Van Eck Hotline on Money and the Economy
For: Friday, September 2, 2011
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August was a volatile and rough month for much of the U.S. economy. That is news that everyone already knows. It was hard to miss the story, as it appeared continuously in the mainstream and financial media and even found its way into pop culture. By the time the stock market hit its low for the recent correction (3-1/2 weeks ago), news of the debt ceiling feud, the downgrade of the U.S. debt rating by Standard & Poor's and the slowing of the economy were all reflected in stock prices. In fact, I believe investors took stocks too low - based on the outlook for corporate earnings. This morning's employment report fit right into those perceptions. Many investors were expecting to see a weak report and that's what they got. However, Wall Street's reaction to the August employment report has a different story to tell. I believe it is important that you hear it.

Today's early selloff in the stock market was a perfect example of myopic attitudes. The headline of the report was scary and investors ran with it. Just a few minutes of their time could have saved them the trouble. While the report was weaker than what we have seen in recent months, it was not as weak as it looked on the surface. That is the connection between today's weakness in stocks and the attitudes regarding the U.S. economy. The skeptics are filtering through the available information and keeping only what they want to see. They have been ignoring a raft of recent economic evidence that suggests the economy is holding its own. Manufacturing in particular has been showing signs of stopping the slowdown triggered by the disasters in Japan. This week alone saw stronger than expected readings of the ISM Manufacturing Index and the Chicago PMI. While both of those reports showed that the pace of manufacturing was still slowing during August, the predicted collapses did not happen.

The August reading of the ISM Manufacturing Index was 50.6. That was down slightly from the July reading of 50.9. However, it was far above the majority of the estimates leading into the report. A drop into the 47 to 48 range was expected by many analysts. As for the August Chicago PMI, it fell to 56.5 from 58.8 in July. That showed a slower pace of growth. However, it was also stronger than the estimated range of 51 to 52. In both cases, analysts weighed the data of recent weeks and predicted huge declines in those two manufacturing gauges. While they displayed some weakness, they were not nearly as bad as expected. Many investors have been acting as if the economy is already in a recession. That's one of the reasons that the estimates for the manufacturing reports were driven so low. I am not saying that the two reports were strong. In fact, they both contained clear evidence of problems with manufacturing. The ISM report showed a contraction in new orders (49.3) and a still low reading of 45 for backlog of orders. The Chicago PMI showed weakening in production, new orders and order backlogs.

The bears believe there is far worse to come. That is where we part company. Manufacturing might muddle around for another month or two, but I expect to see improvement later in the year. I am bullish - they are bearish. The great destruction from the disasters in Japan in March sent untold numbers of ripples out through the global economy. While China recently surpassed Japan in terms of annual GDP, Japan is still the second largest developed nation in the world. Nearly a quarter of Japan's workforce is employed in industry - slightly more than in America. Both of those nations offer the world high quality goods - often expensive high-tech equipment and parts. When Japan was slammed out of the blue on March 11, there was an immediate impact on industries around the world. The auto industry in particular, which tends to operate on tight supplies of parts, was especially hard hit. That slowed the pace of production and eventually slowed down car and truck sales. All of that is known but it has been ignored by far too many analysts and commentators. Politics has played a role, but let's not forget about the tried-and-true myopic attitudes that I mentioned earlier.

When combined with some of the other stresses in the economy this spring and summer (high gas prices, troubles in Washington, the S&P downgrade and more recently the anticipation and then the real impacts from Irene) the Japan disruptions have been amplified. The fact that manufacturers have been seeing a decline in new orders and order backlogs during the past three to six months is tied to the disruptions and a drying up of businesses confidence. By choosing to ignore the Japanese connection, some people have set themselves up for failure. It is common these days to believe that the economy will be in a recession by the end of the year, the stock market will crash, home prices will plummet and unemployment will go up and stay at very elevated levels for years to come. Many economic reports of the past month have been poking holes in that gloomy mindset. During the next few months, there should be more bad news for the bears - meaning signs of stability and recovery in manufacturing activity, consumer spending and employment growth. That is why I am still bullish on the stock market these days - despite all of the talk about a looming crash.

Stocks have been in a bull market for 2-1/2 years (up 81% in that time). Some sellers have been driven by blind panic during the past month. That kind of process tends to burn bright and then run out of fuel in short order. The economy and markets are facing an important crossroads during the time ahead. The word has gone out through the nation that things are bad and destined to get worse. A good-sized chunk of the population believes that policies out of Washington have guaranteed a new recession and all sorts of other nasty things. They have no problem imagining that the recent slowing of growth in the economy has been just the start of a new Time of Troubles. I am here to tell you that things are not as bad as you are being encouraged to believe. Besides the stronger than expected manufacturing indexes that came out this week, there was also a healthy jump of 2.4% in July factory orders. The increase was led by a surge in orders for motor vehicles. They jumped by 9.8% - the strongest one-month gain since early 2003. Commercial airline orders also increased. Both of those developments are clear signs that the Japan related disruptions have been coming to an end. That means 2011 will end on a strong note - not the recession that so many people have been predicting.

All of the nonsense that took place in Washington during late July and into August (and the gamble by S&P to place America's debt rating below that of other nations that do not have anything close to the wealth and resources offered up by America as the ultimate collateral) delivered a heavy blow to confidence. At first, the impact was felt in the stock market. However, that quickly ran its course - with stocks running short of willing sellers after less than two weeks of downside action. The August reading of consumer confidence was released on Tuesday of this week. It was an abysmal 44.5 - down from 59.2 in July. That was the lowest reading since February 2009 (basically the trough for the recession and job losses). The bears celebrated the consumer confidence news. They viewed it as the final support knocked out from beneath the economy and the stock market. I imagine that many of them set up or increased short positions based on the drop in consumer confidence. Well, what goes down can surely go up - and I expect to see confidence trend higher during the rest of the year. Taking a reading of consumer confidence during August was like taking someone's temperature during a bout of fever. The unhealthy reading will look bad but it should be viewed within the context of the disease. In the case of consumers last month, they were overwhelmed by negative news events and a fast developing correction in the stock market.

Before I go, I want to take some time to discuss today's employment report. The headlines have been blaring away all morning about how the U.S. economy failed to produce a net increase in jobs last month. The nonfarm payrolls came in at a reading of zero - meaning no net growth and no net contraction. I have seen dozens of commentaries that have used the nonfarm payrolls report to try and prove that the economy is collapsing. In the days leading up to the report, many analysts reduced their estimates into the area near 15,000. Therefore, when the actual data came out today, I was not too surprised about the flat reading. However, I was not happy either. The economy has a long way to go to regain what was lost during the recession. Flat employment is not going to change that situation. As I said earlier in this Hotline though, the latest report was not as bad as the media and the bears are claiming.

Perhaps you have heard that a strike by Verizon workers (which recently ended) deducted 45,000 jobs from the total. The strike has concluded and they are back to work. Let's wait and see if the usual suspects in the doom and gloom crowd will discount the positive impact from those returning workers a month from now when they most certainly will help to bump the September nonfarm payrolls number higher. If we count the 45,000 Verizon workers, the August report is transformed from the "disaster" that it has been painted as in the media to something more of a middle of the road disappointment. With manufacturing likely to gain some upward momentum during the rest of 2011 and the auto industry in particular looking stronger - employment should improve into the end of the year. The August auto sales numbers were just released. Chrysler posted a 31% increase in year-over-year sales. GM posted an 18% gain and Ford saw its sales climb by 11%. Nissan managed to grow its sales by 19% but both Toyota and Honda are still dealing with supply disruptions due to the earthquake and tsunami damage. Toyota posted a 13% drop in U.S. vehicle sales and Honda saw its sales drop by 24% from August 2010. Just imagine what will be happening with some of the consumer spending data when that situation gets back to normal.

Speaking of consumer spending, many retailers reported strong results for August. The International Council of Shopping Centers says that 26 major retailers posted 4.6% sales growth during August. According to the theories presented by the bears in recent weeks, such sales growth should have been impossible! Apparently, the drop in consumer confidence did not keep people from spending money. Perhaps the fact that the economy has consistently produced new jobs since last October helped to spur on consumer spending. Hourly earnings reportedly grew by 1.9% during the past year. When the recent tax cuts are added to that total, you can see how so many consumers have been able to afford higher prices (inflation). One last thing about today's supposedly flat reading on jobs. The household survey for August showed a significant net gain of 331,000 jobs last month. That report is often overlooked by most analysts and investors. It tends to deal with smaller companies - the part of the economy that I have been looking to create new jobs this year. The strength is yet another sign that the economy is not as bad as some people are claiming. - The M2 money supply just posted its 21st week in a row of gains. M2 grew by $17.9 billion in the latest week - putting the annualized gain of the past 12 weeks at $2.18 trillion. The Fed has already taken supportive steps that have yet to be felt in the everyday economy. I urge you not to bet on a recession with your investments or business plans. More next week.

Next hotline will be updated no later than 8:00 P.M. Eastern on Friday, September 9, 2011