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MCAG MACRO: YELLOW LIGHT

September 8, 2010

I don't believe in coincidence, but let me point out the corny irony of a positive jobs report heading into this year's Labor Day weekend. James Mackintosh put it perfectly in yesterday's FT Short View where he points out that "as the armies of unemployed watched those with jobs take a break, at least they could see market confidence in job creation rising and fear of a double-dip recession receding."

As if to confirm that hesitation is the name of the game equity markets retreated and the curve re-flattened back to pre-NFP levels. The fundamental explanation was renewed European banking system concerns after a Wall Street Journal analysis suggested Europe's banks stress tests understated some lenders' holdings of potentially risky government debt. During the European session equities sold off sharply, there was an increased widening in European sovereign debt spreads, and notable increases in default swaps in the European banking sector. The safe-haven bid overseas caused a flattening in the treasury curve that was mimicked during our session.

This alone, however, doesn't give me the sense that markets have lost their positive undertone. We knew a lot of analysts have been preparing to poke holes in the European stress tests. Jean Claude Trichet said yesterday in an interview with Maria Bartiromo, "Basel III is a work in progress," giving the impression that the news is a mere temporary setback. It doesn't make me want to put on a Euro-steepener yet but it does make me want to explore one here. Last week we saw steepening as the transfer into stocks took life out of the rally in the long end. The addition of a better than expected 67K private sector jobs topped off the optimism that had gained steam last week, or at least, squashed a lot of the pessimism. Although yesterday's retreat may have created opportunity, to put one on this week would be a bit premature as treasury price pressure should get an assist from supply. But as equities embrace underlying positives, bear steepening is inevitable. The Beige book's release today will help set the tone for this month and the next Fed meeting, as well as July trade balance tomorrow and wholesale inventories Friday.

If not for the European situation markets may have paid more attention to new proposals from the Obama administration. The first is a \$50B infrastructure spending program, which will likely fail to win

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Congressional approval and the second is tax write-offs for corporate investment. Could that be correct? Tax write-offs? Although there was more spending proposed in the same breath, this is the first of late of this type of inspiration to business growth we have seen from the current administration. As Larry Kudlow points out, it's not that businesses are not profitable that jobs are not being created. It's that they're as hesitant as you and I amidst all the uncertainty regarding regulation and taxes, which is hindering projection and thus innovation and progressive growth.
<http://www.kudlowsmoneypolitics.blogspot.com/> <http://www.cnbc.com/id/39039492>

As we approach this year's elections we may well see more of this type of pro-business proposal. The democratic majority knows it needs to get a grip if it wants to have any chance for life on the other side of elections. Although minutes and data make clear that recovery has slowed there are still an abundance of bright spots littered throughout the economic atmosphere including key elements of demand, consumer spending and now maybe, just maybe, business investment. I've been saying for a while that we're right where we are supposed to be, growing, but not like we've just broken through a start gate. That in and of itself would inspire fear. All we need now is for our government to recognize that stability will arise from the freedom to know they are not going to get slammed with regulation and taxation. Then we can expect a little progress.

For James Mackintosh and the Financial Times "Short View:"

<http://www.ft.com/cms/s/0/b2d50cce-ba33-11df-8804-00144feabdc0.html>

Kevin Williamson: Another Stimulus, Another Bailout:

<http://www.nationalreview.com/exchequer/245745/another-stimulus-another-bailout>

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