<u>US CONSUMER CONFIDENCE: MANY HAPPY RETURNS?</u>

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"So if I ever get my hand on a dollar again,
I'm gonna hold on to it till them eagles grin."
"Nobody Knows You When You're Down and Out" (Jimmie Cox lyrics, sung by Bessie Smith and others)

I. <u>OVERVIEW</u>

As America travels toward Labor Day, it pays to review the nation's consumer confidence. Assorted measures perform as signposts to assess consumer attitudes and actions. For many, the United States stock marketplace (think of an "overall" benchmark such as the S+P 500) is one. The Conference Board's United States Consumer Confidence Index is another widely watched indicator. Trends for the United States stock battleground do not precisely mirror those in the Consumer Confidence Index ("CCI"). Weathervanes such as the S+P 500 of course do not derive all their revenues or influences directly from Main Street dwellers or from American sources. The US, as the ongoing worldwide economic crisis that emerged in mid-2007 underscores, intertwines with Europe, China, Japan, and other countries around the globe. However, over the past several decades, there has been a rough link in the major patterns of the S+P 500 and the CCI. And many believe that major trends in US equities tend to parallel those of the American economy as a whole.

Stare at the S+P 500's extensive ascent from its March 2009 abyss to its current new rally height on 8/21/12 over 1425, particularly the noteworthy stage from the October 2011 depth at 1075. Grandstanders might believe United States consumers generally are rather joyous, or that they soon will become so. The CCI indeed has climbed significantly from its February 2009 valley of 25.3 (the deepest of the 1967-present period). However, the CCI's subsequent highs around 72.0 (February 2011 and February 2012) lurk far beneath those of 2000 and 2007 (January 2000's 144.7 and July 2007's 111.9). July 2012 flutters at a modest 65.9.

Admittedly the US CCI is only one yardstick for consumer confidence and thus to some extent of the strength and duration of economic recovery in America and elsewhere. Maybe sustained higher US equities and at least partial solutions to various troubles facing consumers (including those overseas) will encourage a significant CCI move over 72.0.

However, the feeble rally in the CCI in comparison with the S+P 500 since February 2009, and particularly after autumn 2011, raises significant questions regarding the present and future strength of the American economy (and even of the S+P 500). After all, US consumers are a substantial percentage (around 70 percent) of American GDP. Current US consumer confidence in context warns of economic weakness, or at least sustained sluggishness.

Summer 2012's recent S+P 500 bull march to new highs over 1425 may continue a while longer. Yet the link between the S+P 500 and "the economy as a whole" is probably notably less than it was a several years ago. But the S+P 500 is not isolated from the economy. So this sustained mediocre (or renewed weakness in) the CCI is ominous for US stocks in general, particularly if other key consumer indicators such as housing, employment, and wages do not soon show substantial strength. Or, suppose there is not major progress on the American fiscal front.

II. <u>HISTORY: CONSUMER CONFIDENCE AND THE S+P 500</u>

The Conference Board releases the CCI monthly (next 8-28-12). In addition to the S+P 500 and the CCI, numerous other consumer or business (commercial) “confidence” measures (variables) exist. These include retail sales, purchasing manager surveys, industrial production, interest rate levels and trends, and commodity prices.

In the following table, a Consumer Confidence Index date is for the given month. For stocks, the high or low is for the day indicated. The S+P 500 and Dow Jones Industrial Average usually achieve key highs (lows) around the same day, but not always. The timing of the DJIA’s important peak (trough) occasionally ties even more closely than the S+P 500’s to one in the Confidence Index. Consequently the table has a couple of Dow references. S+P 500 and DJIA numbers are rounded.

The National Bureau of Economic Research offers guidelines on US recession history (business cycle contractions, peak to trough). Compare the timing of their designations (and the subsequent recoveries) with the CCI and S+P 500 overview relationship. There was a recession from December 1969 to November 1970 (11 months), then another from November 1973 to March 1975 (18 mo). The January-July 1980-one was brief, though a 16 month one ensued from July 1981-November 1982 not long afterwards. Recall the relatively brief ones of July 1990-March 1991 (eight mo) and March-November 2001 (eight mo). The NBER decrees the recent vicious American downturn ran from December 2007 to June 2009 (18 months).

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High (Date)		**Low (Date)**	
Consumer Con. Index	**S+P 500**	**Consumer Con. Index**	**S+P 500**
142.3 (Oct 1968)	109 (12/2/68)	75.7 (Dec 1970)	69 (5/26/70)
		75.2 (Apr 1971)	
116.1 (Dec 1972)	122 (1/11/73)	43.2 (Dec 1974)	61 (10/4/74) [DJIA 570; 12/9/74]
		56.7 (June 1982	
		56.9 (Aug1982)	102 (8/9/82)
		47.3 (Feb 1992)	371 (12/2/91 take-off point)
		100.1 (notable rise from this June 1996 level)	606 (7/16/96)
144.7 (Jan+May 2000)	1553 (3/24/00) [DJIA 11910; 1/14/00]	61.4 (Mar 2003)	789 (3/12/03 final bottom)
111.9 (July 2007)	1556 (initial high 7/16/07) 1576 (major peak 10/11/07) (Final top 1440 on 5/19/08)	25.3 (Feb 2009)	667 (3/6/09)
72.0 (February 2011)	1371 (5/2/11) (initial high 1344 on 2/18/11) (1357 on 7/7/11, 1347’s 7/21/11)	40.9 (Oct 2011)	1075 (10/4/11)

[71.6 February 2012, 65.9 July 2012; S+P 500 highs in rally 4/2/12 at 1422, 5/1/12 at 1415, and 8/21/12's 1427.]

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The S+P 500's 3/24/00 plateau at 1553 neighbors the October 2007 summit (Dow Jones Industrial Average high 1/14/00 around 11910). In contrast, the February 2011 and February 2012 Confidence Index levels dwell far beneath (only 50 percent of) the 144.7 achieved in January 2000 and well south of July 2007's 111.9. So why the current contrast ("relative difference in performance") between US equities and relatively mournful consumer confidence?

III. <u>THE RECENT US STOCK MARKETPLACE RALLY</u>

"Big boss man
Can't you hear me when I call?
You ain't so big
You just tall that's just about all.
You got me working boss man
A workin' around the clock
I want a little drink of whiskey
You sure won't let me stop." "Big Boss Man" (songwriters: Al Smith and Luther Dixon)

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The S+P 500 in recent months- since at least around October 2011- clearly has outpaced US consumer confidence. The Consumer Confidence Index high in February 2012 at 71.6 parallels that of February 2011. Yet the S+P 500 attained new highs in spring and summer 2012 relative to those of May 2011, nearly grazing May 2008's final peak at 1440 (4/2/12 high 1422, 5/1/12 1415, 8/21/12 high 1427; the DJIA high remains 5/1/12's about 13340). Keep in mind the determined rally in US equities since the S+P 500's 6/4/12 S+P 500 low at 1267, whereas the CCI in June 2012 at 62.7 and July 2012 at 65.9 remains under February 2012 as well as rather static.

What factors might account for the upward leap in the S+P 500 compared to the CCI in recent months? How has the S+P 500 flown much closer to its wonderful summits of first quarter 2000 and the beloved 2007/08 heights of the waning days of the Goldilocks Era?

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Suppose one focuses first primarily on the S+P 500 side rather than on the overall consumer (general public). The S+P 500 is a nominal index and thus influenced by creeping inflation. However, that probably is not the key reason. Certainly US nominal corporate earnings generally have been very strong, rising sharply from financial crisis depths. Perhaps more of these revenues derive from overseas sources than in the past. Also, some firms have become more efficient and therefore more profitable. These considerations make many corporations "happier" than the so-called typical American person on the street; stock "spirits" (prices) are more joyous than the consumer's mood.

Though US equity levels and trends obviously influence consumer perspectives, they also intertwine with American and other business and government actions. Money printing (quantitative easing), deficit spending, and dollar trends of course influence economic recovery, stock prices, and consumer viewpoints. America also is not the only nation married to accommodative central bank policies and large fiscal deficits. However, it is unclear whether these considerations alone would necessarily provide “extra” support for the S+P 500 in relation to consumer sentiment. All else equal, money printing would tend to raise nominal prices in general.

However, one could conjecture that these factors nevertheless assist the S+P 500 relatively more due to their entangling somehow with rock-bottom interest rates and share buyback programs. Large corporations like those in the S+P 500 arguably benefit more (can more readily take advantage of) “overall liquidity” than typical consumers, especially when such Main Street inhabitants remain rather indebted by historical standards and also therefore may have comparatively less access to “easy money”.

Even if this is not the case, sustained low interest rates and promises of their continuance by the Federal Reserve have prodded many to purchase stocks. These buyers include not only individuals in America, but institutions and individuals with disposable income around the globe. Despite “flight to quality” havens offered by US Treasuries, very low or negative real interest rates do not appeal to all players. And there is a lot of money seeking “good” (or at least adequate) return (yield). “If debt instruments are unattractive, where should we put our money?” And the US stock marketplace obviously is a huge territory in which to place funds.

In addition, American corporate share buyback programs have been substantial, thus underpinning stocks.

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For further review of equity topics, see “American Corporate Profits and the S+P 500” (8/1/12).

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As part of its campaign to restore the nation’s household balance sheets, the Federal Reserve’s valiant money printing, ground floor interest rates, and other strategies have aimed to rally equity prices. Ardent deficit spending by fearful politicians also fought to assist consumers (and businesses). In any event, significantly due to the stock marketplace rally, US household net worth has repaired much of its losses suffered during the worldwide economic disaster.

American culture associates high and rising stock prices with American Dream success and values, not just wealth, prosperity, and financial security, but also happiness, the “good life”, and a “better life”. So the stock marketplace rally, particularly its renewed uphill charge since autumn 2011 lows, should be making Americans rather happy.

Yet keep staring at those mediocre consumer confidence numbers since February 2011 (or even February 2012). Of course they may venture higher. And of course equities are not the whole picture.

Before investigating other sources for relatively feeble consumer confidence, there may be a reason within the stock domain why the equity rally and thus the mending of household net worth has not translated into a sunnier current consumer mood. Admittedly, even if many stocks are tied up in retirement (pension) accounts, their rallies obviously benefit us. However, to the extent the benefit of these funds are postponed into the future (or we suffer a penalty if we access them prematurely), current day stock rallies perhaps do not make us feel as much of a “here and now” benefit (greater confidence) in our everyday life situation.

IV, CONSUMER WORRIES

Despite the joyous jump in the S+P 500, many Americans justifiably worry quite a bit nowadays about several economic issues. The troubling current and near term US deficit and overall debt situation often captures attention. Although US household debt has slipped somewhat relative to GDP, government debt has ballooned in recent years. Overall US debt remains very elevated by historical standards. In a representative democracy, such high debt surely worries consumers in general. The long run US federal deficit spending horizon scares both economic gurus and Main Street watchers. What prospects are there for reducing it in the current political environment? Note "Financial Forest Fires: US Government Debt" (8/15/12) for further analysis of US debt issues. European sovereign debt challenges are not islands apart from America. Anyway, what else bothers US consumers in addition to (and perhaps far more than) the nation's debt and deficit situation? Review aspects of the key variables of housing, income, and employment.

HOMES

"Oh, give me a home where the buffalo roam
Where the deer and the antelope play
Where seldom is heard a discouraging word
And the skies are not cloudy all day." The song "Home on the Range"

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The home is an integral part of American Dream culture. The fine print of Federal Reserve statistics (Z.1, Flow of Funds, Table B.100, 6/7/12) implies the damage done to consumer confidence due to the collapse in America's housing prices. Owners' equity in household real estate fell off the cliff in the worldwide economic crisis. It was about $13.2 trillion in 2005; that year, owners' equity as a percentage of household real estate was 59.7 percent. The 2006 levels were about $12.9tr and 56.6pc. At end 2008, it levels were just over $7.0tr and 40.2pc. By end 4Q11 (despite the economic "recovery"), owner's equity was even lower, at $6.2tr; the equity percentage also dipped further, to 38.8pc. Thus household real estate suffered a bloody seven trillion dollar loss, and owner's equity slumped about twenty percentage points. The most recent Fed statistics, for 1Q12, show only a slight rebound to $6.7tr and 40.7pc.

And this weak housing situation has occurred despite a dramatic collapse in mortgage rates. From a high of 6.51 percent on 7/23/08, they have plummeted to around 3.60pc (Bankrate.com US home mortgage 30 year fixed national average; recent low 3.54pc 7/24/12). And how available is housing credit nowadays to much of Main Street? Foreclosures have not disappeared from the scene.

Given this housing picture, why wouldn't many consumers be rather pessimistic and reluctant to spend freely?

EARNING A LIVING

"She works hard for the money
So hard for it honey
She works hard for the money
So you better treat her right." Donna Summer, "She Works Hard for the Money"

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US median household income was about $53.2 thousand in 2000. That year ended real income gains covering over 30 years. For 2010, median income (2010 CPI-U-RS adjusted dollars) had fallen about seven percent to under $49.5 thousand. Mean household income statistics tell a similar story. They tumbled 6.6pc over the decade, from $72.3 thousand to just over $67.5 thousand. (U.S. Census Bureau, "Income, Poverty, and Health Insurance Coverage in the United States: 2010, Table A-2; September 2011).

Since the total number of households increased by about 9.7 percent from 2000 to 2010, national income has been spread over a wider expanse.

Although these Census Bureau median and mean household income statistics do not extend to summer 2012, there probably have been little gains since 2010. Review "Usual Weekly Earnings of Wage and Salary Workers" (Bureau of Labor Statistics, 7/18/12). Median weekly earnings in constant 1982-84 dollars were $342 in fourth quarter 2010. They were $338 for 2Q12. These laborers are not the only workers, but their data offer some guidelines.

Incidentally, look at the weekly earnings data from end 2001 to the present; this reveals flat real median weekly earnings. So this group has not advanced over the past decade. So why should the Census Bureau data real incomes rise from 2010 to the present? Another release from the BLS, "Real Earnings-July 2012" (8/15/12) states: "Since reaching a peak in October 2010, real average weekly earnings have fallen 0.4 percent."

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Think of wage and employment levels and trends in the corporate profit context and thus for the S+P 500. Let's not overlook high unemployment levels in the wage and confidence context either.

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Flat to declining real incomes for many Americans contrasts with big earnings and massive wealth for a very narrow group of Americans. This stratification arguably undermines overall consumer confidence by reducing faith in the fairness of the economic system.

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The S+P 500 trends in recent years generally have moved roughly alongside similar ones for commodities "in general". Think of the broad GSCI, which bottomed on 2/19/09 near 306, not long before the S+P 500's 3/6/09 low at 667. The substantial advance in commodities from early 2009 of course influences disposable income and thereby affects confidence.

The broad GSCI 3/1/12 high at 718 fell below spring 2011's 762 pinnacles on 4/11/11 and 5/2/11. However, commodities have raced up in recent months. Note the current GSCI level around 677 in comparison with 6/22/12 low at 556 (10/4/11 low 573).

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Alternative investment theories as well as the effort to keep interest rates near the floor have encouraged yield (return) hunters to own commodities as an "asset class".

UNEMPLOYMENT

"But the bottom step of the ladder
It keeps gettin' higher and higher
Dawn comes soon enough for the working class

It keeps gettin' sooner or later
This is the game that moves as you play". X, "The Have Nots"

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Despite the economic upturn, July 2012's still high 8.3 percent headline unemployment number worries policy makers as well as workers. However, the U-6 category, which also includes "persons marginally attached to the labor force, plus total employed part time for economic reasons" probably better paints the unemployment source of consumer concern and dismay. In July 2012, it was still 15.0pc (up from March 2012's 14.5pc). Though down from October 2009's 17.2pc peak, its dip is modest. Current levels soar over the 7.9pc bottom in December 2006 and breach the 10.4pc summit of September 2003 (and the 11.8pc top of January 1994; this BLS data series apparently extends only back to 1994).

In the face of high unemployment, international competition, and corporate efforts to improve productivity, how secure are jobs? Many US governmental bodies have reduced employment. What if the so-called US output gap is smaller than the Federal Reserve and many others regulators and politicians believe? Will large numbers of jobs easily return to the US, or be created there, unless the nation's wages are flat (or cut)?

LEADERSHIP AND INSTITUTIONS

The Gallup News Service recently polled Americans regarding their "confidence" in various "institutions in American society" (June 7-10, 2012). The category created by adding together the answers "great deal" and quite a lot" reveals dispiriting trends and levels that reflect current mediocre consumer confidence levels (as well as the broad erosion in confidence from the January 2000 CCI peak). Relatively weak consumer (Main Street) confidence in several key political and social institutions parallels many worries regarding America's economic situation.

The combined great deal/quite a lot of confidence in "big business" was only 21 percent in June 2012. Though (going back to 1973), this has never been over 34pc, it is a drop from June 2000's 29pc (up from June 2009's dismal 16pc). Confidence in banks was 60pc in the ancient times of April 1979. Though this measure has oscillated since then, it fell from May 2004's 53pc, reaching a new low of 21pc in June 2012. In contrast to big business and banks, significant faith in small business exists, 63pc in June 2012.

Congress has not been popular for decades, but great deal/quite a lot of confidence in it has ebbed from 30pc in May 2004 to 13pc in June 2012 (11pc July 2010). Confidence in the Presidency in June 2012 was merely 37pc. Faith in the Supreme Court was 50pc in June 2002 but only 37pc in June 2012 (32pc in June 2008).

Confidence in "the church or organized religion" was 66 percent in May 1985 and 60pc in June 2001, but sagged to a new low of 44pc in June 2012. June 2012 great deal/quite a lot confidence in public schools was 29pc, the criminal justice system also 29pc, and newspapers 25pc. However, the public holds the military in high esteem with its 75pc approval (compare the 50pc in November 1981).

V. CONFIDENCE PROSPECTS

Of course there always are reasons for economic optimism, such as high corporate earnings. The worldwide and American recovery may pick up speed again despite slowing growth and current challenges. The International Monetary Fund ("World Economic Outlook Update", 7/16/12) predicts worldwide growth will rise from 3.5pc in 2012 to 3.9pc in 2013 (it was 5.3pc in 2010 and 3.9pc in 2011). It forecasts US GDP will advance 2.3pc in 2013, up a bit from 2012's 2.0pc rise (US growth fell from 3.0pc in 2010 to 1.7pc in 2011).

But what if economic growth for the balance of 2012 and 2013 in the US and around the world disappoints optimists?

And anyways, America's current national deficit and debt situation and its probable near term and long run fiscal prospects justify significant consumer concerns. Moreover, the housing, earnings, unemployment, and household debt factors also help to explain mediocre consumer confidence, both in absolute terms and relative to the S+P 500's heights.

Thus the S+P 500 probably has ventured somewhat on its own happy bullish voyage in recent months relative to the Conference Board Consumer Confidence measure and several factors that probably influence that confidence (and that also matter to stock marketplace players).So a modest earnings decline could weaken equities significantly, not merely a bit (and thereby the consumer balance sheet and confidence). So could further deterioration in the American fiscal landscape (or that in Europe or elsewhere). How close is America to repairing its national debt situation? In any event, the S+P 500 interrelates with trends in interest rates, the US dollar and other currencies, and commodities.

How much longer will deficit spending and the Fed's various easing measures (and those of other central banks) support US (and international) confidence (buy time)? Another round of quantitative easing by the Fed (QE3; or others), if it occurs, perhaps may help to propel equities even higher for a while. However, that action will not necessarily boost American consumer confidence very much. Again, look at the significant sources of consumer fears alongside the mediocre current confidence levels. Besides, money printing does not generate sustained real economic growth.

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