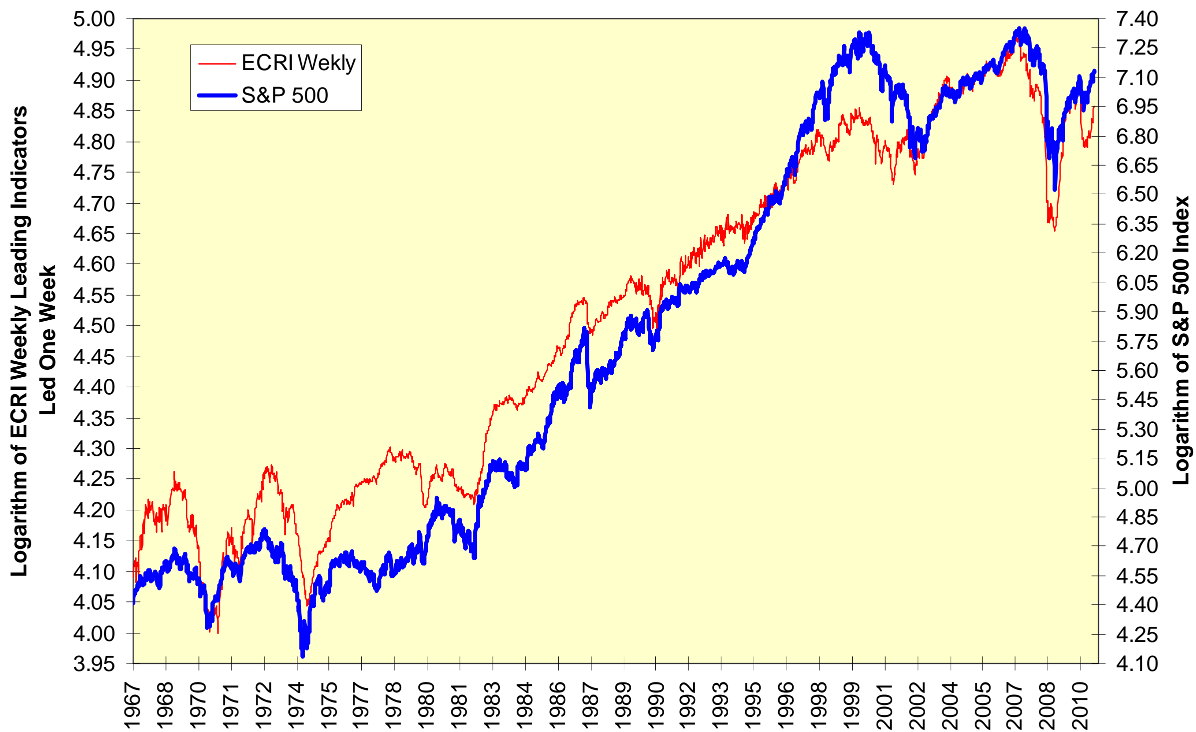
Leading Indicators' Divergence Closing

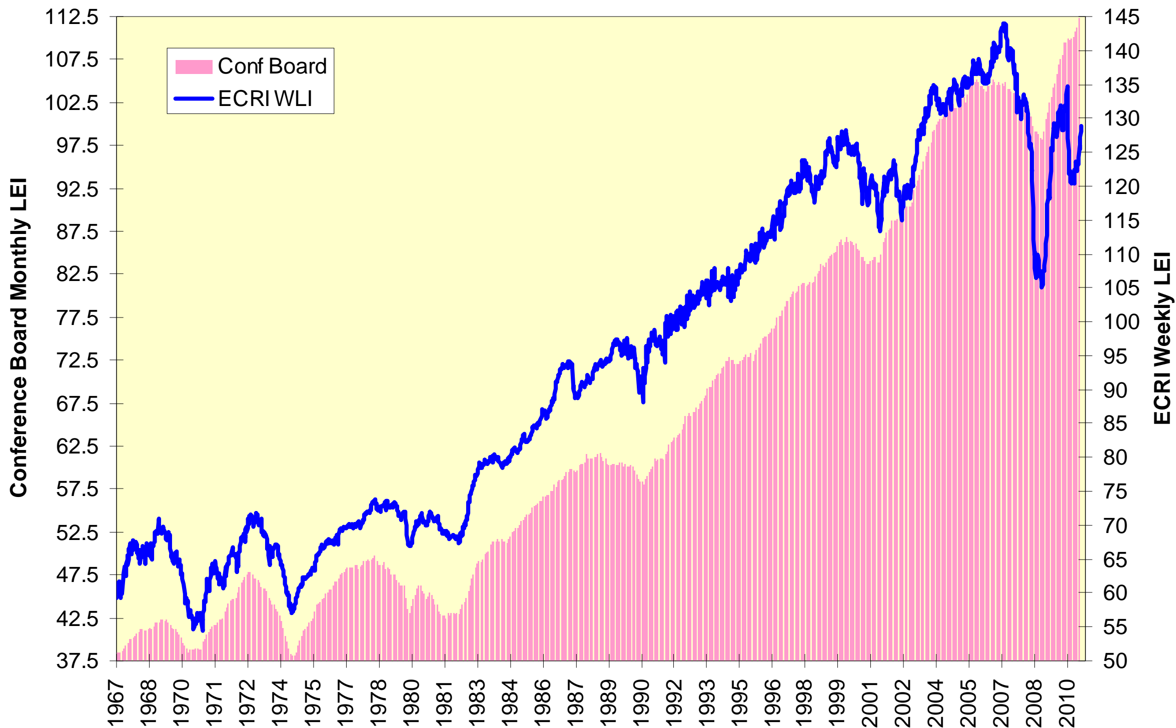
Despite the fact no one believes it, past performance does not predict future results. However, as it is more available at any given time than is future performance, and as leopards neither change their spots nor mix their metaphors, people devote a great deal of time dissecting the past. Why, the securities acts of the 1930s, the ones that gave us the SEC, are based in part on the belief an investor can outfox the market if only enough historic information is disclosed in quarterly reports. This is the very same SEC unable to discover Ponzi schemes to which they have been alerted, but I digress.

Then there is the belief certain economic indicators can foretell events and obviate the need for Ouija boards, Tarot cards and goat entrails. I last discussed two indices of these leading economic indicators, the Conference Board's monthly and the Economic Cycle Research Institute's weekly, in June 2010. The conclusions then were the ECRI index was too dependent on the course of the S&P 500 and its nosedive in the second quarter was the result of a huge drop in mortgage applications for new purchases, a development related to the termination of the first-time homebuyers' tax credit.

As the downturn in the ECRI index seemed to presage a double-dip recession it provided aid and comfort to both the excitable boys at the Federal Reserve itching to roll fresh batch of Benjamins off the presses and to various cackling misanthropes in the financial commentariat who, for reasons no doubt related to childhood traumas, seem to have a need to predict impending doom each and every day.

Half A Year Onward
Now that the stock market is on a tear to the upside and the Mortgage Bankers Association's index of new purchase applications has climbed from 172.1 to 199.8, let's revisit the ECRI index in relation to both the S&P 500 and the Conference Board index.





The ECRI index is still below historic trend on both comparisons and no doubt will remain so for as long as the growth rate in M2 remains low and new jobless claims remain high in addition to the state of the mortgage market. However, the divergences noted in June 2010 are closing and only the willful can deny the trend still.

Finally, should we attribute any of the ongoing economic rebound to QE2? No; monetary policy works with long and variable lags and is too non-deterministic in its outcomes. We certainly can and have argued the hint of QE2 affected financial markets instantly and profoundly, but it would be a stretch indeed to claim the stock market rally net of bond market losses since that announcement has produced enough of a wealth effect to matter for the economy as a whole. Will this stop the Federal Reserve from claiming credit for a macro boost while disclaiming blame for rising inflation? Are you new here?

The plain and simple truth is QE2 was a monetary bridge too far; it was putting lighter fluid on charcoal already glowing and will devolve into an inflationary mess. But before that moment arrives, it shall be onwards and upwards for the indices of leading economic indicators.