# THE MARTIN LETTER

Volume 1, Issue 1
July 23, 2012

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*I am not among those who fear the people. They, and not the rich, are our dependence for continued freedom. And to preserve their independence, we must not let our rulers load us with perpetual debt. We must make our election between _economy and liberty_, or_profusion and servitude_. If we run into such debts, as that we must be taxed in our meat and in our drink, in our necessaries and our comforts, in our labors and our amusements, for our callings and our creeds, as the people of England are, our people, like them, must come to labor sixteen hours in the twenty-four, give the earnings of fifteen of these to the government for their debts and daily expenses; and the sixteenth being insufficient to afford us bread, we must live, as they now do, on oatmeal and potatoes; have no time to think, no means of calling the mismanagers to account; but be glad to obtain subsistence by hiring ourselves to rivet their chains on the necks of our fellow-sufferers. Our landholders, too, like theirs, retaining indeed the title and stewardship of estates called theirs, but held really in trust for the treasury, must wander, like theirs, in foreign countries, and be contented with penury, obscurity, exile, and the glory of the nation. This example reads to us the salutary lesson, that private fortunes are destroyed by public as well as by private extravagance. And this is the tendency of all human governments. A departure from principle in one instance becomes a precedent for a second; that second for a third; and so on, till the bulk of the society is reduced to be mere automatons of misery, and to have no sensibilities left but for sinning and suffering. Then begins, indeed, the _bellum omnium in omnia_, which some philosophers observing to be so general in this world, have mistaken it for the natural, instead of the abusive state of man. And the fore horse of this frightful team is public debt. Taxation follows that, and in its train wretchedness and oppression.*

--Thomas Jefferson, 3rd U.S. President, Letter to Samuel Kercheval, Monticello, July 12, 1816

# Safe-haven Progression

Different people will move at different rates through the various safe-haven assets that are available to them. Some investors will have a hard time making the transition from paper to hard assets; others will embrace hard assets more easily. Back in March 2006, I put together a progression of asset preferences that investors would go through during the Winter phase of our Kondratieff Long Wave Cycle. Looking back on the main themes of the list, they still look valid and appropriate. Therefore, I will repeat them here:

1. A flight from questionable securities / currencies into strong securities / currencies
2. Intense liquidation of inventory and commodities
3. Liquidation of commercial real estate, houses, and farms both through foreclosures and sacrifice sales at small fractions of former values
4. Flight from bank deposits into strong currencies and gold
5. Flight from strong currencies into gold

This list is simplistic, and designed for a primarily deflationary depression, but please don't judge my 2006 work too harshly. We are in a Kondratieff Winter, only ours is somewhat different from those of prior Long Wave Cycles. We now have the entire world on a fiat money system. That's a big difference from any other Long Wave Cycle since the 1700's, and it serves to slow things down a lot. For example, the economic meltdown that occurred basically in three to five years after 1929 is replaced in our Kondratieff Winter by a stagflationary quagmire that may last decades.

Thus, it is fairly clear that we still have a lot of stage 1 to go through at the present time, with U.S. currency, stocks, and bonds being perceived as strong. And while we have experienced stages 2, 3, and 4 since I created the list in 2006, we got over it. We actually moved backward in the sequence, and appear to presently find ourselves firmly back in stage 1. Nowadays, Europe fizzles, and Japan is likely the next national catastrophe. Thus, the United States is still the preferred safe-haven destination for the world's investor capital. The strongest security is still deemed to be U.S. government Treasuries, just as it was in 2006. We are still seeing the entire world shift its money to the U.S. because the U.S. is still viewed as perhaps the only safe place for wealth in a world that is printing all of its currencies without reservation. At present, the euro is in danger of breaking below support at \$1.19 per euro. A break of that support could send the euro down to \$1.10 per euro, and provide a further shot in the arm for the U.S. dollar and U.S. government Treasuries.

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# Bond Bull

There is some evidence that the Fed purchased 61% of the Treasury debt that was sold in 2011. More recent data shows that from March 2011 until March 2012, Federal Reserve banks gobbled up around 24% of the increase in the total outstanding public debt securities issued by the Treasury, with private investors purchasing almost 67% of it. That's still a high percentage for the Fed, but I would like to state that Treasuries have been in a bull market up until the writing of this essay. No one can dispute that. Thus, even though the Fed likely purchased 61% of

Treasury debt sold at auction in 2011, the Fed did not single-handedly create the bull market in Treasuries.  Sorry, but it is just not possible for the Fed to create a bull market.  The Fed can certainly manipulate markets.  In fact, if one reads between the lines of the Fed's very own statements, then they admit to manipulating markets.  But manipulation is constrained to slowing down a bull market's advance or curtailing the drop of a bear market.  Manipulation is never turning a bear into a bull or a bull into a bear.  No entity on Earth is powerful enough to do that.  Thus, Treasuries up until today have been in a natural bull market, possibly enhanced by Fed buying of Treasuries.  Reconcile yourself with that fact.

Let's take a look at the 31-year bull market in U.S. government Treasuries (Chart below courtesy of [StockCharts.com](StockCharts.com)):

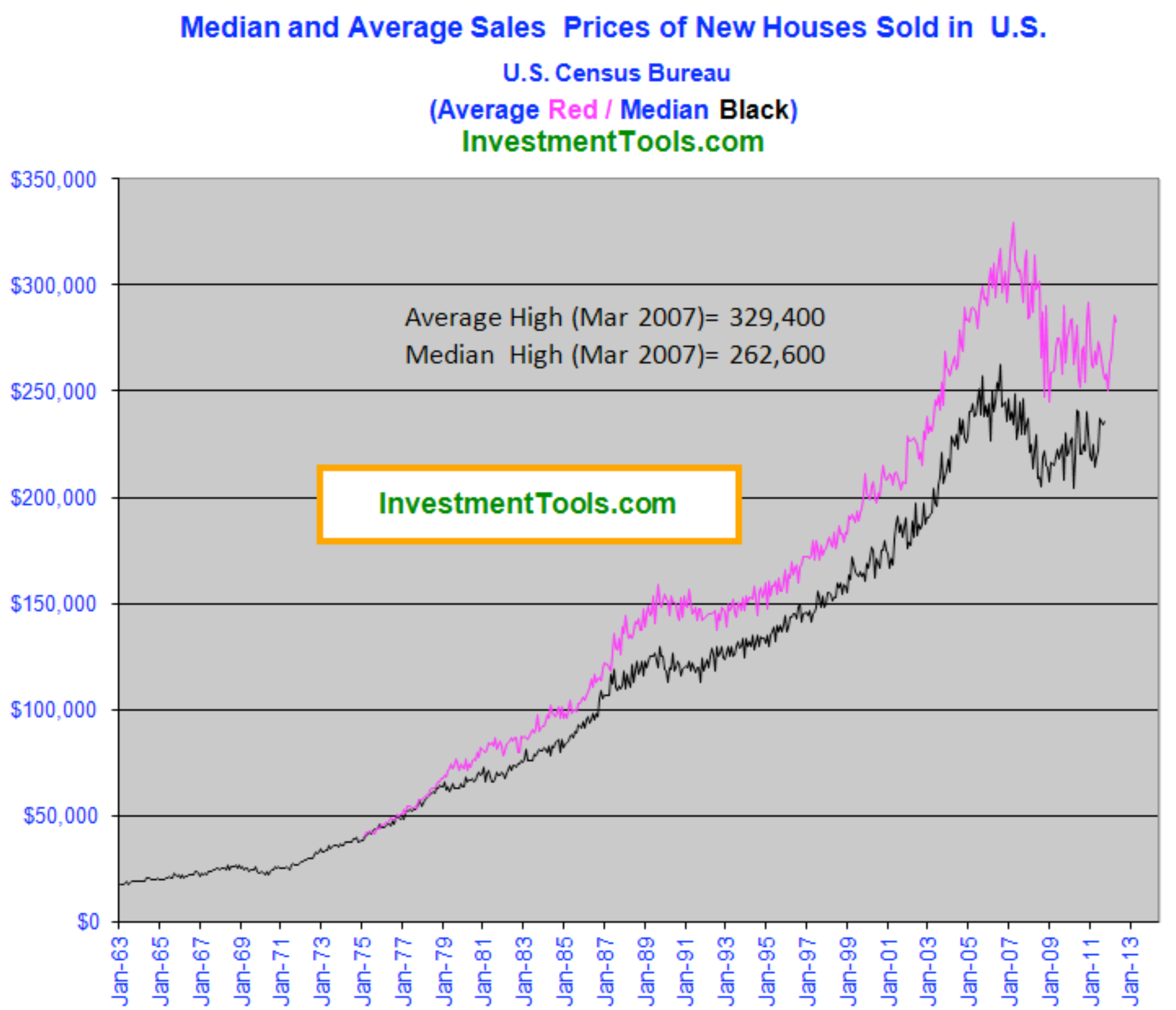

If one connects the high points and low points with straight lines, then one gets a channel in which the price has moved for most of the last three decades.  Right now, Treasuries appear to be at the high end of the channel.  Thus, from a technical perspective, Treasuries are now at a critical juncture.  Should price head back down into the channel, then one could expect either a softening of price for a while until price reaches the lower boundary of the channel, or one could expect that the bull market is completely over.  During the 2008 panic, Treasuries briefly exceeded the upper boundary of the channel only to fall back into the channel.  Nevertheless, the bull market continued after a 2.5-year consolidation period, making new highs in 2011.

It appears that bullish and bearish economists are nearly united in agreeing that this bull market must end soon.  The bulls would rather see money pour into stocks than bonds, and so they have a bias against Treasuries.  The bears find it outrageous that the U.S. government and Federal Reserve can borrow irresponsibly, print currency with reckless abandon, and yet be rewarded with declining interest rates that actually serve to facilitate more of the same negative behavior.

But what if Treasury prices were to continue advancing?  The implication would be that price will have "jumped the channel," a very bullish occurrence.  Whenever a security jumps out of a long-term channel to the upside, a whole new realm of higher prices gets opened up, and usually with some price acceleration.  Sometimes it's good to truly open one's mind to the possibilities.  Instead of just blindly saying "that can't happen," it occasionally helps to ask "what if it does?"

Until now, the Treasury market was a fear trade. Investors purchased Treasuries as a perceived safe-haven. But what if it becomes a greed trade? Investors wouldn't just buy Treasuries in order to hide out with a tiny bit of interest, but rather invest in them with expectations of great capital gains. Investors would essentially flip Treasuries, much as they once flipped houses, hoping each time that there exists one more incrementally greater fool.

I remember very well how people chided me a few years ago when I told them to sell their investment property in 2006 at the height of the housing bubble. The typical response was "Peter, you're out of your mind. Why would I want to sell? Real estate is the ultimate investment. Not only is it safe, but it always goes up. What could be safer than real estate?" Real estate in the United States had gone into the mania stage of its bubble. Let's take a look at the recent U.S. real estate bubble (http://www.investmenttools.com/median_and_average_sales_prices_of_houses_sold_in_the_us.htm):



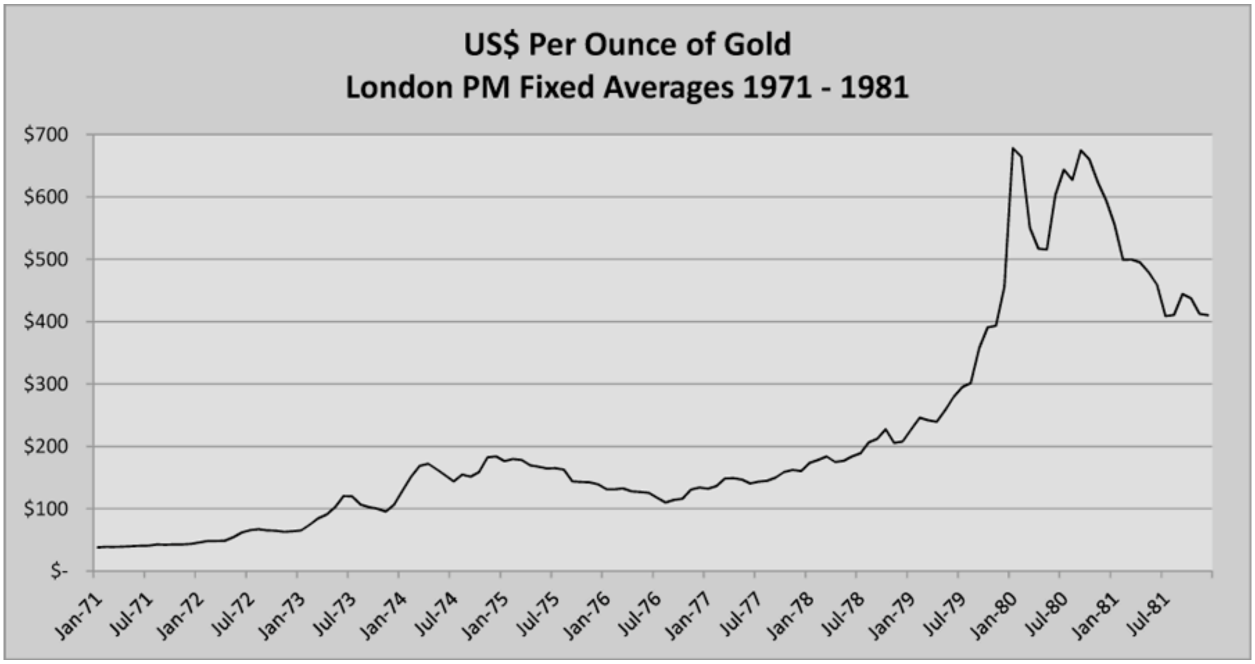

Notice its shape. There is a long, gradual run-up until its first correction in the early 1990's. By 2002, the pace of price increases quickens heading into the mania that bred widespread delusion of housing being the ultimate investment. Then came the crash.

As a side note of importance, the recent 20% advance in house prices in the United States is the biggest 5-month gain on record since 1968. The sharpness of this advance is a very strong indicator that the final bottom for housing value has not yet been seen. Real estate investors should take note that while a continued countertrend rally is certainly possible, and by all means likely, significant down side action should be expected at some point in the future. The final bottom in housing value should be accompanied by a multi-year period during which housing values hardly change; it is not reasonable for the final bottom to be V-shaped, as was the recent local bottom. Please note my careful language in that I use the word "value." It is possible that nominal prices have now bottomed for good. But real prices, or values, likely have not reached their final nadir. Instead, we likely just passed something called a "bull trap," portrayed in graphical form in the bubble phases diagram later in this essay.

The pattern of the housing bubble portrayed above should be familiar to investors, as we saw it just a few years earlier in the NASDAQ bubble (Chart below courtesy of [StockCharts.com](StockCharts.com)):

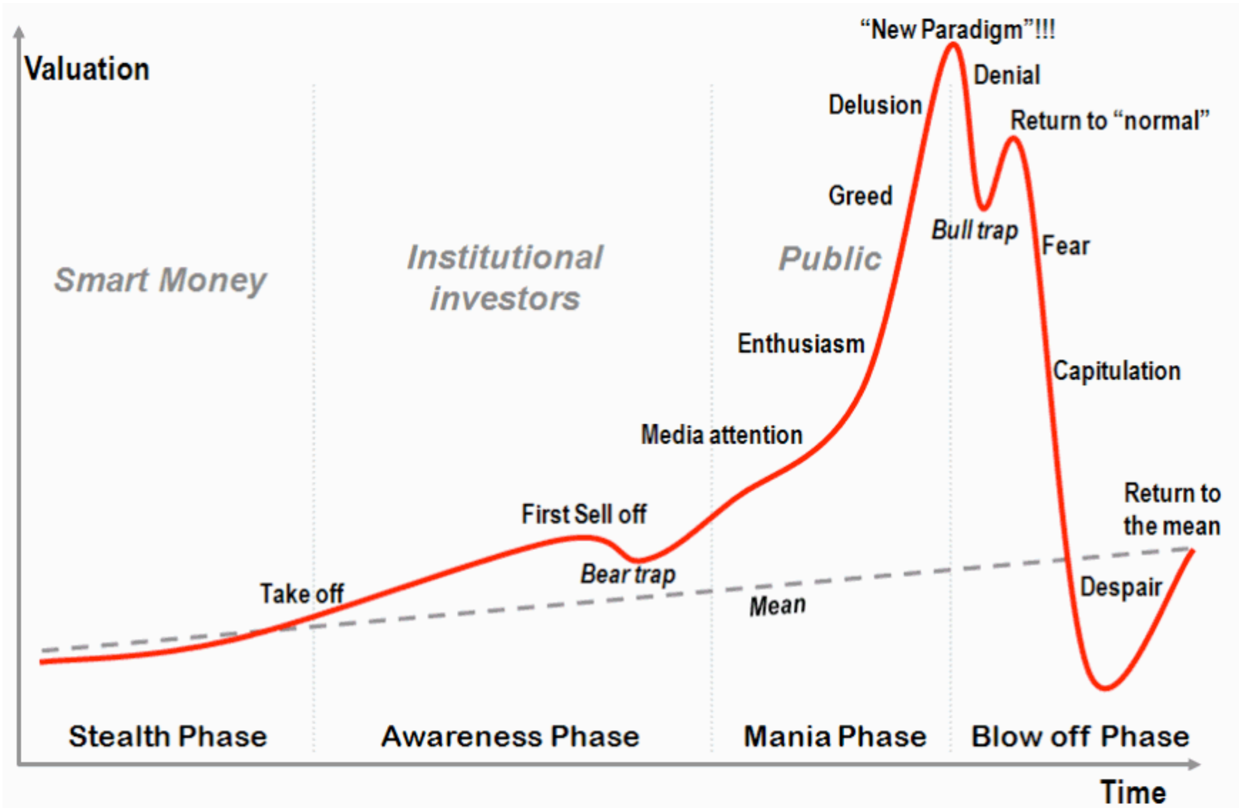

As with housing, the initial price increases in tech stocks were followed by a scary correction, this time in 1998. But that correction preceded an increase in the pace of price increases, leading into the mania of late 1999 and early 2000. Of course, a crash followed that mania.

Housing and tech stocks were the recent bubbles. Going back farther in time, however, one notices the same pattern with the gold bubble of the 1970's:




In this case, the early 70's bull market was strong, but the pace quickened after the major correction of 1974-76. The mania of 1979 was followed by the crash after 1980.

It just so happens that Canadian author, Professor Jean-Paul Rodrigue of Hofstra University, has taken the time to characterize the phases that almost all investment bubbles go through. The reader will recognize the general pattern he presents, given how closely it matches with the three real-world bubbles presented above. Conveniently, it shows the psychology of people during the development of a bubble, thus facilitating an understanding of the usual errors in judgement that investors make over the course of its unfolding:




With this background into bull markets and bubbles laid out, it is important to recognize that almost all secular bull markets end in a mania and a crash, i.e. almost all bull markets enter into a bubble blow off phase when they end. I have studied market history my entire adult life, and truthfully, I cannot think of any secular bull market that did not end in a mania and a crash. At some delusional point during the mania, the investment ceases to be questioned, as it is considered the ultimate investment and a new paradigm.

Some people are just starting to feel that way about Treasuries, after the 31-year bull market that I identified at the beginning of this section: they are the latest asset class that feels safe. What could go wrong? To bet against Treasuries, one would have to believe that the United States government could no longer fulfill its fiscal obligations, i.e. the U.S. would have to be going bankrupt. And that has never happened in the entire history of the United States. The U.S. is the only nation where a dollar bill from 1863 is still legal tender. That is a long standing record that the world's investors will not easily forget. By contrast, European nations have routinely cancelled their currencies, and replaced them. Thus, global investors will require hard evidence before discarding the U.S. dollar and the debt associated with it as a safe haven. Ultimately, such evidence will be provided, but that is later in the process of shifting through the aforementioned safe havens among which investors can choose.

One thing to note about the mania phase is that it's characterized by a climb up a classic "wall of worry" prior to the investment being considered the new paradigm. Investors, even at the beginning of the rise of media attention, wonder how much higher the entity in question can rise in price. Right now, Treasury holders suffer from a sickening feeling that gnaws at all investors in the debt of a ponzi unit, i.e. the Treasuries of the United States. They wonder how long the fiscal irresponsibility can go on. There are even some very intelligent, highly educated economists who have been advocating that investors should short Treasuries for the last few years. To a very limited extent, I've even tried that myself.

But every analyst, investor, and economist needs to look himself or herself in the mirror. The reflection should be one of a composed, well considered, and open-minded person. Success in investing entails recognizing one's mistakes, and reversing them from time to time. **It's more important to be profitable than right.** As John F. Kennedy once said, "**an error doesn't become a mistake until you refuse to correct it.**" There comes a time when one must throw in the towel on a mistimed investment, and realize that the world of investments sometimes works in mysterious ways that do not always make sense at the time.

Ironically, it is in fact the doubters of Treasuries that can and do provide this bull market with its fuel. Those investors who are short Treasuries will periodically cover their short positions as the bull market relentlessly marches forward. In the act of covering, by definition, these investors must purchase the Treasuries that they once shorted. Thus, the Treasury doubters out there actually drive the Treasury bull market higher. At some point, the Treasury bull market will end. That point will arrive when hardly anyone doubts that Treasuries are going to move any higher, i.e. when the grand total short position on Treasuries is almost zero. That is the irony of all financial markets: when almost no one is in position to profit from the downfall of an asset class, that is when that particular asset class will begin its most vicious descent.

At present, everyone knows that interest rates in the U.S. must inevitably rise to higher levels, and the implication is that Treasury prices must fall. Treasury prices and Treasury interest rates, after all, always move in opposition to one another. But "inevitable" is not the same thing as "imminent." The inflection in the curve of interest rates is coming to the United States, i.e. the decline in interest rates is going to end. It is inevitable. But that doesn't mean that U.S. interest rates have to rise in the near future. In fact, U.S. interest rates can first decline some more.

Some readers may find my suggestion of a further drop in U.S. interest rates absurd. But the explanation for such a potential future occurrence is quite simple. Like it or not, Europe and Japan, two of the largest world economies possessing citizens of ample investment capital, are in worse shape than the United States. Right now, the U.S. is being given a pass. Since the U.S. economy is stronger than that of Japan or Europe, and since the U.S. has only one fiscal authority instead of the 17 of Europe, the world's investors have chosen to focus their attention on the sovereign debt of other nations. For now, that attention is squarely on Europe, as one can see by the rising interest rates in the so-called PIIGS nations. Citizens of these European countries are justifiably fearful of their currency, the euro, as well as the sovereign debt of their nations. For the time being, many of them have chosen to shift their capital to the safest non-European security that they know: U.S. government Treasuries.

I suppose that the day will come when the world's investors cease shifting their capital from Europe to the United States. But after Europe, the next logical candidate for sovereign debt scrutiny is not actually the United States; instead, it is Japan. While an American reader may legitimately bewail the fact that U.S. government debt recently surpassed U.S. annual GDP, this situation does not even remotely approach the nightmarish proportions present in Japan. Japan has recently exceeded a 225% debt to GDP ratio, and spends fully one half of its tax revenue on interest payments on existing debt. In spite of these facts, Japan is not under any kind of sovereign debt pressure right now; in fact, the proportion of its public debt owned by foreigners recently reached a record percentage of the total debt. Oddly enough, the yen currency is considered a safe haven. Indeed, the yen must rise in order to continue attracting buyers to Japanese Government Bonds (JGBs), for the interest rate on the ten-year JGB is only around 0.8%. That is quite a bit lower than the 1.49% yield on a 10-year U.S. government note, and does provide an indication of how low U.S. interest rates could go, given that Japan has been a tremendous forecaster of the U.S. economy for the last 12 years. But unfortunately, the implication is that Japan is caught in a vicious cycle: it needs a strong yen so that yields, and hence interest costs can stay low, but a strong currency will kill domestic companies reliant upon exports. It's a form of "crowding out" that the currency market inflicts upon nations that implement quantitative easing in their bond markets, as Japan has done for decades. Thus, the currently benign situation will certainly change, with eventual yield spikes resulting in a toppling of the Japanese debt bubble. The result will be that Japanese people will experience the fear now prevalent in Europe. The average Japanese citizen has well over $100,000 in savings. Multiply that by 127 million people. Imagine the tsunami of Japanese capital that can eventually make its way into U.S. government Treasuries when the yen and JGBs finally come under pressure as the euro and various Eurozone government bonds already have.

In the coming years, as continued inflow of European and then Japanese capital continues to bolster the U.S. fiscal position by increasing Treasury demand, an interesting development can occur. While Europe and Japan suffer under rising interest rates, and interest rates in the U.S. remain level or even fall, a certain American arrogance can develop. We may even hear some highly regarded American economists start to talk about the "financial superiority" of the United States, even though its balance sheet isn't any better than that of Greece just a few short years ago. And the reader knows what follows pride, right?

Does my suggestion of a Treasury mania seem stupid? Absurd perhaps? Then consider how the apparent stupidity of my suggestion may actually act as a supporting argument for it. The 70's gold, 90's NASDAQ, recent housing, and almost all other bull markets became utterly stupid in their final mania phases. In this case, the dumbness of my suggestion actually gives it credence! All of these other bull markets demonstrated erratic, totally illogical behavior in their final phases. Yet they are matters of market history, not up for debate. They occurred the way that they occurred, and nothing can change those patterns now.

Today, I question why one would expect the Treasury bull market not to demonstrate the same erratic, illogical behavior that these other bull markets demonstrated. Why would the Treasury bull market end any differently than any other long-term bull market? It shouldn't. It always ends the same: with a mania, followed by a crash. The reader may find such an outcome hard to envision. Believe me, I find it hard as well. But history shows that such an outcome is logical. Human beings are creatures of habit, and they do not easily let go of things that they have relied upon for a long time. We now have 31 years of history showing us the tried and true investment doctrine that bonds move higher over time. That's just the way it is. It doesn't matter that it is totally nonsensical to place one's capital into 30-year U.S. government Treasuries, and somehow be happy with a 2.55% return. We are just plain confident that bonds will be safe, and that's that. Those who have been forecasting the demise of U.S. government Treasuries over the last few years should bear in mind a famous quote from the late German economist Rudi Dornbusch: "The loss of confidence takes longer than you think it should and happens faster than you thought it could." Be prepared, dear reader. The Treasury bull market can move a lot higher. And when it ends, it can end most precipitously. If the reader refuses to believe in the possibility of my suggestion of a coming Treasury mania, then I ask the reader to consider the implication of my suggestion being wrong. The implication is that the 31-year bond bull market will be perhaps the only bull market in history that just rolls over, and gently dies without going into a mania first. Really? Is that what we are to believe? It's different this time?

Bright investors question why flight capital won't move into Singapore, Korean, or Vietnamese bonds? After all, these countries have better balance sheets and faster growing economies than does the United States. The answer is that these markets are not liquid enough to absorb the potential flood of flight capital coming from Europe and Japan. Only the U.S. sovereign debt market is large enough to absorb such a capital influx.

Money typically moves back and forth between stocks and bonds. But lately, even a stock market advance has not implied that Treasuries would fall. Instead, they merely go sideways. The stock market advance from October 2011 until end of March 2012 would normally have been a great opportunity for Treasuries to give ground. Instead, they mostly went sideways. Doubters of the Treasury bull market need to ask themselves a simple question. During the recent stock market surge, why didn't the bond market roll over and die right there? If one were to look for a great opportunity for Treasuries to roll over and die, giving up the ghost if you will, then there couldn't have been a better opportunity than those six months. Yet the idea of Treasuries dying was a non-starter, a total failure during that time.

On a technical basis, there is a difference between the weekly and monthly pictures for Treasuries. The weekly picture has a positive price-volume pattern, whereas the monthly picture shows a negative one. Thus, I could easily envision Treasuries rising in the coming weeks, and consolidating thereafter, as they have done so many times recently.

What would be an indication that a Treasury mania is not developing? If the stock market panics, and bonds do not react by moving higher, then there will be something seriously wrong in the bond market. At that point, one would have to call the bond bull into question. On the other hand, if Treasuries remain above the previously identified price channel, and then rocket higher during a coming equity panic, then Treasuries will have jumped the channel.

And just as the debt of other countries appears to be in doubt before such doubt reflects upon U.S. government Treasuries, I also expect there to be a progression within the sphere of debt itself. In other words, it will likely be municipal debt that will be doubted prior to national debt. The reader has undoubtedly observed the recent bankruptcy of Stockton, California. Other cities and perhaps even some states will follow, thus putting downward pressure upon municipal bond prices. In the coming years, it is likely that debt-oriented capital will flow from muni debt into federal debt like Treasuries. The very last debt market to go into a long-term decline will be U.S. government debt. Prior to that inevitable decline, those very same Treasuries can become quite popular as a perceived safe haven.

Virtually no one is calling for a Treasury mania right now. And neither will I. This essay is simply meant to call the reader's attention to the possibility that one may develop. As an investor, one should always take all the possibilities into account. The one thing that may be missing in the Treasury bull market is a significant bear trap. We may need to have one of those first, perhaps during a significant bout of price inflation, prior to a deflationary time that causes Treasuries to go into a mania. Then again, there have been several 17-26% drops in Treasury prices since the bull market began. These may suffice to set the stage for the enthusiasm of a mania phase.

Of course, the Treasury bull market will eventually end. The higher it goes, the more painful that end will be. If Treasuries now launch themselves into a mania phase, then the crash that follows will have the most violent, brutal, cutting, and destructive impact imaginable upon the economy. A Treasury crash implies an interest rate spike. Suddenly and dramatically higher interest rates serve to smash industries like housing and automotive because their sales depend upon easy financing at low interest rates. The Great Depression was actually fairly mild immediately after its October 1929 beginning; it wasn't until the interest rate spike of 1931 that the economy really imploded.

As Thomas Jefferson so presciently recognized in the opening quote, perpetual debt cannot be sustained, and is ultimately detrimental to society. We will likely have waited almost two centuries for his warning to fulfill itself in reality, but it will come true. History shows us that a debtor government must eventually pay the piper.

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## Gold and Mining Shares

Let me begin by stating that gold remains in a bull market, and will be in a bull market for quite a few more years. That said, there certainly are corrections in every bull market, and we are going through one of those in gold right now. The purpose of this section is to lay out a further decline that may lie just ahead, though it is not guaranteed. Recently, gold investors have observed a support zone (in pink below in chart courtesy of StockCharts.com) for the metal that has held several times in the area of $1525 per ounce since the local top in September 2011:


The $1525 per ounce level has been basically accepted as the new floor for the metal. And it may yet turn out to be the floor if gold investors get lucky.

But what if the price of gold were to dip below say $1520 per ounce, and close under that level for two or three days? The answer is that there would most likely be a gold panic after such a significant support level is broken to the down side. There isn't that much support for gold under the $1520 per ounce level. The $1390-1450 per ounce area might support price for a while, but the likely ending point for the current correction is $1301 per ounce, given that this level would represent a nearly perfect 50% Fibonacci retracement of the advance from the recent $681 per ounce trough to the $1923 per ounce record high. A panic would also be the perfect end to the current gold cyclical bear market. It would scare most gold investors out of the gold market permanently, thus preventing them from enjoying the ensuing advance in the metal's price, which will likely go to record levels.

If indeed the stock market panics soon, as I believe it will, and investors pursue Treasuries as a safe haven asset, then they will need dollars to purchase those Treasuries. A rising dollar can create a sell-off in commodities and gold via deflation fears. If gold were to drop below $1520 per ounce, then it could easily fall to $1301 per ounce in short order. The long term still looks great for gold, but traders should be aware of what can happen in the short term. A decline to $1301 per ounce would represent a fairly typical ~32% correction from the $1923 per ounce all-time high set last year.

Another reason to suspect a coming decline in gold is the fact that it's about to complete a consolidation triangle that began in early May 2012, having entered the triangle by moving down in price. Once again, a triangle consolidation will typically resolve itself with price continuing in the same direction as the move going into the triangle.

Furthermore, the typical action during a cyclical bear market is to have violent and vicious upward advances during the decline in order to bait buyers back into the market so that they can be buried in losses later. By contrast, an cyclical bull market is typically characterized by small up moves with occasionally large and scary down moves in order to convince investors to exit the market so that they do not enjoy the full fruit accorded by the market's advance.

An unbiased observer of gold's correction since last September must acknowledge that there were quite a few sharp upward advances, but that the general trend was down. The implication is that gold is in a cyclical bear market. Such a bear market tends to keep investors involved as long as possible so that they will be fully invested right through the final panic. I believe it likely that such a gold panic may be right around the corner.

Support of the idea of a gold cyclical bear market is found in the ratio of gold mining stocks to the price of the metal, which has been declining (Chart below courtesy of StockCharts.com):


Worse yet is the fact that the ratio recently turned a former line of support (in blue above) into a line of resistance. The implication is that an upcoming decline in gold can very seriously damage the shares of gold mining companies. I had hoped that the ratio could hold above the 50-day moving average, and perhaps recapture the 200-day moving average. But alas, no.

The most important consideration, as usual, is the currency market. Let's take a longer term monthly view of the dollar index (Chart below courtesy of [StockCharts.com](http://stockcharts.com)):


Here one can see a massive symmetrical consolidation triangle. It has dominated our investment fortunes the past few years. As is the case with most consolidation triangles, this one will likely resolve itself in the same direction as the original move into the consolidation, i.e. downward. But one can also see that there is still some room for the dollar index to advance to around 86 prior to the next anticipated dollar decline. Thus, it makes sense to expect such a dollar advance to bolster yet one more rise in U.S. government Treasuries, and also to hurt commodities and gold. After that, should the dollar begin an expected decline, gold and commodities can recover, and Treasuries would either consolidate or correct.

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# The “Fiscal Cliff”

Certain well-known professors have been talking publicly about a coming “fiscal cliff” here in the United States. They proclaim that early 2013 is the approximate date of its arrival, and a good portion of Wall Street and Main Street is quite worried about it as well. Please. I’m not a professor, and I don’t have a Ph.D. But I also don’t need those credentials in order to blast holes into such wanton theories. Let me be blunt, concise, and clear. Call me when the yield curve has inverted. That would be a great sign of a coming recession, as the bond market has a good track record of buying up intermediate-duration bonds prior to recessions. Don’t bother me too much with recession talk when the yield curve is nicely positive like it is right now. Call me when price inflation starts to rear its ugly head in a nasty way like in the first half of 2008 when some truckers stopped working because their costs outstripped their revenues. At the leading edge of a recession, price inflation shows up because production slows, resulting in fewer goods and services with the same amount of currency chasing them. Don’t bother me when gasoline prices are generally declining like they are now, which acts like a tax break for virtually every person and business. Call me when capacity utilization is at least over 80%, and preferably over 81%, thus indicating that the economy could overheat. Don’t bother me when capacity utilization is a very sweet and benign 79% (and gently rising at +2.6% annualized), a rate that allows for growth with minimal price inflation, i.e. the best of both worlds. It could be noted that retail sales did decline in June, but it is precisely when the data turns weakest, and economists throw in the towel, that growth tends to start surprising on the upside. So with June being only a mildly negative retail sales number, I’m not going to throw in the towel on an otherwise fantastic uptrend that has not slid meaningfully since 2009. Call me when consumer credit shows signs of leveling out instead of growing healthily at an annualized +5% as it is today. If I were inclined to be bearish right now, then I would be scared to death to stand in front of a credit growth freight train that expanded at only a +3% rate six months ago. Credit is not just growing; it’s accelerating! Also, don’t bother me when the M1 money multiplier is making its fastest push since the Great Recession to getting back over 1, rising faster than it has since 1987, thus indicating that U.S. fractional reserve banking now has its best chance in the last three years to start working again. And let’s not forget that it’s virtually unheard of to enter a recession when Leading Economic Indicators are rising. Nope, I’m sorry. There are times to be bearish on the economy, and I will be bearish when the time comes. The reader may mark my words on that. But now isn’t one of those times. The “fiscal cliff” promoters need to go back to Economics 101. Difficulties in the federal budget will be smoothed over as they always are, if not with growth, then with dollar printing. I realize that it’s become popular to think of the federal government as not having any clue about anything, but let’s give Congress a little bit of credit. It’s illogical to assume that the Congress will voluntarily permit a recession to take place just to balance their books, when they can postpone disaster so easily. Don’t misunderstand me. There will be plenty of stock market volatility, even this year, and likely this month. And there is an economic cliff coming down the road as well. But why anyone would say that an economic cliff is coming in the near term for the United States is beyond me. Europe is a different story, with a recession having started. But their recession will continue to be mild because Europe is a net exporter, and its global customers are all growing. The U.S. does not export so much to Europe that a mild recession in Europe could somehow pull the U.S. into recession. This whole idea of the U.S. economy falling off of a cliff in the near-term is a non-starter. Forget about it.

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I hope that you found this information to be helpful. Please contact Martin Financial Solutions, LLC at 602-538-9704 for more information on our outlook.

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The author used the FRED (Federal Reserve Economic Data) database from the Federal Reserve Bank of St. Louis to assemble some of the data used herein.