TECHNICAL SCOOP
CHART OF THE WEEK

Charts and commentary by David Chapman

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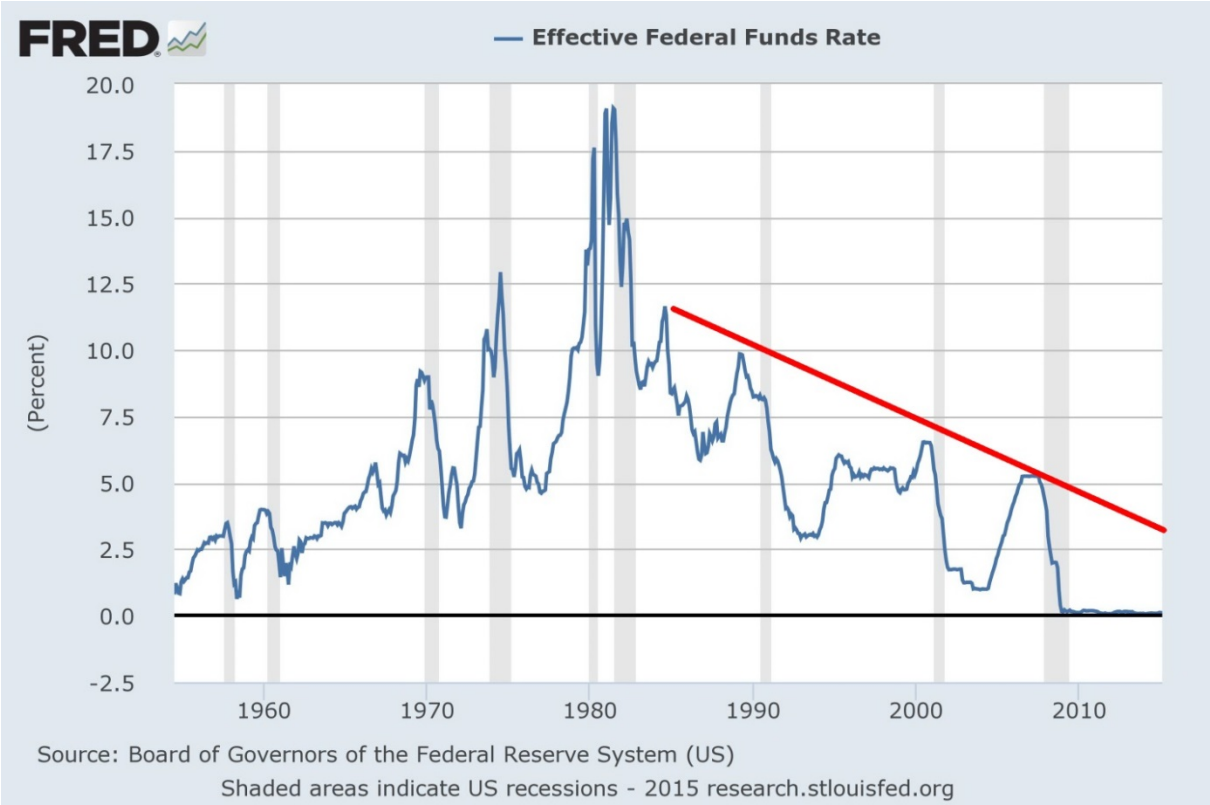
The Fed Drops "Patient"



Source: www.research.stlouisfed.org

The Fed lost patience. Well they did not so much as lose patience but they dropped the word "patient" in their "guidance" language. It seemed to be widely expected that they would. Then the Fed talked out of both sides of its mouth simultaneously (aka – Fed speak). The Fed may no longer be "patient" but in the same breath they downgraded the expected pace of growth and inflation. In other words, they are no longer using the word "patient" but they will still be "patient". Go figure that one out. The word "patient" may have become the most overused word in the English language over the past few months.

The Fed has held the official rate at 0%-0.25% since late 2008 following the financial crash of 2008. It has been an unprecedented length of time for an abnormally low official rate. Prior to that, the lowest rate was 1% following the High Tech/Internet crash of 2000-2002. Since 1954, the key Fed rate has never been so low. The highest was 19% plus in 1981. But that was in another time.

With the Fed losing its patience but still concerned about growth and inflation, the market took that as a signal that there would be no interest rate hike any time too soon. Some still believe that the rate hike could come by June 2015 but others now don't see a rate hike until 2016. The markets celebrated as stocks, bonds and even gold and silver all rallied. Oh and oil reversed off new lows and closed higher on the day. The big loser was the US$ Index as it tumbled 1.2%. The currencies (Euro, Pound, Yen, Swiss Franc and Cdn$) all enjoyed a strong up day.

If one wants to figure out what the Fed was actually talking about on March 18, 2015 following the FOMC meeting there is a word for it all. "Gibberish"! Or as I noted in the opening paragraph it is Fed speak. How else can one explain how one can drop the word "patient" from their guidance then in the same breath state that they have downgraded their outlook for growth and inflation? Even Janet Yellen was quoted as saying at the press conference after the Fed statement "Just because we removed the word 'patient' from the statement doesn't mean we're going to be impatient". Talk about double speak.

Granted the Fed is in a quandary. The rest of the developed world is in a funk with both Japan and the Euro zone in recessionary conditions or low growth. No other major OECD country is raising interest rates. If anything, the tendency has been to cut interest rates. The Fed has no wiggle room if the US were to also see growth slow or worse slide into recession. How does one cut interest rates when they are already at zero? Or do they go the way of the Euro zone and even Japan with negative interest rates?

It is also possible that the Fed has noted that the stock markets appeared poised on the edge of breaking down under a possible ascending wedge triangle. At the end of the day, the best way to keep people's minds off a struggling economy is to help push the stock market higher. If a rising stock market is the measurement of a strong economy than one might think that the economy was doing just fine. Instead, at best it is muddling. As to inflation, the recent PPI and CPI releases are indicating that the US economy could be joining the Euro zone and Japan in sliding into deflation. That is a far cry from the desired 2% inflation target of the Fed.

As to the economy, I am sure the Fed is looking at many of the same charts that I look at from time to time. After all, the Fed produces these charts. First, a word on employment, which everyone continues to hail as to why the Fed might hike interest rates sooner rather than later. The nonfarm payroll number may be one of the most overestimated numbers produced. The number is largely a guesstimate. Many of the so-called jobs are low wage, part-time or the over used self-employment, which for many is a euphemism for "I am out of work so I am now a consultant".

The first chart shows the unemployment rate (U3) overlaid with the unemployment rate (U6) that includes marginally attached workers plus total employed part-time for economic reasons. John Williams www.shadowstats.com publishes one more unemployment rate, which is U6 plus discouraged workers

unemployed beyond one year. The U3 unemployment rate is 5.5% and the U6 unemployment rate is 11% but Williams unemployment rate is 23% and has been at that level for months.

The U3 unemployment rate remains above levels seen in the late 1990's and prior to the financial crash and recession of 2007-2010. Quite tellingly, the U6 unemployment rate is nowhere near its lows. The spread between U3 and U6 unemployment is currently 5.5 points. At the peak in 2010, it was 7.3. In December 2007, the spread was 3.8. The U6/U3 ratio is at its highest level at 2. The ratio saw its lows back in 2002 at 1.63.

Source: www.research.stlouisfed.org

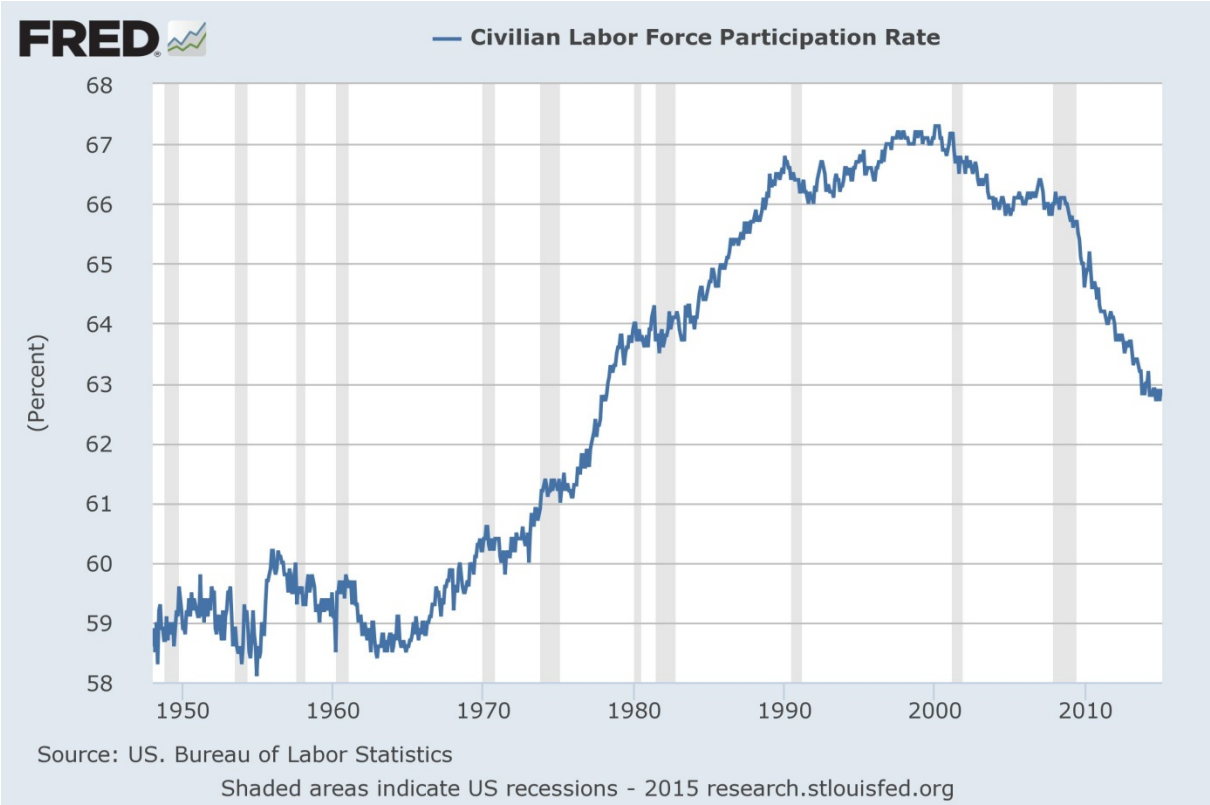
As has been noted on numerous occasions the unemployment rate is falling not because more people are working but because the labour force participation rate is falling. The labour force participation rate at 62.8 is at levels seen back in the late 1970's. The civilian employment population ratio is also dragging along at multi-year lows. That ratio takes the number of people employed in relation to the total population. Again, that ratio is back at levels last seen in the late 1970's. There are actually fewer people working today then there was in 2000 (148.5 million today vs. 153.4 million in 2000). Those working part-time remains at multi-year highs. Current levels are 27.5 million vs. 28.1 million in July 2013. These levels are higher than at any time prior to the recession of 2007-2010.

People are also unemployed longer. Prior to the recession of 2007-2010, the average duration of unemployment was 17 weeks. At its peak in 2011, the average duration of unemployment hit 40 weeks. Today it is just under 32 weeks albeit it has been declining slowly. Going back to 1950 the highest it had ever been prior to the 2007-2010 recession was 21 weeks during the recession of 1980-1982. Overall

fewer people are working despite an increase in population and people are unemployed for a longer period than they ever have been over the past 65 years.

One thing that zero percent interest rates and three rounds of QE has been successful with is pushing up the value of the stock market. While traditional measurements of inflation are showing signs of deflation, the real inflation has been in assets. As I have noted in the past the stimulus of low interest rates and QE for the most part has never really made it into the real economy. It has instead resulted in inflating assets. Now the value of equities in relation to GDP is at its highest level since the dot.com bubble of the late 1990's. Today it is at levels even higher than they were in 2007. It is a potential measurement of overvaluation in the stock market.

The indicator is known as the Buffett Indicator named after Warren Buffett. The indicator takes the ratio of market capitalization of corporate equities to GDP. That chart is shown below following the three employment charts from the Federal Reserve.



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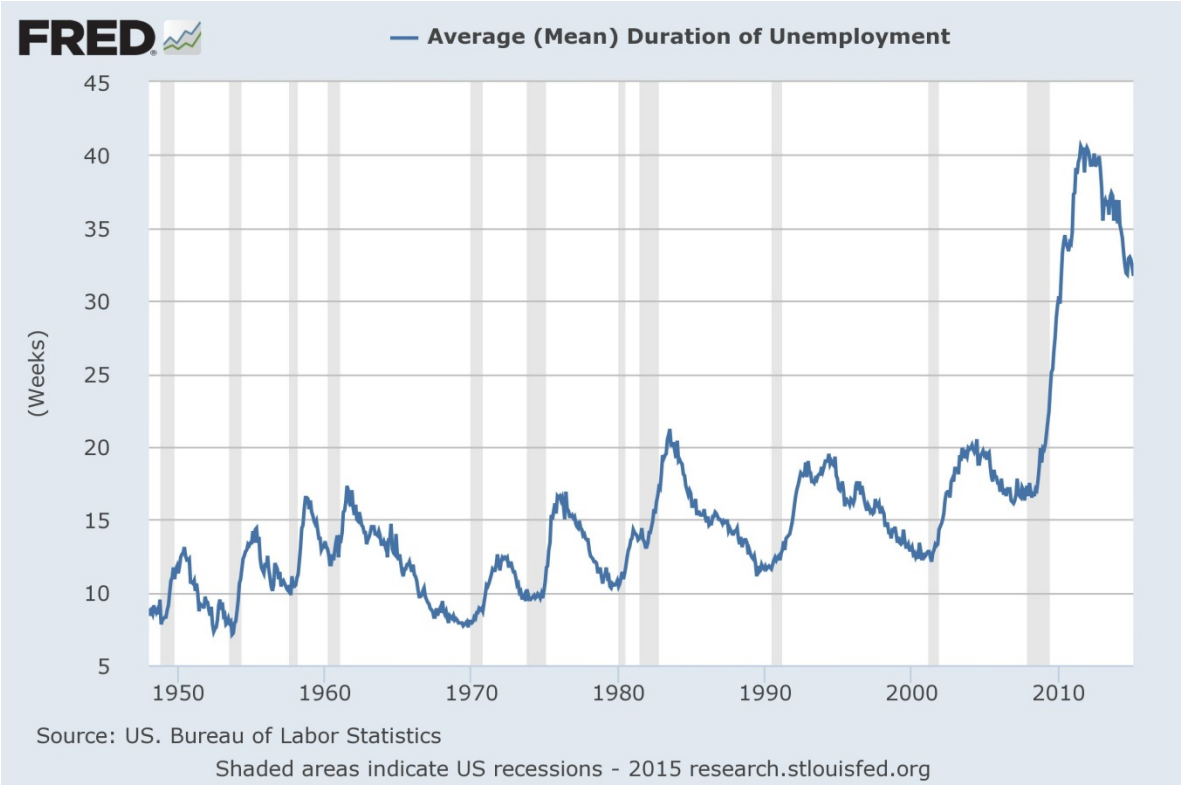

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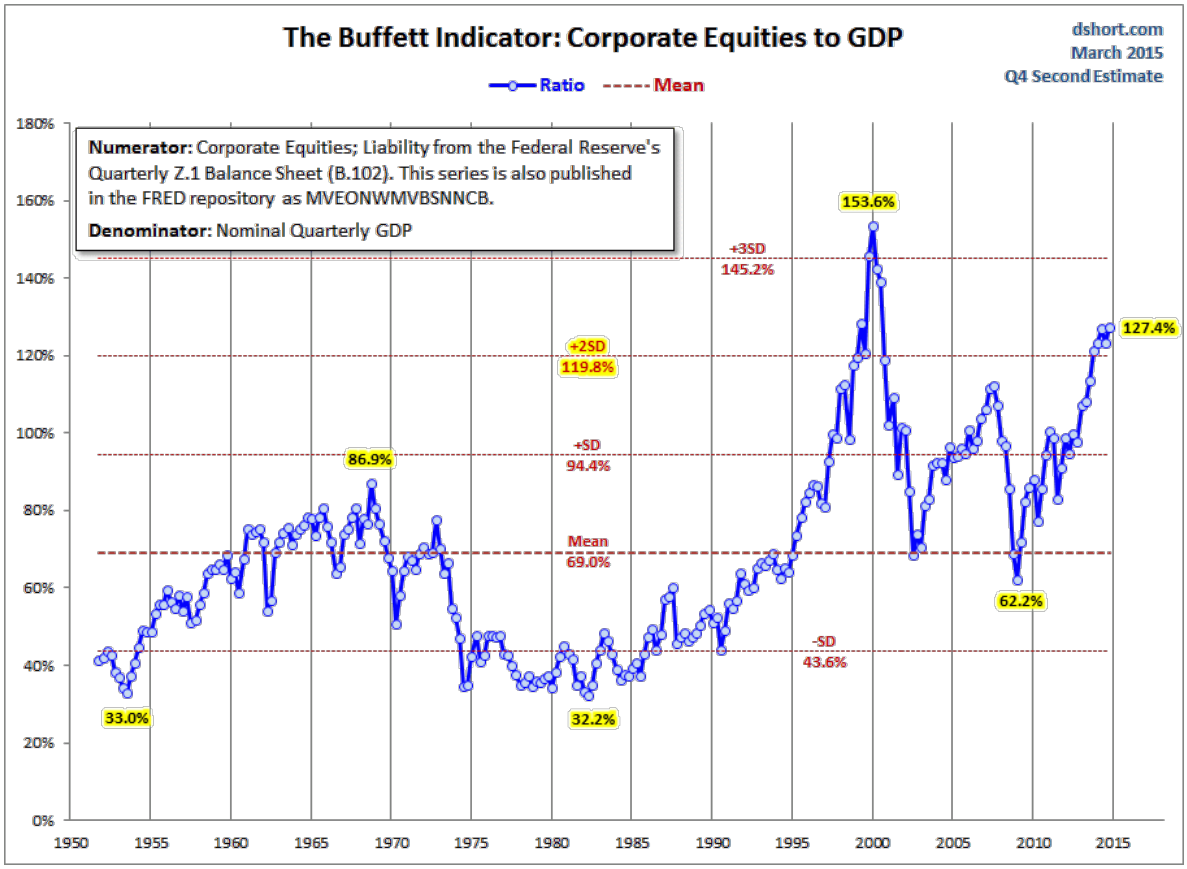
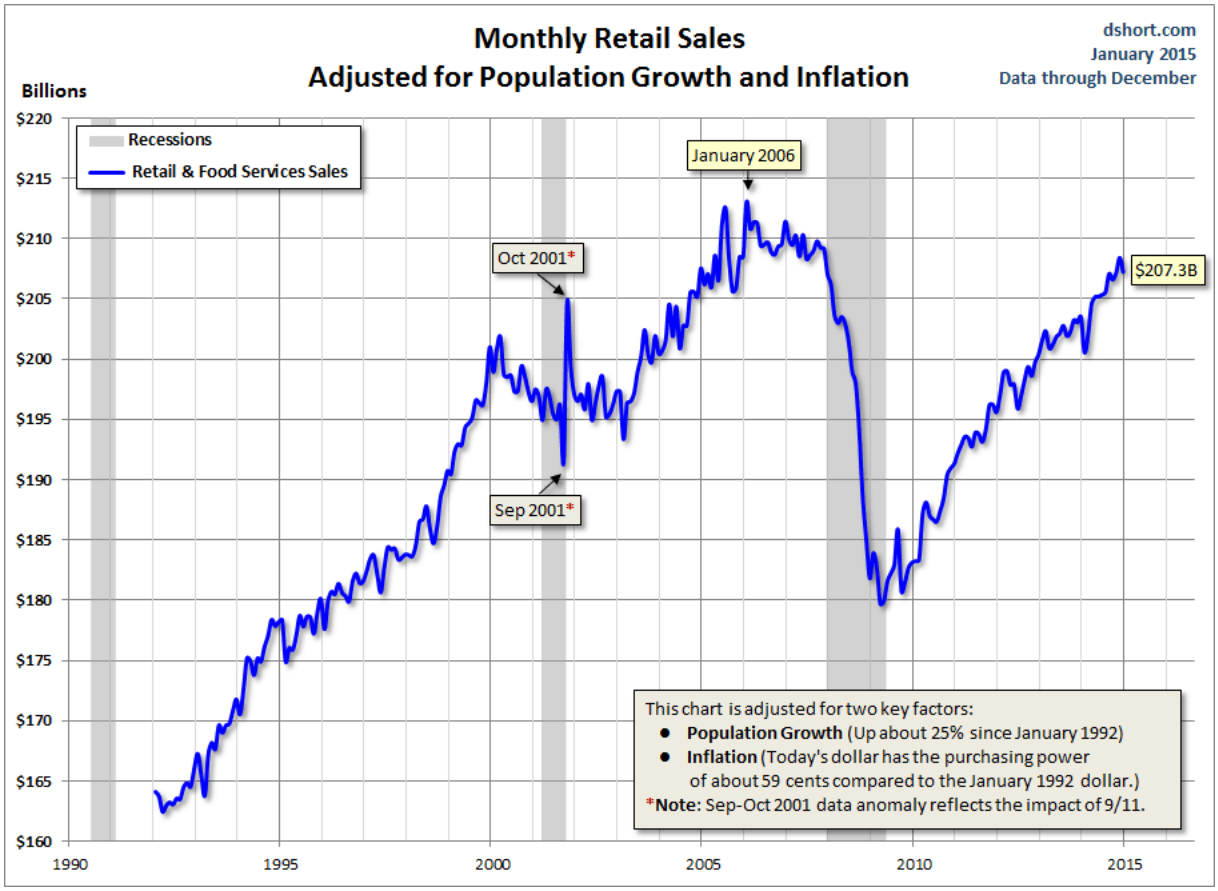


Source: www.dshort.com

Household net worth has also risen sharply over the past number of years along with equity valuations. As with the stock market, the rise is primarily due to asset inflation. While household net worth is up 83% from where it was at the peak of the dot.com bubble in inflation adjusted terms it is only up 40%. Wages on the other hand are only up 17% in the same time and real median household income is actually down almost 10%. So where is the boom? Another interesting figure is the average net worth of the US household is $310 thousand but the median net worth is $45 thousand meaning half of US households have a net worth less than $45 thousand.

Retail sales are another case in point about an economy not as strong as it would appear. While actual retail sales are at record levels (despite slipping the past few months) when one adjusts retail sales for inflation and population growth retail sales are back about where they were ten years ago. An interesting chart is shown below that reflects that while retail sales have grown since the 2007-2010 recession from roughly $180/person to roughly $207/person it remains below the peak of 2006 when it was roughly $212/person. Given weak retail sales over the past few months since this chart was produced, the current level may well be lower than where it was in January 2015.



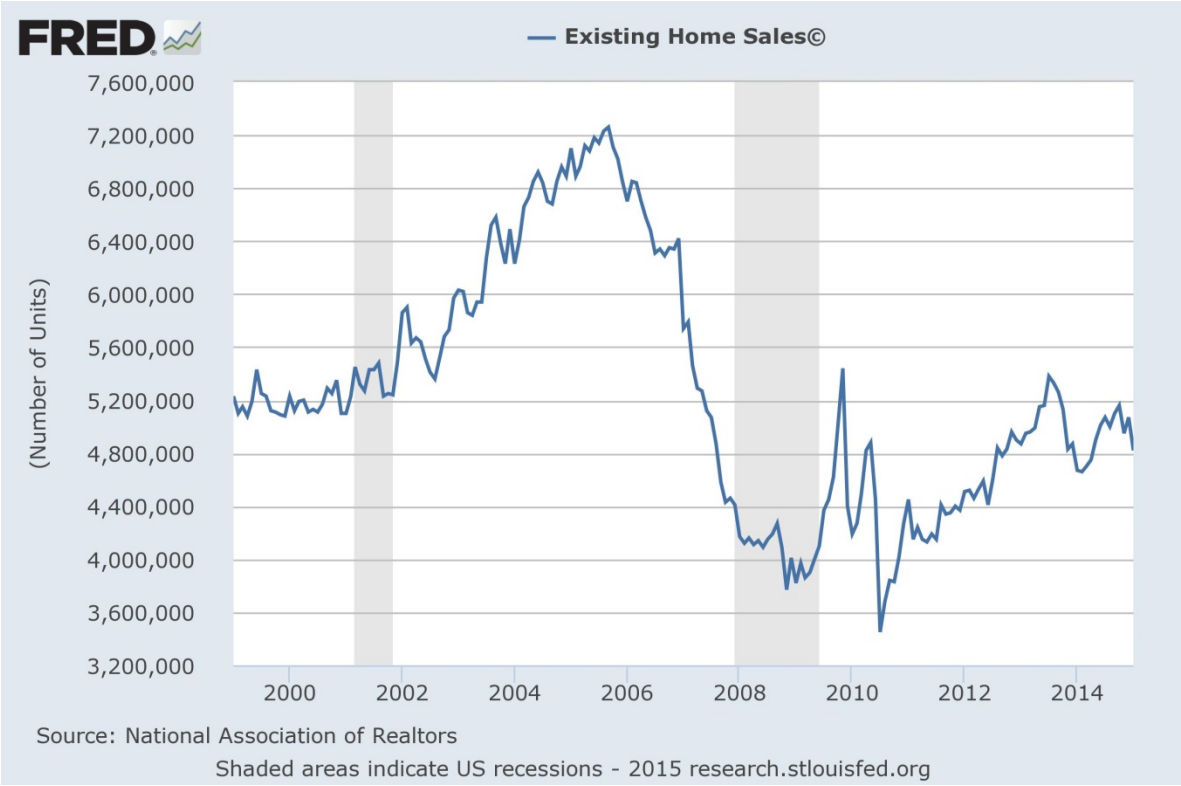
Source: www.dshort.com

Many tout the housing recovery as evidence that the economy is improving. Well yes, housing has improved but overall it remains well below peaks seen in 2006. Existing home sales remain not only below the peak seen in 2006 but are below levels seen in 2000. Existing home sales have started once again to turn down and have failed a recent peak. Technically that suggests weakness and the possibility for new lows.

With new home sales, the situation is even worse. New home sales are not only well below the peak of 2005 but they are down to levels seen in the early 1990's and early 1980's recessions. This is not what one would call a robust recovery. Finally housing starts are at levels seen at recessionary lows during the late 1960's, and the recessions of 1974-1975, 1980-1982 and 1990-1992.

Given three rounds of QE since the financial crash of 2008 plus interest rates held at historical lows one would think that the housing market would be a lot stronger. Not only is the housing market not stronger (ok barely) but it is in some cases at levels seen 20-40 years ago.

Three housing charts follow that show this situation.



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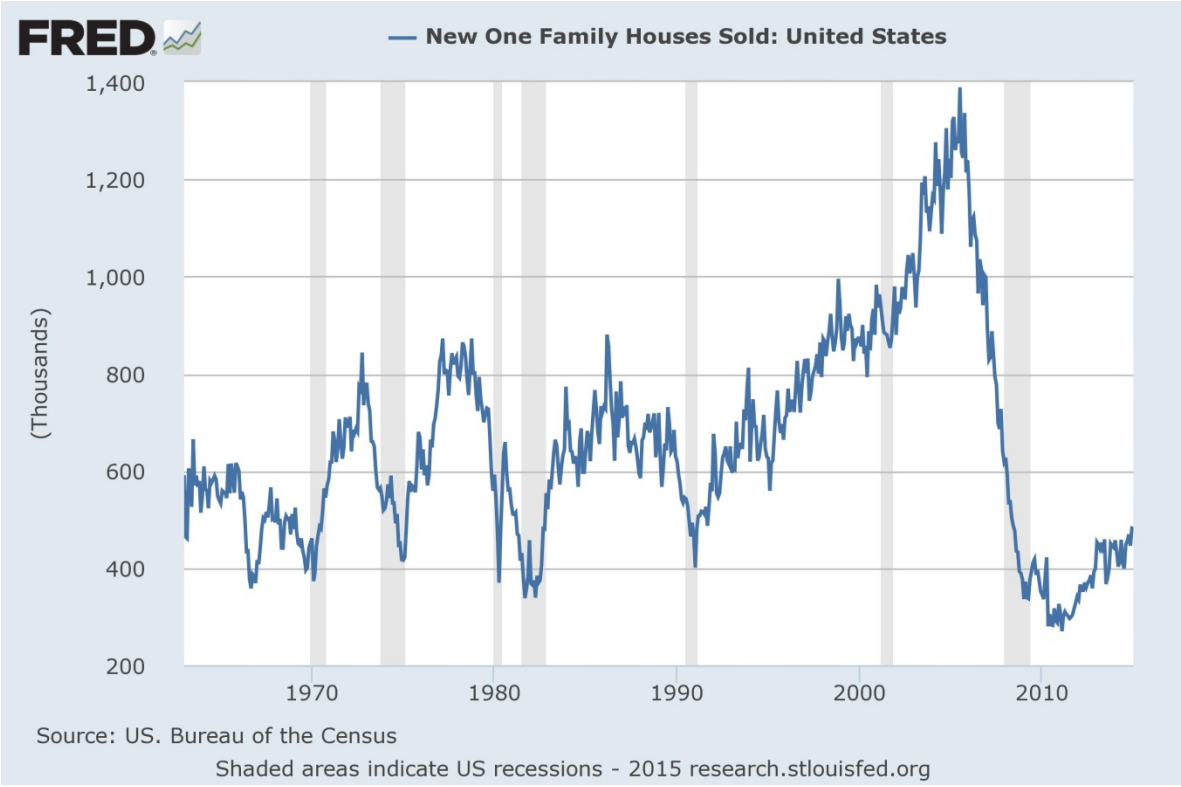

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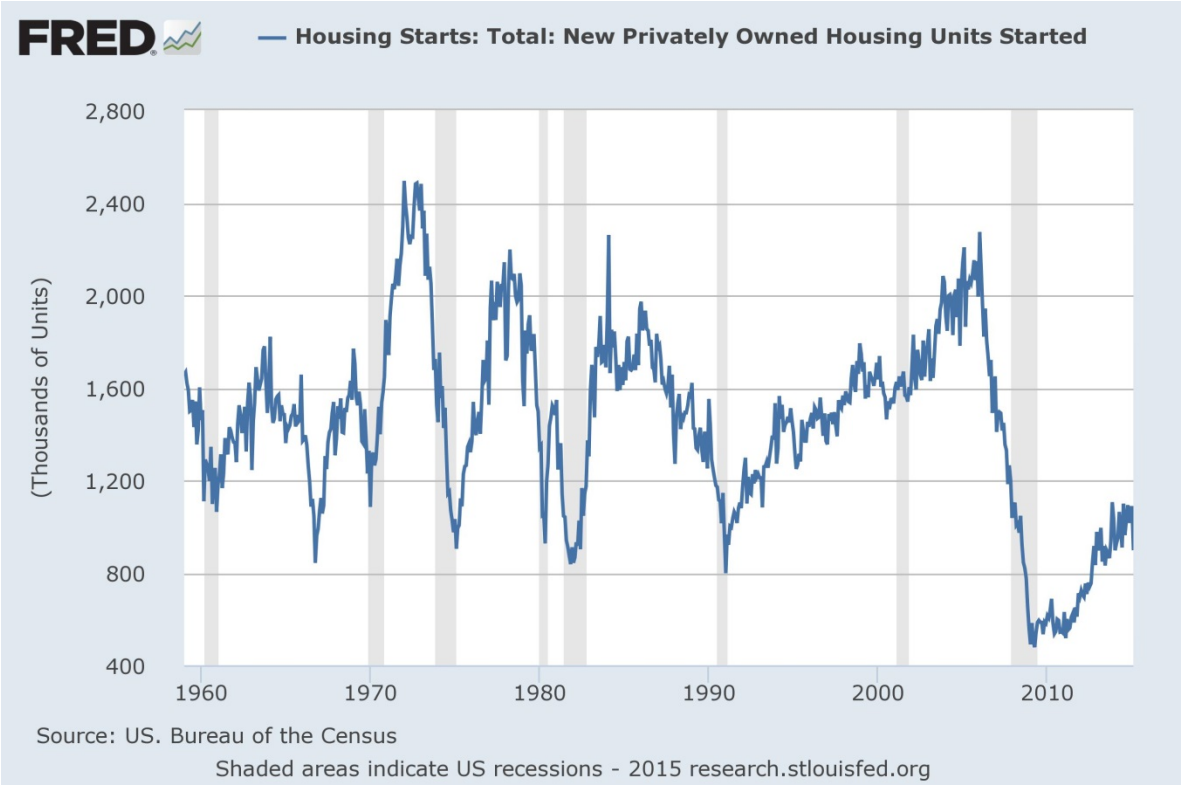
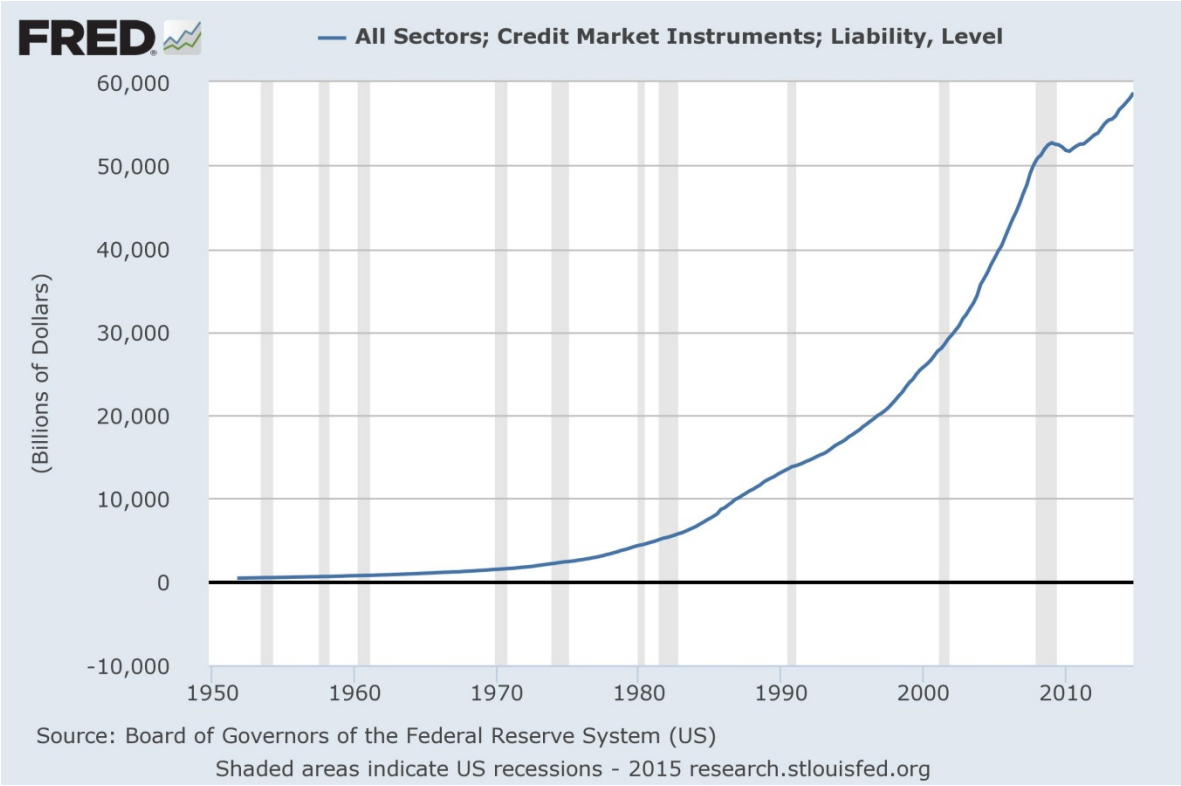


Source: www.research.stlouisfed.org

Finally, one cannot ignore the debt situation. Total US debt has grown $8.6 trillion since the end of 2007 to $58.7 trillion at the end of 2014. Government debt has seen the largest growth up $7.9 trillion (note: this is public debt growth only – Total or grosses US government debt has grown by about $9.2 trillion. Debt to GDP was 68% at the end of 2007. Today debt to GDP is 103%. Countries with a government debt to GDP over 100% tend to experience weak economic growth and are subject to economic shocks). In addition, the US has roughly $95.6 trillion of unfunded liabilities. Corporate debt has also gone up sharply from $6.3 trillion at the end of 2007 to $7.6 trillion today.

If there have been declines it has been financial debt (banks etc.) that have seen a decline of just over $2 trillion. The prime reason for that is that banks have seen their loan books fall because they are not able to find sufficient credit worthy customers to lend to. As well, banks tightened their credit requirements considerably following the financial crash of 2008.

Households have seen their debt decline by roughly $500 billion. Most of it has occurred because households are taking on less mortgage debt even as consumer debt (credit cards) has soared. Given the shock of the 2008 financial crisis the consumer has deleveraged but not by very much. Consumer debt had soared for the previous three decades. At least US households have deleveraged to some extent. In Canada, the consumer continues to leverage higher and their debt to income ratio is the highest ever.



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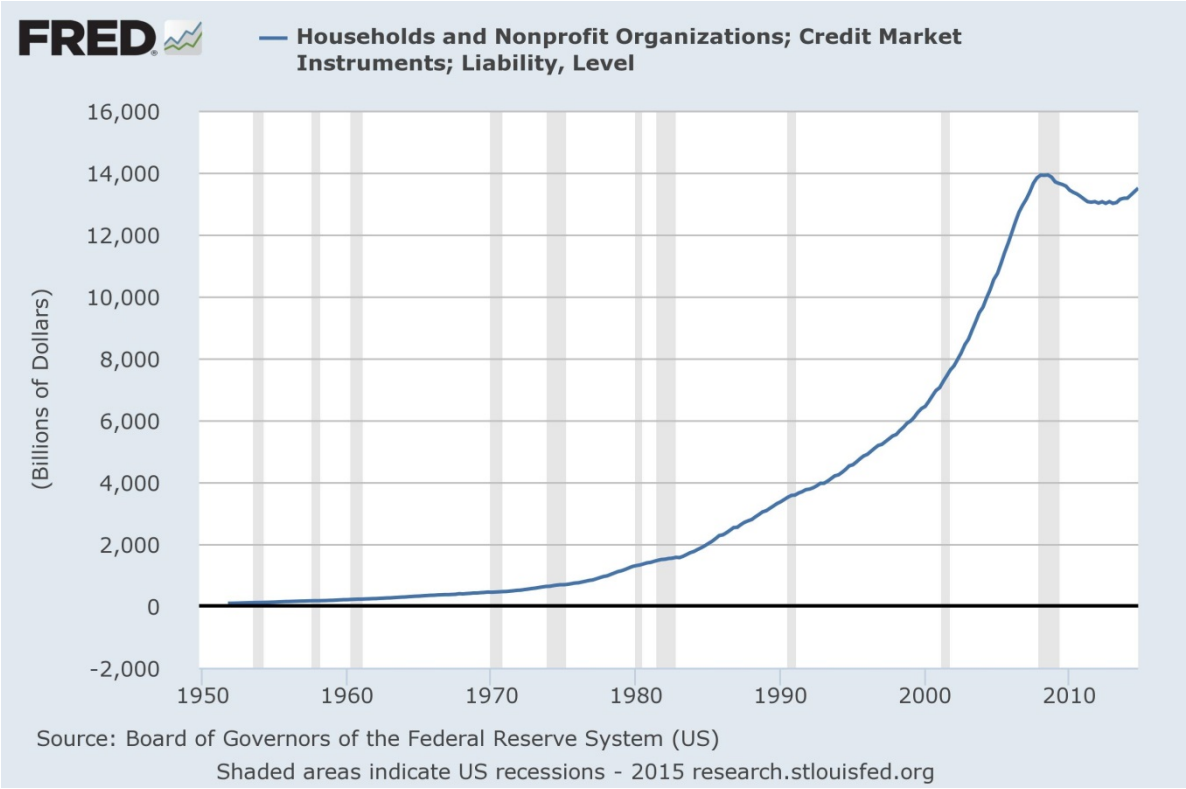

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The Fed is caught between a rock and hard place. That may explain why the Fed's official statement and Janet Yellen's press conference were both in some respects confusing. The Fed is no longer "patient" but they are concerned about weakness in economic data and inflation (or in this case deflation). An interest rate hike could occur but the Fed faces pressure from other countries to hold off even as they have no wiggle room for lowering interest rates if another recession were to develop. The Fed effectively signaled that ultra-loose monetary policies are to continue and they dampened expectations that any rate hike would happen by June. This pushed out interest rate hike expectations to September and maybe even later into 2016.

The Fed is too well aware that the global and US debt situation remains fragile and the economy would have difficulty with higher interest rates. Despite six years of QE and an ultra-loose monetary policy with interest rates historically low, many aspects of the economy remain sluggish at best even as it has created an asset bubble given the high level of the US stock market. All the talk about hiking interest rates coupled with economic weakness in the Euro zone and Japan has driven the US$ to multi-year highs. It is now at levels that threaten the recovery as the export market contracts and US multinationals have lower global earnings because of the strong US$.

The US$'s position as the world's sole reserve currency remains under constant attack because of currency wars. China is leading the charge to weaken the role of the US$ in the world and strengthen the Chinese Yuan through the creation of financial institutions led by China that would challenge the supremacy of the IMF and the World Bank. Many believe that the military build-up in Europe vs. Russia and even in Asia vs. China is a result of this direct challenge to the US$ and US global hegemony. We live in interesting times. The Fed may have dropped "patient" but the world is increasingly becoming "impatient".

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