ECRI Weekly Leading Index Misleading

This may surprise you, but our solons at the Federal Reserve have been known to make it up as they go along or simply cherry-pick the data supporting what they want to do anyway, whichever is more expedient. I remember an episode from the later Greenspan years when their designated mouthpiece-in-charge at a leading national business newspaper said about a recent bout of tap-dancing, "They use the forward-looking indicators."

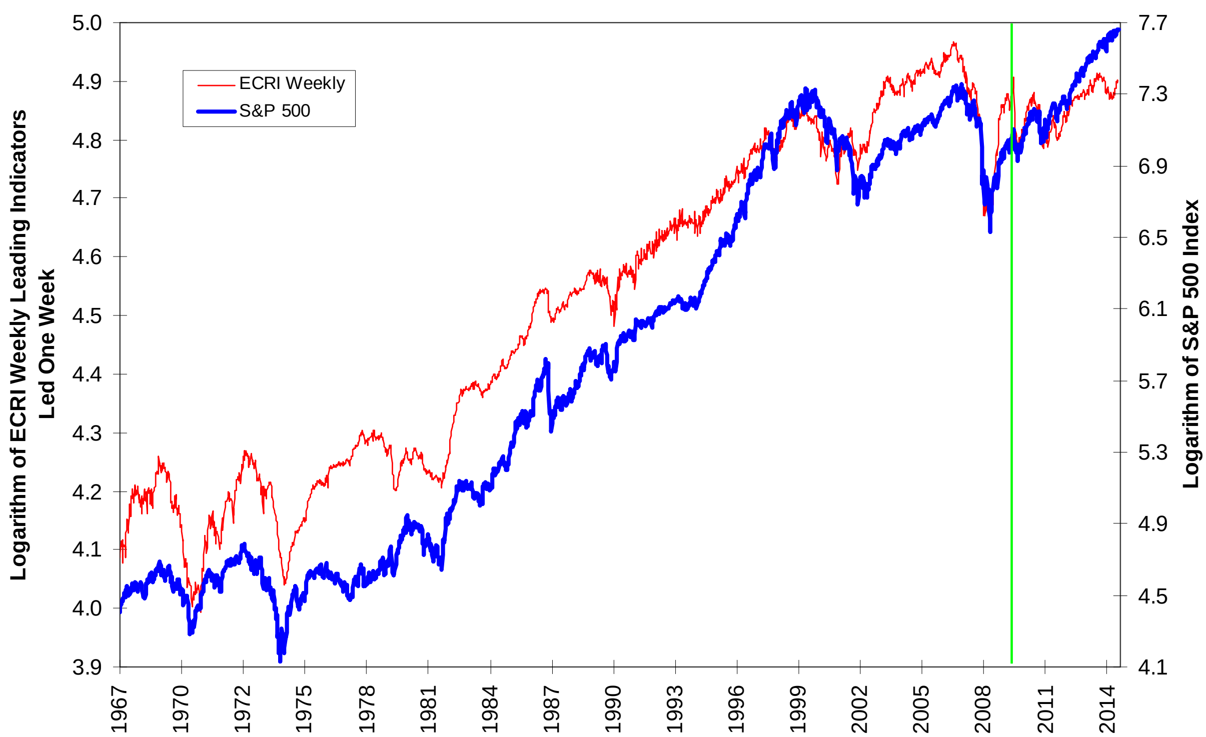
In other words, while you slobs are looking in the rearview mirror, we are heeding the calls from tomorrow. Who will be driving whom in an Über cab tonight?

Look Ahead To Get Ahead
Let's take a look at the ECRI Weekly index of leading economic indicators. This index includes mortgage applications, an exceptionally volatile series linked to long-term interest rates. They climbed by 71.7% between early September 2014 and mid-January 2015 as mortgage rates fell and have decreased by 27.7%. Their inclusion in an index of leading economic indicators would invite all manner of self-fulfilling prophecies if policymakers responded to a rise in mortgage applications by raising short-term interest rates and vice-versa.

The index also includes the Moody's Baa – ten-year Treasury yield spread. This spread has increased 30 basis points since late March even as the OAS of the Merrill Lynch Corporate & High-Yield Master has decreased by seven basis points. We would be hard-pressed to classify the environment of the past two months as one of deteriorating corporate credit quality as opposed to one affected by rising ten-year Treasury yields.

The ECRI index has moved within the very narrow range of 130.1 to 135.6 since July 2014. U.S. equities as measured by the S&P 500 index returned 9.34%. Prior to April 2010 (green vertical line), the logarithm of the ECRI index was essentially the logarithm of the S&P 500 lagged one week; the r-squared or percentage of variance explained of this relationship from January 1967 through April 2010 was more than 0.977. Post-April 2010, it has declined to 0.669.

Leading Indicators Lagging Stock Market Advance



Comparison To Conference Board LEI
The ECRI index' downturn differs markedly from the Conference Board's monthly index of leading economic indicators.

ECRI index components not included materially in the Conference Board index are:

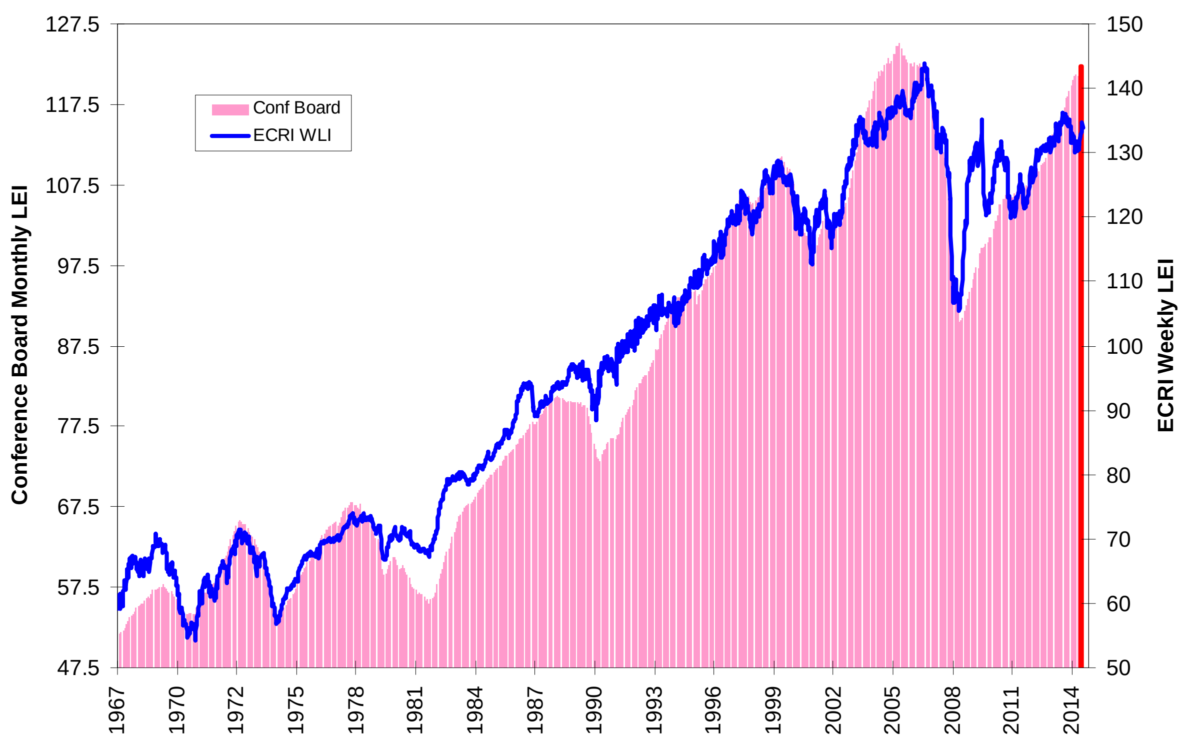
1. Mortgage applications, purchase index;
2. Moody's seasoned Baa corporate bonds;
3. Baa - ten-year UST yield spread; and
4. JOC-ECRI industrial price index

Conference Board components not included materially in the ECRI index are:

1. Average weekly work hours;
2. New manufacturing orders;
3. Vendor performance;
4. Building permits;
5. The yield curve spread; and
6. Consumer expectations

The downward pressure on the ECRI Weekly index has maintained a divergence from the Conference Board's monthly index of leading economic indicators extant since the start of QE1 and its distortion of the mortgage market. Downturns in the ECRI Weekly index in the summers of both 2010 and 2011, in the spring of 2012 and over the winter of 2014-2015 were poor predictors of subsequent economic growth. The simple fact is real GDP has increased at an average annual rate of 2.1% since the recession's official end in 2009:Q2. As the Conference Board's monthly index has continued to advance over this period and has yet to emit a false negative signal, it should be considered the more useful of the two leading indicators.

ECRI Weekly Index Diverging From Conference Board Monthly Index



Regardless, these leading economic indicator indices are abstractions. They markets you trade are a reality. Adjust the time and attention you pay to both accordingly.