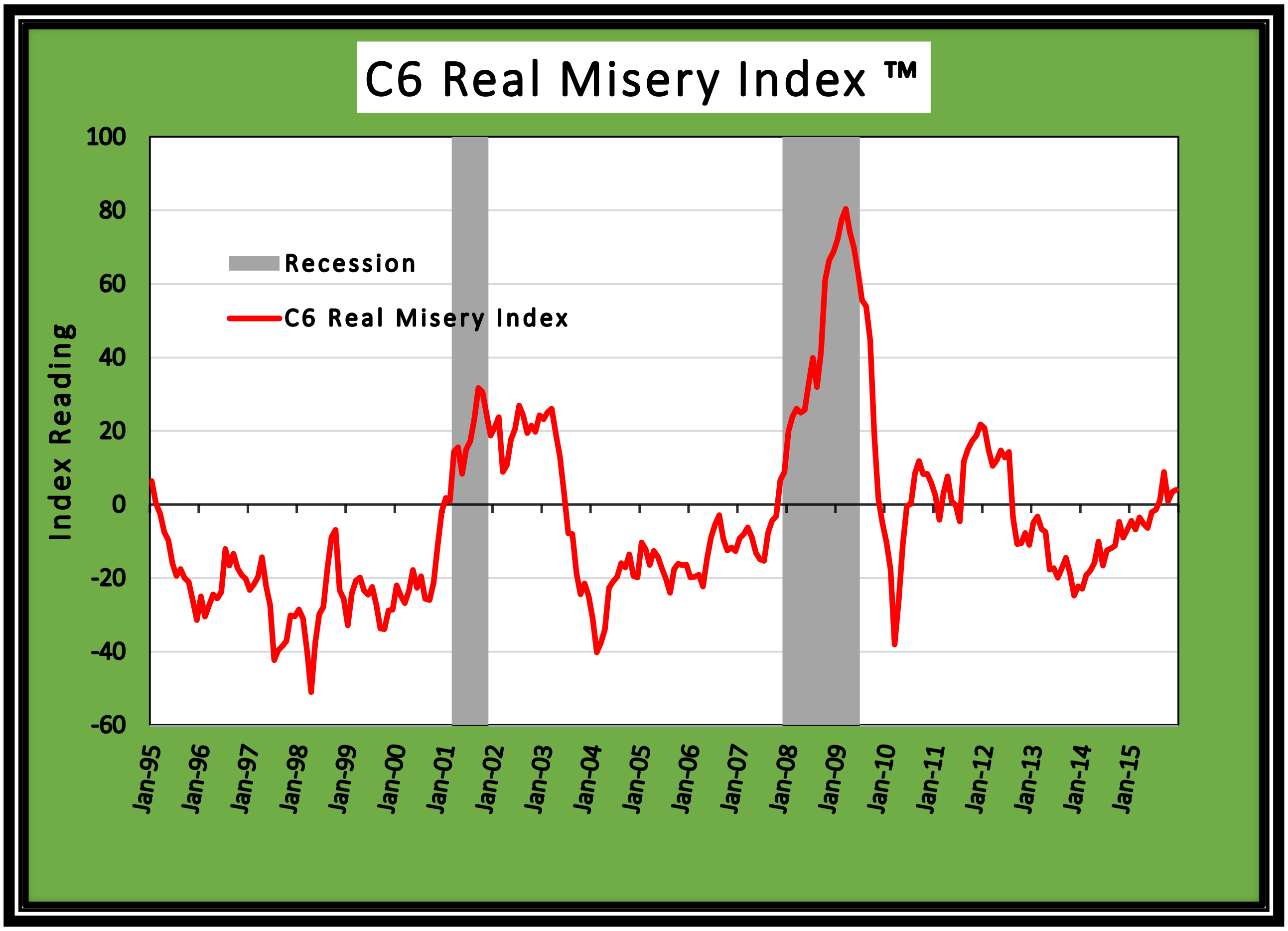
The C6 Real Misery Index™ (C6 RMI) is a six factor model that is designed to provide a more realistic picture of "misery" in the U.S. economy, especially for the dwindling middle class. The six factors that make up the C6 formula were chosen on the basis of factors which make common sense in today's economy (hence the C6 name – six factors and the first initial of the author's last name).

A primary advantage of the C6 RMI is that it is designed to capture bursting credit bubbles in a stag-deflationary environment (slow economic growth and credit-driven asset bubbles in one or more markets). The higher the index, the more pressure on Fed to ease monetary policy and on politicians to adopt economic stimulus measures. Also, a higher index is likely to indicate higher frustration and anger among the public at large.

All six factors of the C6 RMI have been generally favorable since the end of the last recession in 2009. The upward move in the index over the past eighteen months has occurred despite the decline in energy prices. From a probability standpoint, the next significant index move is likely to be upward. This has negative implications for traditional stock indices. Returns are likely to be muted at best and solidly negative in some years.

With low, and in some cases, negative investment returns, there will be increasing pressure on pension funds. It is a great concern that many pension funds are significantly underfunded even with the strong stock market performance since 2009. With approximately 10,000 baby boomers reaching the age of 65 every day until the year 2030, the pension problem will likely get much worse. Given the U.S. government debt situation -- $16 trillion outstanding and at least another $66 trillion of entitlement promises (present value), the outlook is grim. If there is any consolation at all, the outlook in Japan and Europe is even worse.

The C6 Real Misery Index™ Monitor:



Current Reading: +4.0

Trend: Trending higher (unfavorable)

Key observations:

- The index spiked up in the late 2007 to early 2009 recessionary period, reaching a peak reading of 80.5 as of March 1, 2009.

- The index came down dramatically in late 2009 and early 2010 as Quantitative Easing (QE) and other economic stimulus measures kicked in.
- After rising to positive territory and peaking at 20.8 in January 2012, the index went back down to negative territory.
- The index has been creeping back up since January 2014 and broke back into positive territory with the August 2015 reading.
- Reflating the housing and equity markets has come at a very high cost – artificially low interest rates, Quantitative Easing programs (QE 1, 2, and 3), and significant Federal Reserve Bank balance sheet expansion.

The C6 Real Misery Index Composition:

There are two primary goals of the C6 RMI formula: to reflect economic reality and to be simple to calculate and understand. I came up with six factors that made logical sense to me (hence the C6 name – six factors and the first initial of the author's last name). Here are the components:

- **Unemployment Rate** (U6 - includes discouraged and underemployed workers and those working part-time for economic reasons)
- **Consumer Price Index (CPI) – Cleveland Fed Median** (annual change)
- **Real Interest Rate** (3 month Treasury Bill rate – Cleveland Median CPI)
- **Compensation: Wage and Salary Disbursements** (year/year change)
- **S&P/Case-Shiller U.S. National Home Price Index©** (year/year change)
- **Russell 3000® Price Index** (year/year change)

Independent financial consultant Tom Cammack (CFA) is the creator of the C6 RMI. Previously, Cammack was a senior investment manager with the Teacher Retirement System of Texas for 24 years. A white paper more fully explaining the creation of the index is available at www.RealMisery.com. Cammack also publishes the bi-monthly newsletter, *The Real Misery Monitor*. You are welcome to contact Tom at tom.cammack@realmisery.com.