



Weekly Economic and Market Comment 12-18-11

Note: I will not publish a weekly next week. Have a Joyous, safe holiday!

The week ahead: The more important data releases this week and next are:

- Tuesday, December 20: November Housing starts are expected to rise a small amount to 636,000 from October's 628,000.
- Thursday, December 22: The second revision of 3rd quarter GDP is expected to come in at 2%, the same as last month's first revision.
- Thursday, December 22: The Index of Leading Indicators is expected to rise 0.3% following October's sharp 0.9% rise.
- Friday, December 23: November Durable Goods Orders are expected to be up 1.9% following October's 0.7% decline.
- Tuesday, December 27: The Conference Board's December Consumer Confidence Index will be released at 10:00am EDT. Last month the index jumped sharply to 56 from 39.8, mostly on an increase in the perceived outlook for jobs. Of all the data in the coming two weeks, I think this index has the most chance of moving the market.

Unless they deviate sharply from the consensus, I do not expect this week's data to be market moving.

The Budget: After much posturing, Congress passed a continuing resolution to fund the government and will pass a minimum 2 month extension of the 2% payroll tax cut for employees and an extension of unemployment benefits. There are a couple of other provisions in this bill, but I do not expect them to have a market impact. With the minimum U.S. policy effort, attention will likely remain on Eurozone developments.

Europe: My base case for the Eurozone is that it will be in recession through most of 2012, but that the sovereign and bank debt crisis will gradually be defused. Last week, I described the result of the European summit as a good start to dealing with the longer-term need to have a fiscal framework for avoiding future sovereign debt crisis, but leaving the problem of dealing with the current crisis more or less unresolved.

Most observers, including myself, feel that the measures taken to date, namely setting aside the ESFS fund and supplementing it with funds to be controlled and distributed by the IMF, are

insufficient to deal with the current problem. European banks may need more capital than is being allocated and even more is needed to bring sovereign debt rates down to a level that does not exacerbate the problem as vulnerable countries get their debt under control. Where I differ with the most pessimistic forecasters is that I think the ECB and other central banks are well aware of what must be done to gradually allow countries to get their deficits down to a sustainable level. Despite the ECB protestations to the contrary, I think central banks will do what is necessary to avoid a dangerous, systemic collapse of the European banking system and the “depression” that would result if they fail.

China, Asia and emerging markets: Although I expect some further slowing the Asian and emerging market countries, I think that, led by a reversal of Chinese policy to become more stimulative, the European recession will not result in a world recession. China’s five year plan relies on more of the growth and stimulus to come from domestic developments. The recent setback in commodity prices is an indication of a slowdown in world growth but also acts as a mitigating factor, increasing real household and business income.

Equities: I continue to expect a weak year-end stock market rally, but trading in the next two weeks is likely to be choppy and the gain, if any, small. Volume will continue to be light and my range on the S&P through year end is 1200 to 1260, below my previous forecast of 1220 to 1300.

Looking into 2012, I am of two minds. My base case has been that U.S. stocks will make further limited gains in the first half and my target is 1360-1380. However, consistent with my discussion of the Eurozone debt crisis, the alternative is another sharp move down. Eurozone sovereign debt spreads will, in my opinion, be the most important indicators of whether the base case or the alternative case materializes. I will have more to say in my next monthly when I resurrect a “defunct” economist Nikolai Kondratiev and set out the worst case scenario if my base case is wrong. The economic and market impact is not pretty!

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