Boenning Morning Comment

This report is prepared for us by Tower Bridge Advisors June 25, 2010

Stocks got clobbered yesterday as investor moods continued to sour. On Wednesday afternoon, the Federal Reserve, in its post-FOMC meeting statement, offered a sober picture of the economy. But almost by definition, what the Fed described on Wednesday was old news. We all knew consumer spending was slowing. We all knew that Europe faces a debt crisis on uncertain consequences that might impact our growth. So there should have only been a limited reaction to the statement if not for very tenuous investor psychology. Yesterday's economic news wasn't so bad. Weekly jobless claims fell more than expected. Durable goods orders fell but if you back out the always volatile military aircraft orders, the numbers were also better than expected. About the only negative news yesterday was the widening of Greek credit default swap spreads, hardly a reason in and of itself for the market to drop almost 150 points.

It is not uncommon for investors to become overly concerned about the economy. Market strategist Barton Biggs has often noted that markets have predicted 10 of the last 5 recessions (I may have the exact numbers he used wrong; my apologies. But you get the point.). While I can't rule out a double-dip recession and I am very concerned about government actions, I want to start by pointing out that growth slowing from 3-4% to 1-3% doesn't constitute a recession. To presume that growth is going to slip from 3-4% to a negative number is a much bigger leap and one unsupported by any data we have seen to date. If the economy is to go back into recession, it presumes a significant part of the economy is about to experience decreased activity.

Let's examine that thought. One part of the economy at the forefront of investor minds this week is housing. I am not going to try and tie a bow around the housing picture. It stinks. It stinks for a lot of reasons but mostly it stinks because buyers are not confident that what they might buy will hold its value. On Wednesday it was disclosed that new home sales, the numbers that show up in GDP, were running at a 300,000 annual rate. That is 25% or less of what is normal. Said somewhat differently, new home construction is down over 80% from its peak. It can't go much lower. It may not go any lower. So if the economy is about to fall into a recession from current levels, it won't be because of housing. There is simply no room left to fall.

It certainly won't be because the Federal government plans to spend less. That hasn't happened since George Washington was inaugurated and it certainly won't happen under President Obama. It also won't be because business investment spending is crumbling. Quite the contrary. Investment spending is strong and every survey of corporate managers suggests it will go higher. Corporations are flush with cash and they haven't invested in their businesses for several years.

If you want to find one obvious area of weakness it might be state and local government spending. With stimulus money being withdrawn, local governments have to cut back on spending in order to balance budgets. Tax receipts should begin to rise during the next year but they won't close the gap. However, state and local government spending declines alone aren't going to create a recession.

If there is to be one, it, therefore, is going to have to be because of a significant contraction in consumer spending. Yes, I know May and June appear to be rather punk spending months. But there are very few signs of absolute declines. Government data for May showed a decline in retail sales month-to-month on a seasonally adjusted basis. But sales were up significantly year-over-year and were up moderately before seasonal adjustments. Just last week, Wal-Mart, the nation's largest retailer, predicted Q2 same store sales up 0-2%. That excludes the benefit from additional stores. Total sales may grow closer to 5% or more. That may not be a great number but it doesn't spell recession. Almost all of the big retailers are still seeing gains and expect them to continue. They may not be huge but a gain is a gain and it certainly doesn't spell r-e-c-e-s-s-i-o-n.

GDP includes other factors like inventory changes and trade but my point is that the consumer, who is two-thirds of the economy, continues to spend albeit carefully. Businesses continue to invest. The Federal government can't help itself. It continues to spend. I simply don't see how you get to a recession based on the facts, not the hysteria.

All is not perfect. Our government has been doing plenty to make our economic lives more difficult. Financial regulatory reform is in its final steps and we have to watch carefully. Congress is set to do some strange things if watchdogs don't keep on top of every little detail. One little episode yesterday had Congress trying to lay the entire cost of bailing our Fannie Mae and Freddie Mac on the nation's banks. That would clearly lead to disastrous consequences. Fortunately, cooler heads quickly prevailed. The bill potentially does a lot of good things but the devil is always in the details and we won't know them for a few days or weeks. Sovereign debt tremors in Europe continue to erupt. We will see if they can be contained. So far they have but they don't go away.

Investors have reacted by running to safety. 10-year Treasuries flirted with the 3% level yesterday threatening to go under 3%. Shorter term bonds yield only a fraction of 1%. One has to be quite fearful to believe that tying up money at a 3% return for 10-years is the best investment available.

My bottom line is that investors should try and look and the facts and not be driven by either fear or panic stirred up in the media or by overreading the market's behavior. Maybe I am all wrong and the consumer will head back to the bunkers like they did in the fall of 2008 but I see absolutely no indication that is happening yet. Until then, I have to believe that the stock market is simply going through one of its manic episodes and investors should look for safe buying opportunities rather than sell emotionally. One cannot tell when emotions have run their course and there doesn't appear to be any reason to race and buy everything on you shopping list right now. Technically, stocks may well test their recent lows. But we have seen psychology turn on a dime. One or two decent economic reports and optimism will be right back. Next week there will be a lot of data culminating in next Friday's big employment report. If private sector jobs growth is better than in June, my guess is that stocks will stabilize and rally. Of course, bad will move stocks lower. We'll watch and react.

I don't have my head in the sand. Ultimately, banks have to be willing to lend, and businesses have to be confident enough to hire. Housing has to stabilize. The Federal government needs to focus on restoring growth and not on bashing or blaming business for everything wrong. Things have been moving in the right direction but at a frustratingly slow pace.

Today Supreme Court Justice Sonya Sotomayor is 56. Carly Simon is 65.

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