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November 15, 2010
Economic Commentary

Gluskin Sheff

MARKET MUSINGS & DATA DECIPHERING

Breakfast Lite with Dave

U.S. CONSUMER CONFIDENCE — LESS THAN MEETS THE EYE

The University of Michigan consumer sentiment index ticked up in November, to 69.3 from 67.7 in October, and the headlines were screaming at how it hit a five-month high. There was no mention of the fact that:

1. It is still off the 76.0 nearby peak posted in June.
2. At 69.3, it is not only well below average economic expansion levels of 99.0, but is still below what we generally see in recessions (74.0).
3. The report itself was hardly universally positive — sentiment was down in the Northeast (64.5 from 65.2), the South (65.2 from 68.3) and was basically flat in the Midwest (72.8 from 72.4). All the strength was in the West — 77.1 from 63.3 — and was likely more due to the Giants' World Series victory than anything to do with the economy.
4. People aged 35-54 saw their confidence levels fall too (only the breadwinner age group) — to a four-month low of 70.2 from 70.5 (a record high unemployment rate of over 8% likely at play here for this age group).

What's incredible was how little impact the weak U.S. dollar and the bounce in commodity prices have had on household inflation expectations. The median 5-10-year inflation expectation measure remained at 2.8%, about where it has been for six months. Now the one-year median inflation expectations gauge did rise to 3.0% in November from 2.7% in October and 2.2% in September, so this is not a case of the consumer being ignorant about what is happening to the price of crude, copper and food. It is just that the consumer knows that the commodity boom and weakness in the U.S. dollar is likely not going to be a multi-year feature of the landscape any more than it was when oil was piercing $140/bbl in the summer of 2008 (recall that six months later, everyone was talking about deflation — who would-a thunk?).

THE LONG AND THE SHORT OF IT

Following the Fed's first strong hints at QE2 in late August, we saw some wild movements in terms of market positioning across a variety of asset classes. These swings are highlighted in the weekly Commitment of Traders report, which we have discussed in the recent past. While fundamentals, valuation and technicals are all key in determining the direction of asset prices, how investors are positioned is no less important and right now, there is still an extreme level of speculative activity in some cases that is set to unwind as the risk-on trade fades away.

IN THE FULL ISSUE OF BREAKFAST WITH DAVE

- While you were sleeping: the action in equities is rather mixed, but with a downward bias; bond markets across the globe are selling off; the U.S. dollar is firm on continued debt concerns in Europe
- U.S. consumer confidence, less than meets the eye: yes, the early reading on the University of Michigan consumer sentiment index did pop to a five-month high, but this is still below the level we saw back in June and the whole report itself is not universally positive
- The long and the short of it: while fundamentals, valuation and technicals are all key in determining the direction of asset prices, how investors are positioned is no less important and right now, there is still an extreme level of speculative activity in some cases that is set to unwind as the risk-on trade fades away.
- Equity market sentiment still too bullish
- Discord, not accord
- Putting the pop in the crop
- Three reasons why I'm worried about U.S. retailers

EQUITY MARKET SENTIMENT STILL TOO BULLISH

As we said last week, the fact that the Market Vane Sentiment Poll was at the high end of the range, the Investors Intelligence poll showing more than twice as many bulls as there are bears, the Barron's Big Money poll revealing 62% bullishness towards equities and only 3% towards bonds, and the fact that equity PMs are now just sitting at 3.5% cash, were all signs of a stock market that was overextended and ripe for a corrective phase. And, despite the sloppy week the market just endured — for the first time in over two months — page B7 of the weekend WSJ still runs with a huge article titled *How to Play a Market Rally*. We're not sure, from a contrary perspective, if this is what a bull wants to see at the high end of the range for the S&P 500.

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DISCORD, NOT ACCORD

In late 2008, the G20 got together in Washington to solve the world's problems as the Great Recession deepened. This actually turned out to be a major turning point since everyone was on the same page in terms of rescuing the global economy. China came out of the gates with a massive fiscal package, which started to percolate right away; Germany was the first to unveil a 'cash-for-clunkers' program to spur consumer spending; then the U.S. unveiled a large-scale fiscal stimulus plan, which of course, never did live up to its advanced billing in terms of redressing what is now very clearly a chronic unemployment problem.

So, this latest G20 meeting where lots was discussed but little action taken may well be a watershed but in a different direction because what it underscored was how divided the world is right now and how insular it has become. The front page of the weekend WSJ said it best, *U.S. Gets Scant Help at Divided Summit.*

PUTTING THE POP IN THE CROP

If you are looking for secular growth, then focus on the farm — great article on this file on page A3 of the weekend WSJ — *Land Becomes Cash Crop in Farm Belt*. Farmland values in the U.S. are up a healthy and hardly bubbly 6.4% over the past year. And, because of the runup in cotton, corn wheat and soybean prices, net farm incomes have enjoyed a 24% increase, to $77 billion. The continued protein shift in China coupled with the weak U.S. dollar remains a boon for this sector of the economy and perhaps one reason why the latest economic data out of the Midwest have looked particularly decent.

Canadian real estate of all kinds have been in a bull market too and while looking pricey in many areas, it could well reflect demand from fundamental forces as opposed to speculative pressures. In particular, organic growth from solid demographics. Just have a look at the front page of the Saturday NYT — *Defying Trend, Canada Lures More Migrants*.

Gluskin Sheff

Gluskin Sheff at a Glance

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$1 million invested in our Canadian Equity Portfolio in 1991 (its inception date) would have grown to $9.1 million[2] on September 30, 2010 versus $5.9 million for the S&P/TSX Total Return Index over the same period.

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For further information, please contact questions@gluskinsheff.com

Notes:

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