Transcript: Macro Research Provider Illuminates Recovery Stress Points – Eric Pomboy – Think Piece

Featuring: Eric Pomboy

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Synopsis: Eric Pomboy is one of the most highly-respected chartists and analysts in the market today. His work is used by institutional investors, hedge funds and market commentators to make key investment decisions on a daily basis.

Eric's deep-dives into all aspects of key economic data throw up a series of charts which at a single glance tell and simplify remarkably complex stories.

Getting access to Eric's work will help investors understand how the unfolding data will help shape capital flows between asset classes and identify key stress points in what is acknowledged by many as an anemic recovery

Topics: Macro, US Economy, Energy Commodities

Tags: Meridian, CPI, Inflation, Autos, Retail

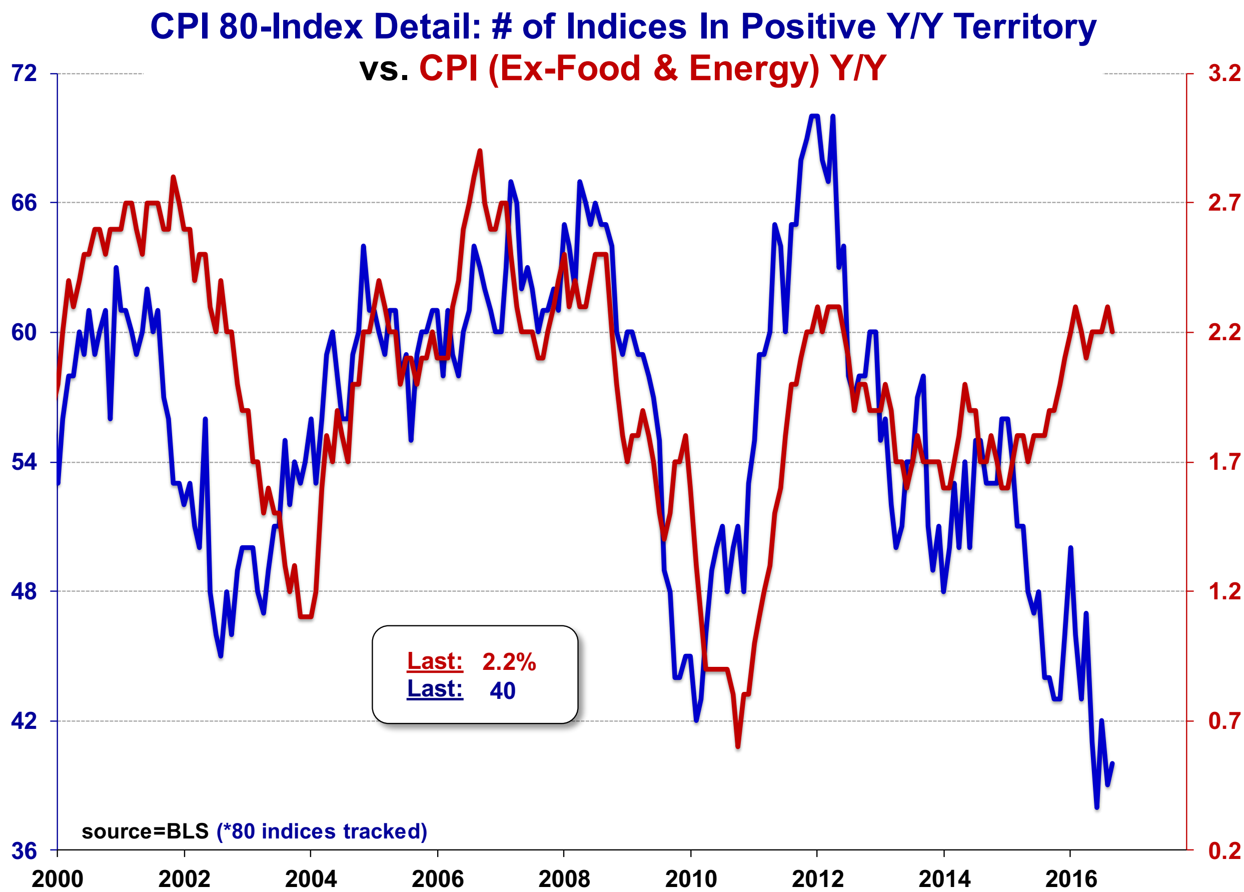
Video Link:
https://www.realvision.com/channel/realvision/videos/1778e5f880914ce6a01ee6e0284e8144

Highlights:

Eric Pomboy: And I think the best way to get at the consumer to see what their situation is, is to begin with the inflation data, and then move backwards. So what we did is we went through the entire BLS CPI report. And anybody who's looked at this data release on their website, downloaded the data and looked at any of this, realize that there is a couple hundred– at least– indices to look at. It's just an absurd amount of data. But we narrowed it down to basically the second to final layer of data, before you get to the ridiculously minutiae.

But anyway, it covers absolutely everything. We came up with 80 indices. So we wanted to see how many out of these 80 indices are actually rising versus falling on a year-over-year basis. And we came up with a number of 40. So exactly half– as of the last CPI report-- are moving higher on year-over-year basis. This is actually below where it was during the last recession, and well below where it was in the previous recession. So there's a lot of deflationary– again, this is not a measure of inflation it's just a number that is only rising above 0 year over year.

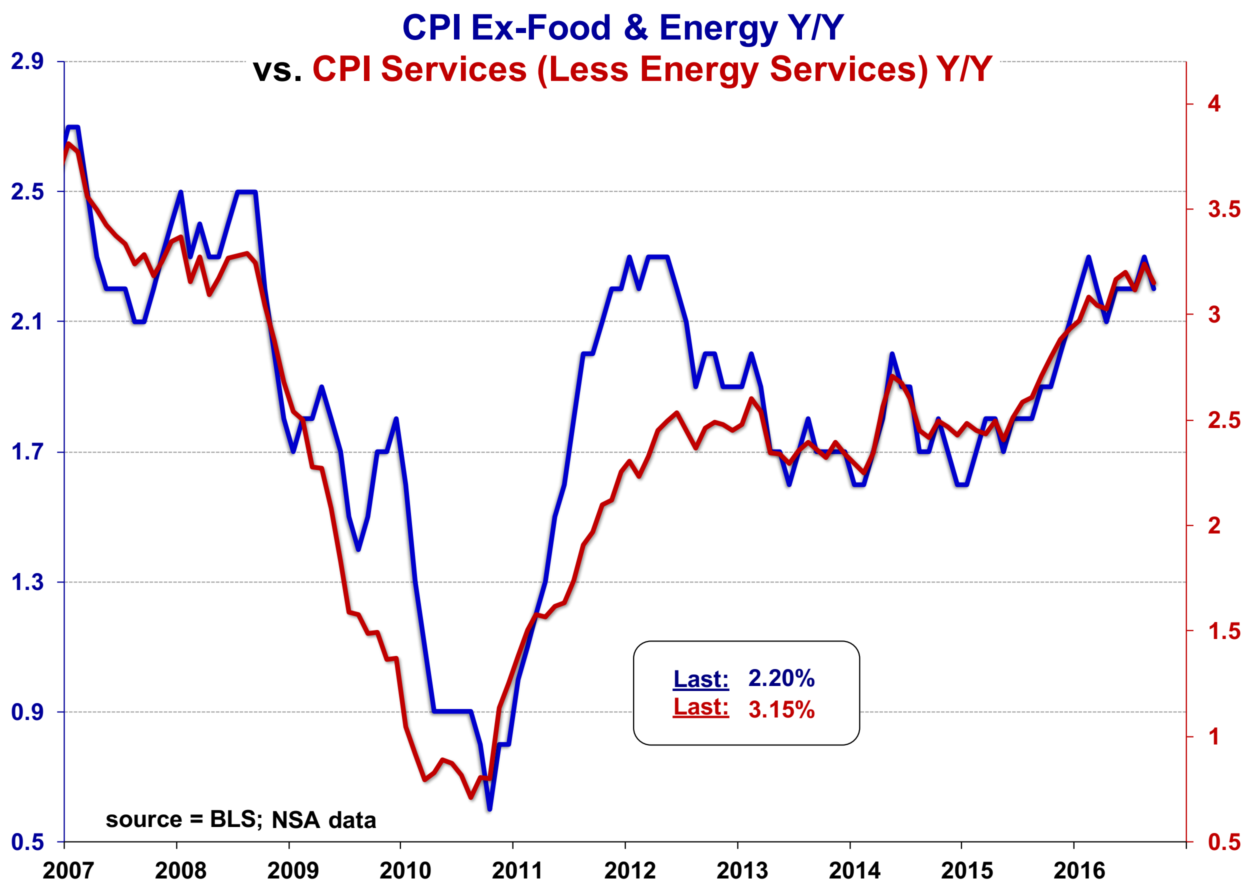
But then, what we do is we overlay core CPI on top of this. Now, typically, these two have a very tight correlation. And that would make sense. But in this case, we see that there's a big divergence. You see, core CPI running hot at 2.2%, or running hot, we'll get to that in a moment. And yet, all these indicators are saying, well, wait a minute. Everything's below 0% or mostly at a recession level. So we wanted to figure out what is it. There's got to be something in this core CPI data that's obviously running very, very hot, to actually have to push it up to 2.2%.



So then, we looked at OK, how many of these 80 indicators are actually running very hot at 5% or more year over year? We came up with 6. Out of those 6, only 4 have a relative importance to the overall calculation of CPI of 1% or more. And it sounds like a small number, but it's actually– as far as the CPI goes, it's actually– not an insignificant amount.

So those 4 indicators are health insurance, prescription drugs, auto insurance, and hospital services. So this is all very health care-related, except for the insurance component. And then, if you go down another layer and you look at what's rising between 3% and 5%, you get into the housing. So owner's equivalent rent, rent of primary residence. So all this inflation you're seeing in the core CPI is health care and housing-related.

Then, we move on and say OK, well, let's make sure. So we overlay the core CPI with CPI services excluding energy services. Now, that ex-energy services component is largely health care and housing and utilities. Now, you'll see that this correlation– and they typically move together, but the correlation over the last few years– is unmistakable. It is tick for tick. So that confirms that it really is almost entirely health care and housing, utilities that are pushing this index higher.



So looking further at this chart of core CPI versus CPI services, ex-energy services, again, it's all health care and housing-related. This is really not your classic definition of inflation, which is too much money chasing too few goods. So let's look at these two components. They're both a literal and figurative tax. So the housing is essentially a tax on consumer spending. The higher it goes, the less disposable income you have, you're unable to buy stuff. And it just goes towards this mandatory outlay.

The other one is actually a literal tax, because as ruled by the Supreme Court, we all know that the Affordable Care Act is a tax. So instead of this idea of too much money chasing too few goods, we actually have stagnant wages chasing higher and higher taxes. So this is a very toxic environment for the consumer. And this is definitely not the inflation that the Fed is looking for.

So when we look at the earnings data of the last payroll report– which was met with a lot of fanfare– which is that average hourly earnings are jumped to I think, it was 2.8% year-over-year. And it's a great looking chart. But it is a positive, but it doesn't really tell you much, because you're not factoring in how many hours worked per week. So your wages are rising, but your hours are declining on net. You may be doing even or maybe potentially less than you were prior.

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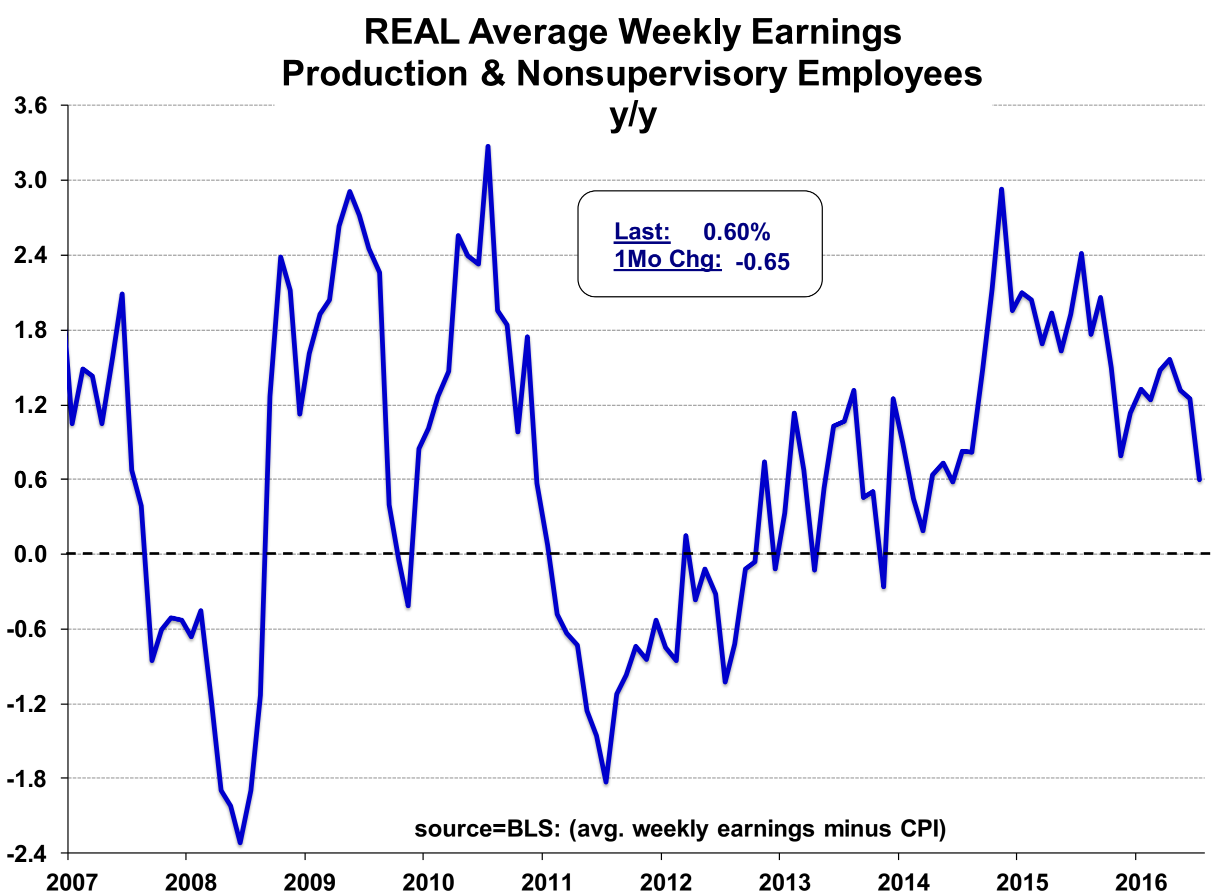
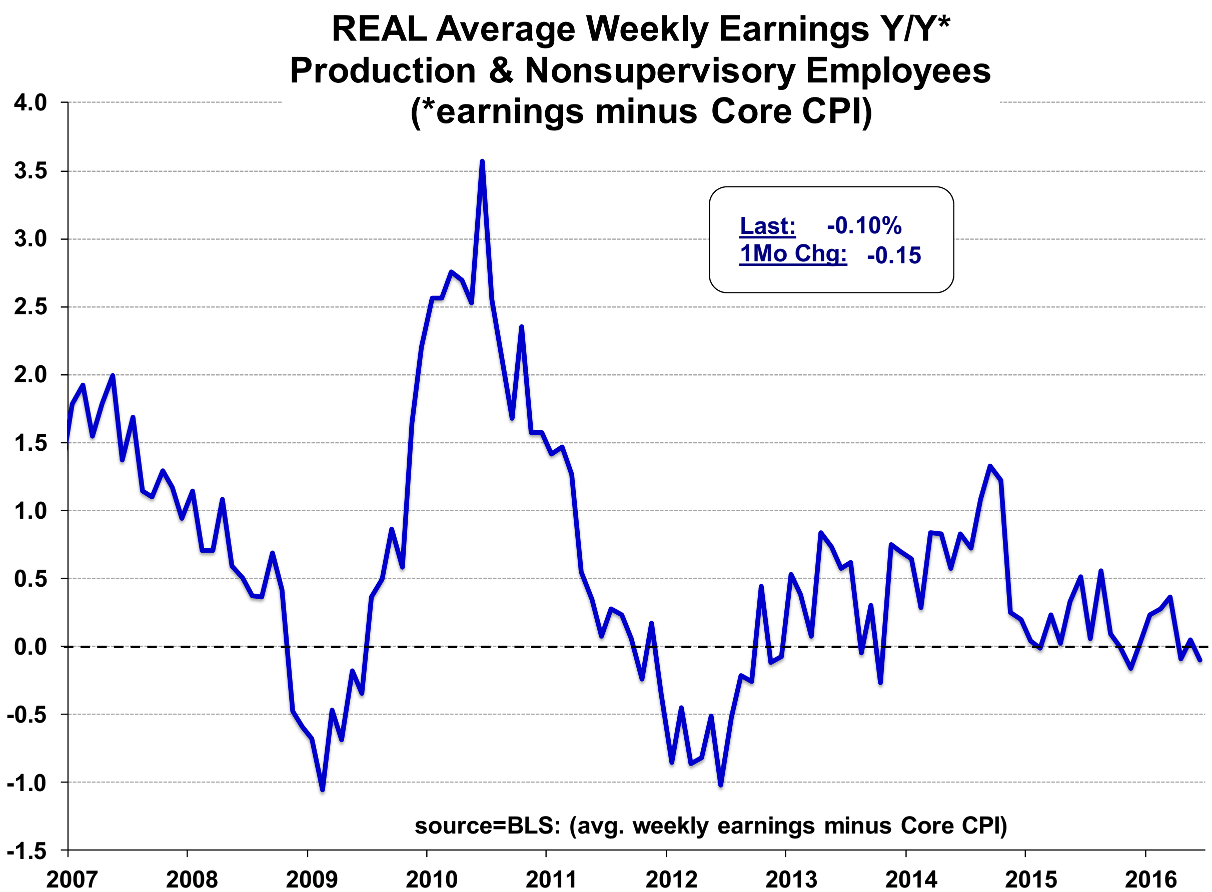
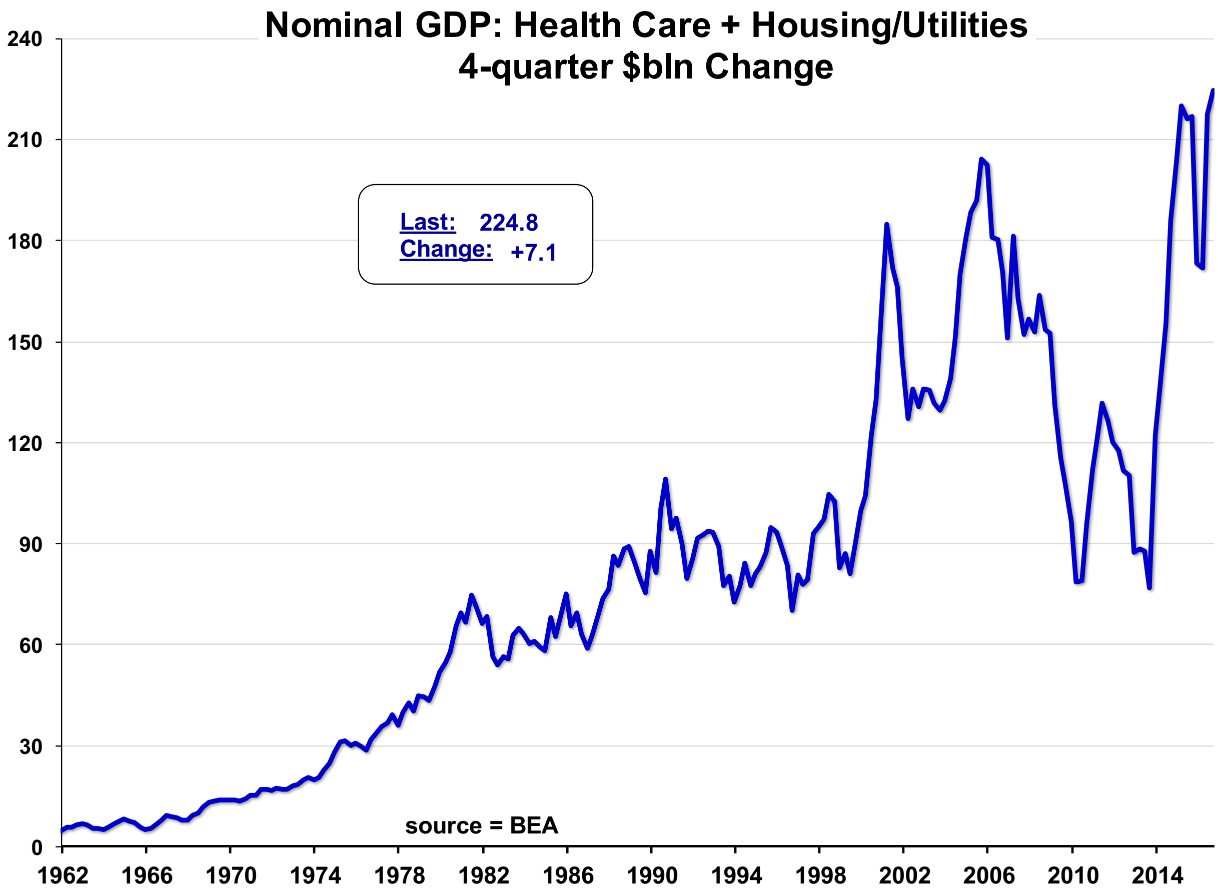


But what's also interesting is to think well, hold on a minute, here. That may not even be a fair calculation, because you have the core CPI which is running really hot. And these are the two largest outlays for the consumer of health care and housing, utilities. And these are really, really taking off, mostly health care. And in nominal dollars, it's just an enormous outlay. So they're maybe even under-represented in the CPI.

So if we actually do average weekly earnings of these non-supervisory employees, and we adjust that for the core CPI, you'll see that earnings are in fact negative year-over-year, down 0.1%. So this is a very, very tough environment for the consumer. And next year– as we all know– just announced a couple of weeks ago the new Affordable Care Act premiums are set to spike for next year.



This is certainly not going to help out the consumer, and it's just going to add to their headwinds. We certainly would see a lot of struggling retail sales certain to continue. And it's very difficult to see how the consumer can really weather this storm, because these outlays are just getting to be just too much. If you look at a four quarter change, a yearly change of health care and housing, utilities, it just jumped to the highest on record. That is really an astonishing number.



So these costs in particularly health care– and I've written about this before, is that– they have the potential to permanently cripple the consumer. And I don't say that lightly, I mean, this is a very, very serious problem. And along with that, it has the potential to cripple an already fragile economy.

Eric Pomboy: I'm Eric Pomboy, President of Meridian Macro Research. We started in 2009. Prior to that, I worked with my sister, Stephanie, whom you're well aware of. She's been on Real Vision several times. She's a tough act to follow. And when I worked with my sister, I was brought on board to develop or build on the research database that they had. And a large part of that was digging into a lot of the charts, creating charts, downloading lots of data. And I think I went above and beyond my mandate. And it turned into a bit of an obsession for me.

Also while there, I discovered that a lot of these clients, fund managers– from small to midsize to large institutions– didn't really have access to these charts, or they didn't have people in-house who were there to build this out or understand how to do it, or take the time to do it. So we were kind of filling that void.

And after a time, we went from hundreds of charts to thousands of charts. And I realized that this can be an interesting standalone business, because it was clearly quite a bit of demand out there. So thus, here we are. Meridian Macro started in 2009, and it's been great. We wanted to create this platform that was very user-friendly. So we update clients on all the macro data, chart format, plus running commentary.

And the chart packages that we send out, we update every single macro data you can think of. And it's very user-friendly. We have active buttons and you can zip through this stuff. And that was kind of the thing that I wanted. The product that I wanted was to make it very user-friendly, so that whoever it is looking at this can get a real sense for the data, because we give it just a great look. We get through all the bullet points. And not just month-to-month data, we look at the overall trends. We identify, we do a lot of comparative analysis. So we get probably the best look at the macro data that I think is out there.

Our clients range from small to mid-sized hedge funds, up to a handful of the larger institutions. And we've gotten a great response. And things are going pretty well. I figured I'd run through a few charts, here. And a lot what we focus on– at least recently in the past several years– which is growing importance, because it's a fairly weak component of the economy. It really is the consumer.

And I think the best way to get at the consumer to see what their situation is, is to begin with the inflation data, and then move backwards. So what we did is we went through the entire BLS CPI report. And anybody who's looked at this data release on their website, downloaded the data and looked at any of this, realize that there is a couple hundred– at least– indices to look at. It's just an absurd amount of data. But we narrowed it down to basically the second to final layer of data, before you get to the ridiculously minutiae.

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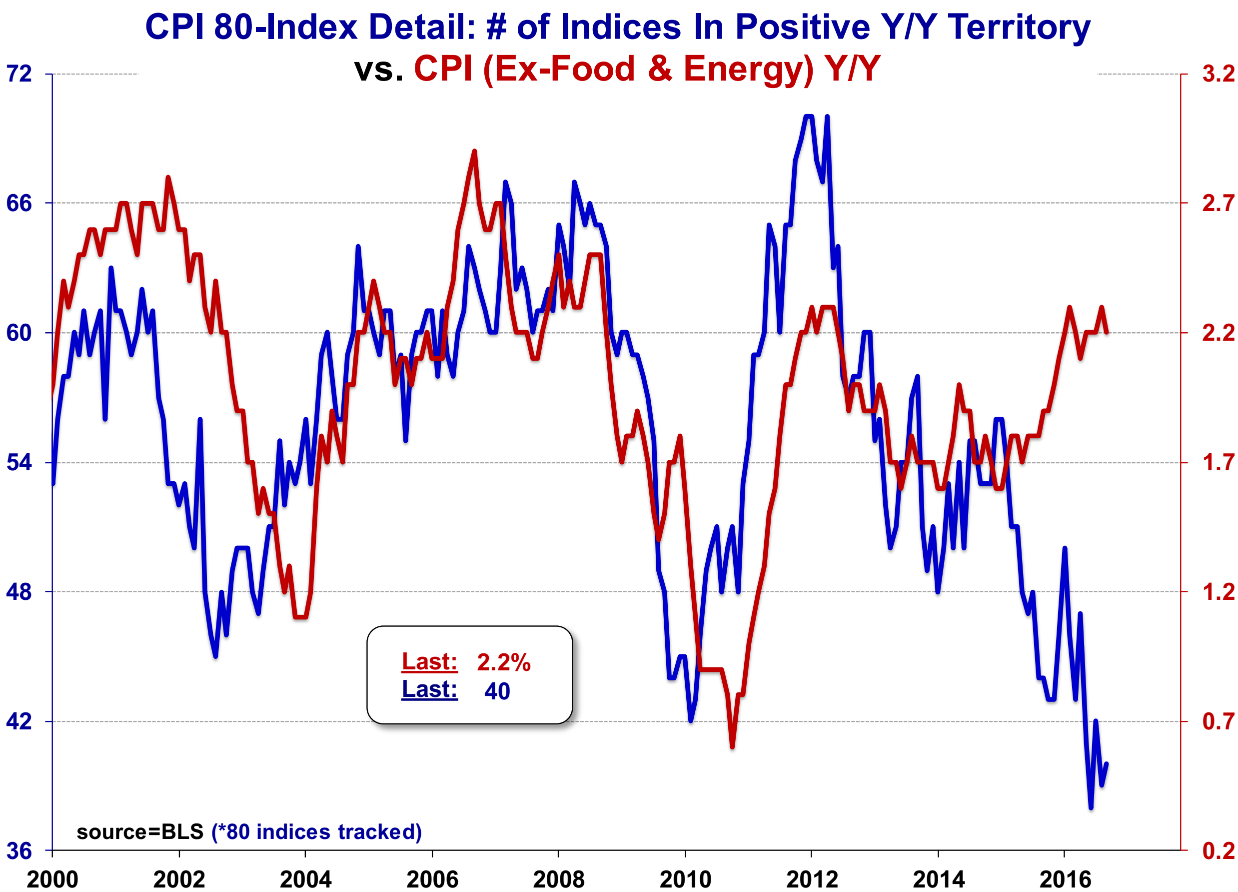

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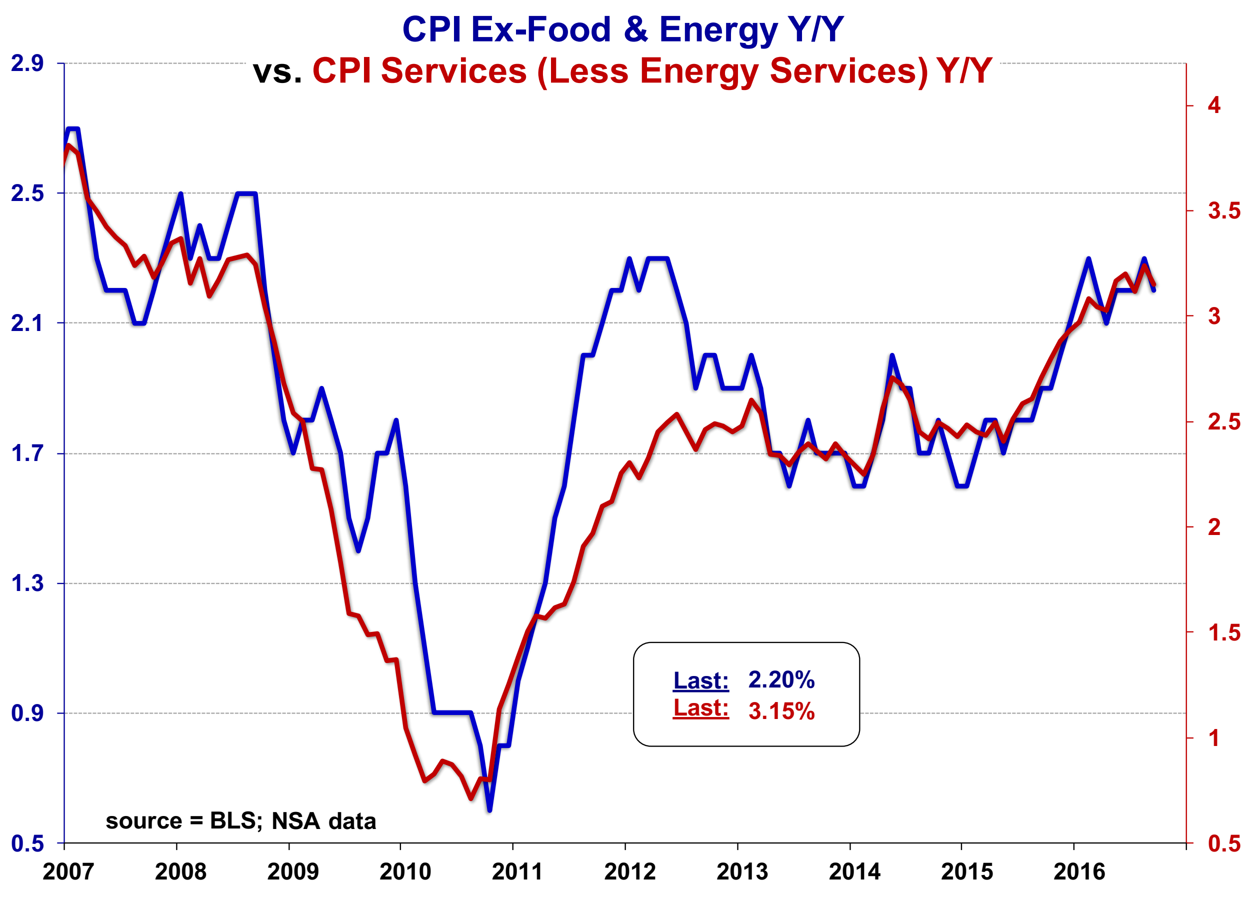

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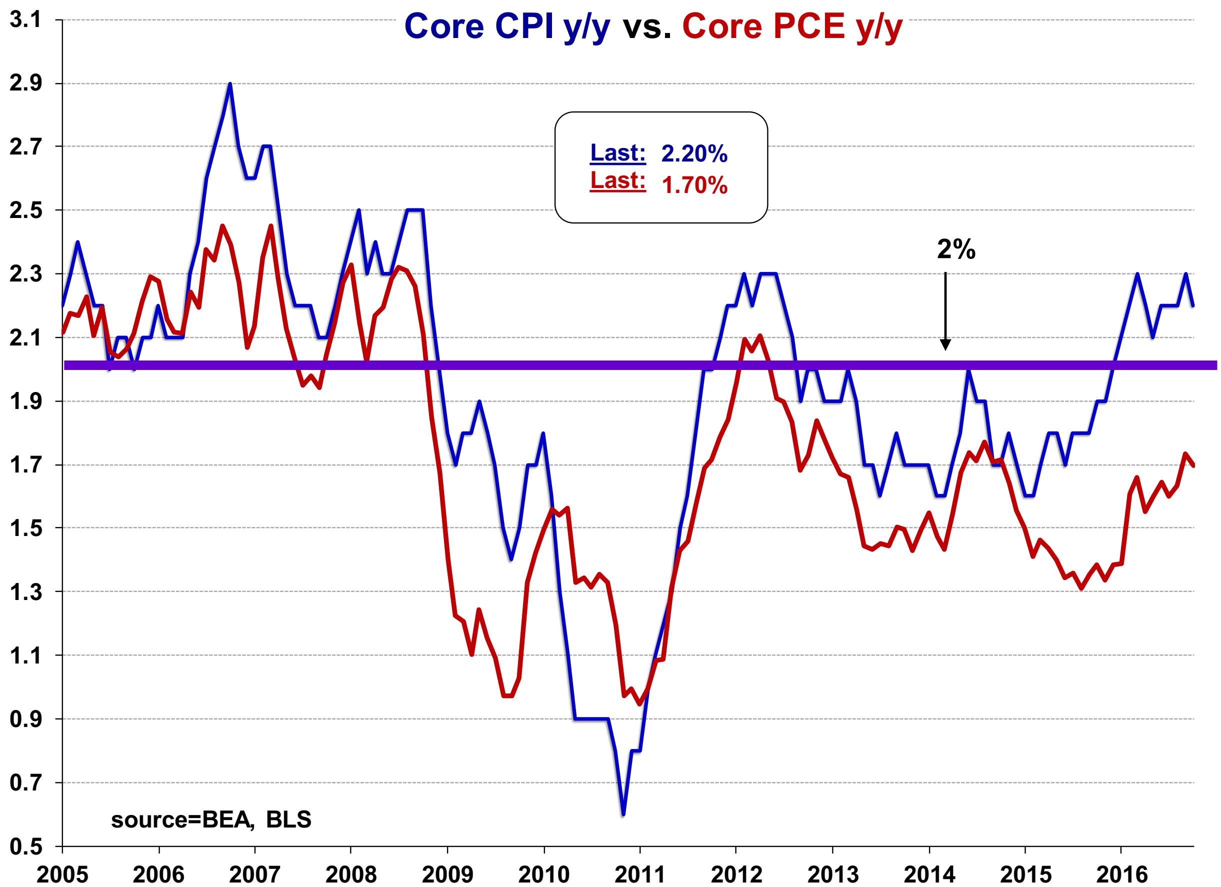
But everybody all across the media are saying, oh my gosh, we're a 2.2 on the core CPI. This is great. Why isn't the Fed moving? And what's interesting, of course, I think the most recent was the Fed's Evans who came out, and it's echoed by other members who say, well, we're willing to let inflation run a little hot. And well, now you know why, because this is not the inflation that they want. It's not people out buying goods and running out and spending at the mall and doing all sorts of fun things with their money. It's going more and more to these taxes. And that's a very difficult environment for the consumer.

So another metric which the Fed looks at is you have the core PCE versus core CPI. So essentially, the CPI is a measure of the price of things. And the PCE is a measure of consumer spending on things. So when you put these two together, you see that the core CPI is running at 2.2, but the core PCE is at 1.7. So this has been below the Fed's target of 2% for 53 months in a row. This is unheard of.



And even at that, the core PCE includes this housing and utilities. So even that 1.7, excluding that, it's got to be much lower. Because even that is being pushed up by these taxes effectively. So again, the Fed is saying, well, we're going to wait. We're going to let inflation run a little hot, which means you can see core CPI running at 2.8 and core PCE running at 2.2. And the Fed may still say, well, we're going to let inflation keep running a little hot. And people are just going to be scratching their heads, saying, what's going on here? So now you'll know if and why they just seem very hesitant to begin a true rate hike cycle.

So when we look at the earnings data of the last payroll report– which was met with a lot of fanfare– which is that average hourly earnings are jumped to I think, it was 2.8% year-over-year. And it's a great looking chart. But it is a positive, but it doesn't really tell you much, because you're not factoring in how many hours worked per week. So your wages are rising, but your hours are declining on net. You may be doing even or maybe potentially less than you were prior.

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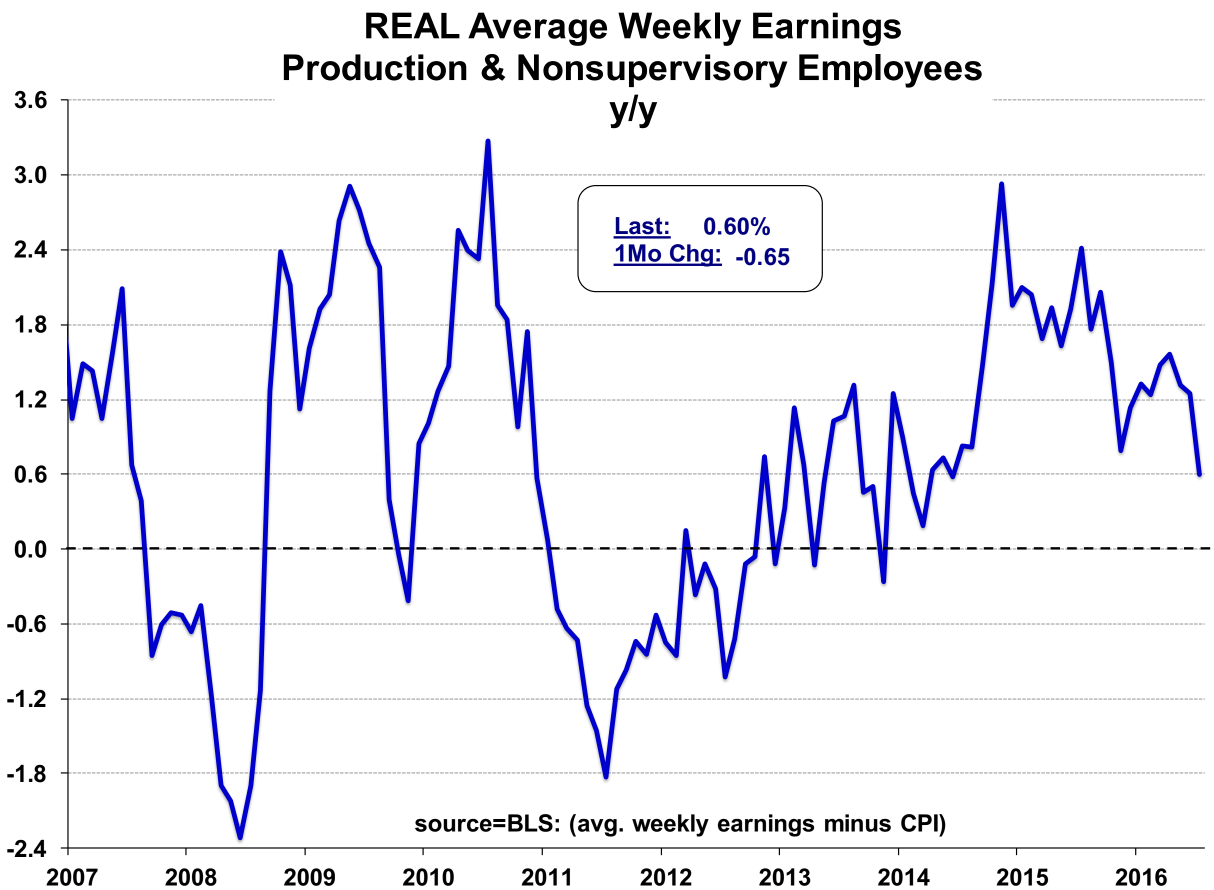

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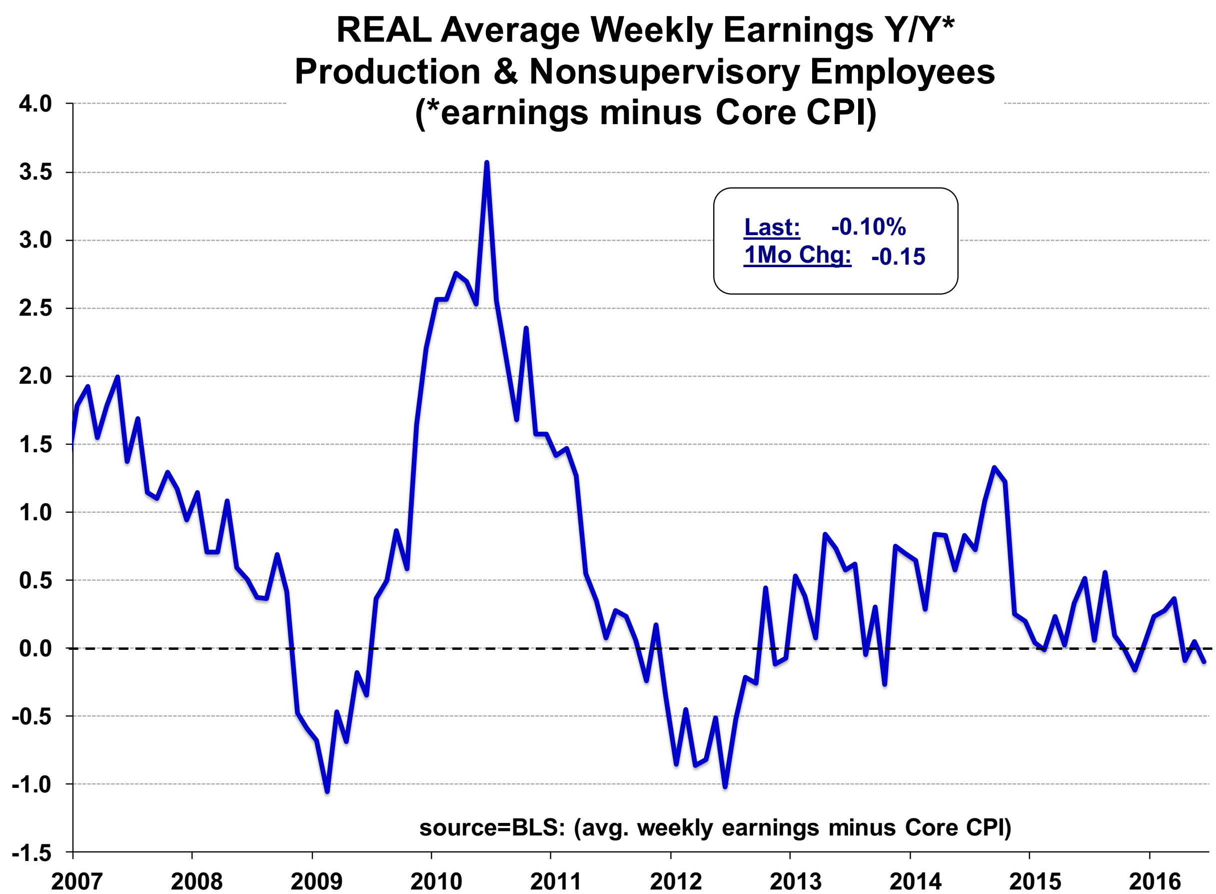

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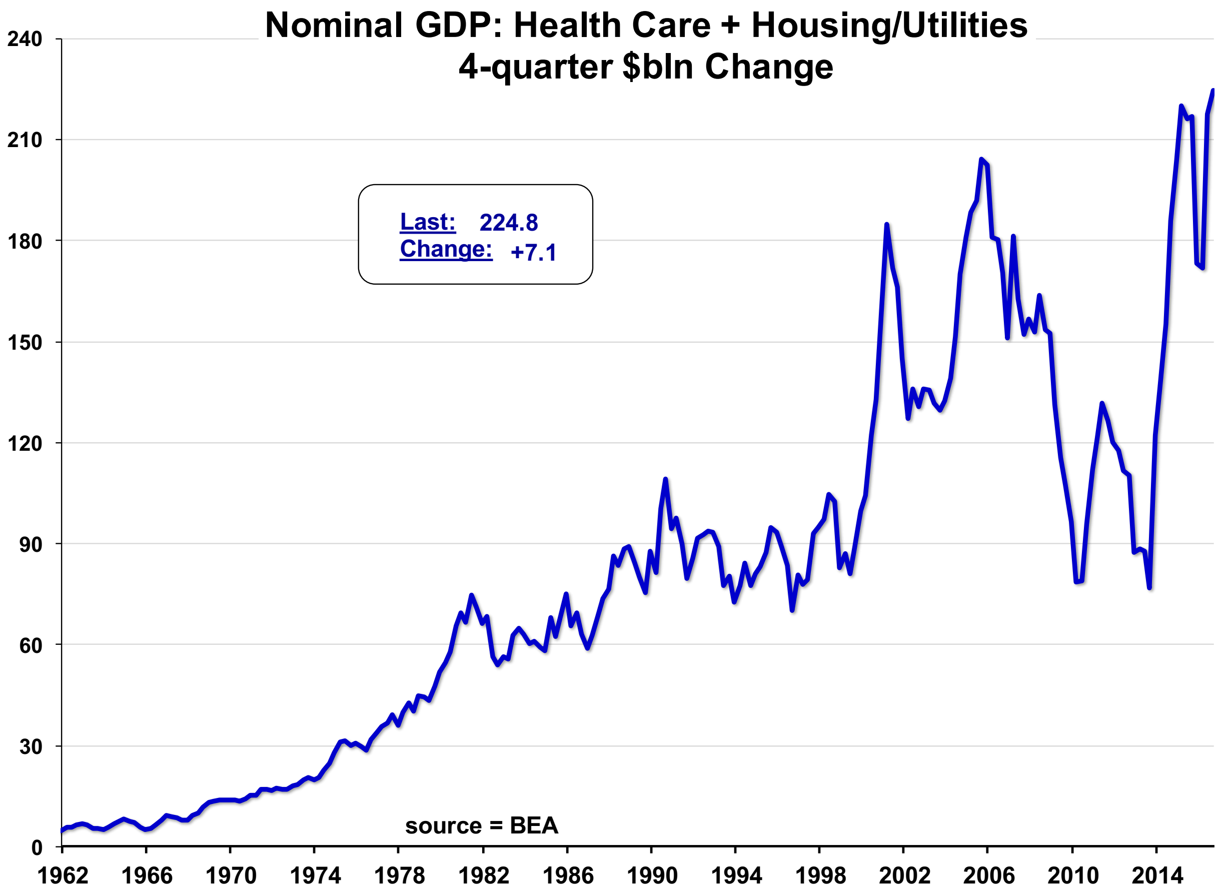

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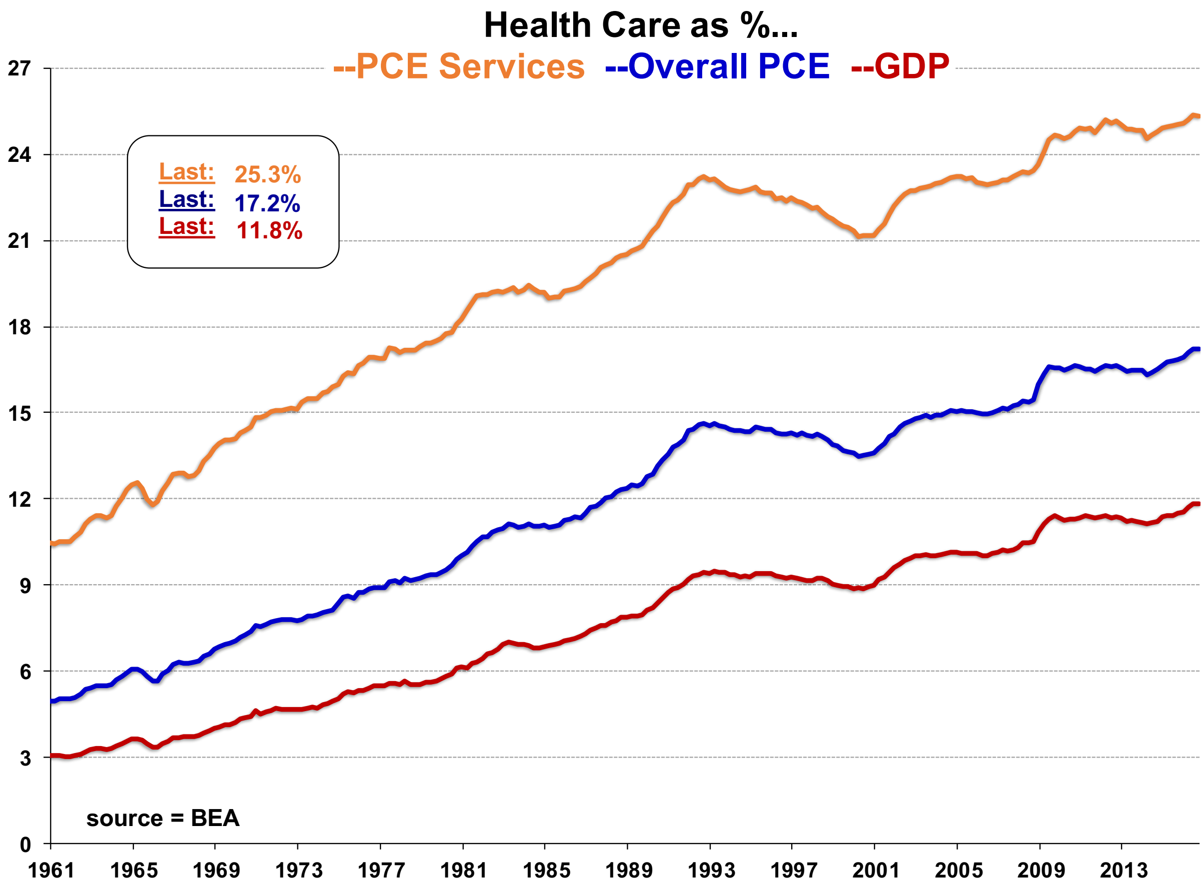
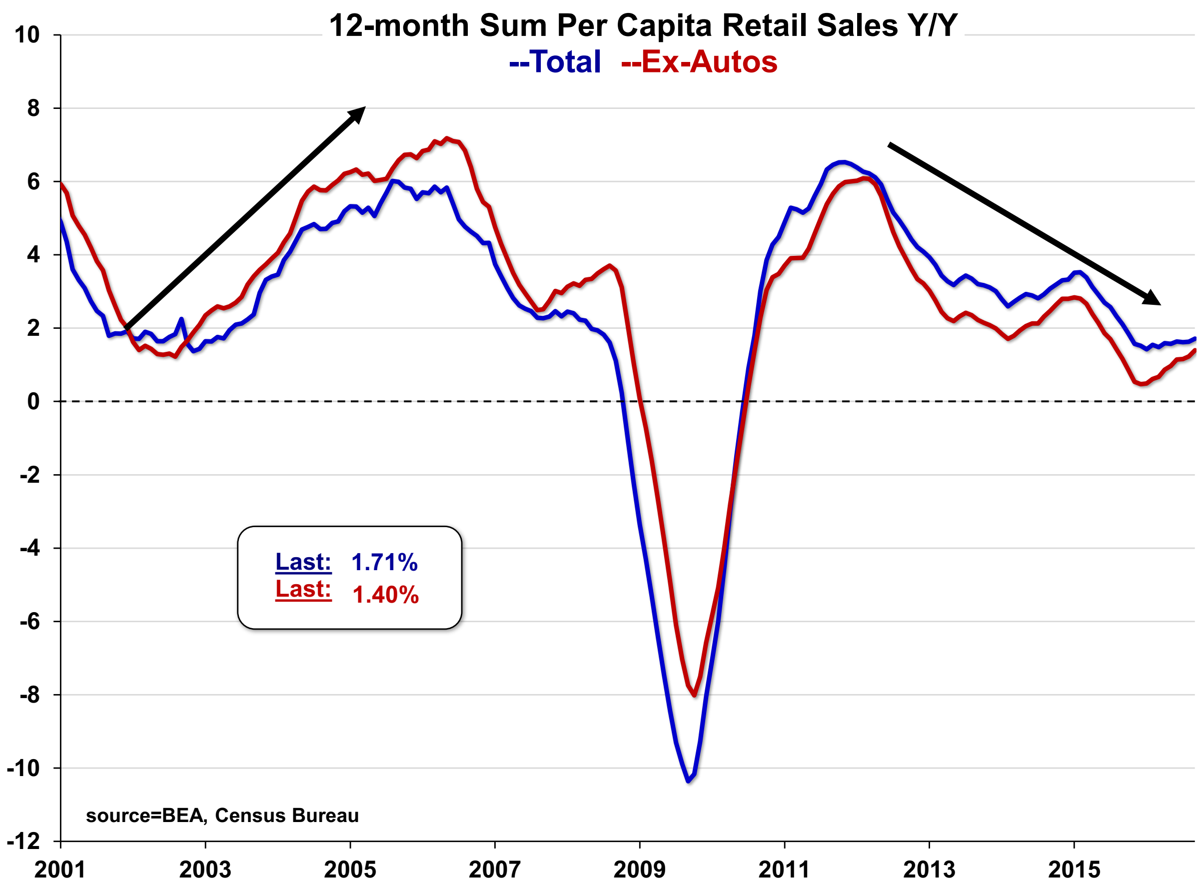


So with the new President-elect Trump coming in, and they're discussing repealing or placing his health care law, it better be a very big change. Because if you're going to have a reduction of, say, 10% or 15%, I just don't think that's going to cut it. It's really got to be an enormous cut back, 40%, 50%. That sounds like a crazy number, but given how much has jumped just in the last three years, that might actually be what it takes to at least get the consumer to feel even somewhat relaxed, and able to get out maybe spend a little of their extra relief or tax cut from a reduction in those costs.

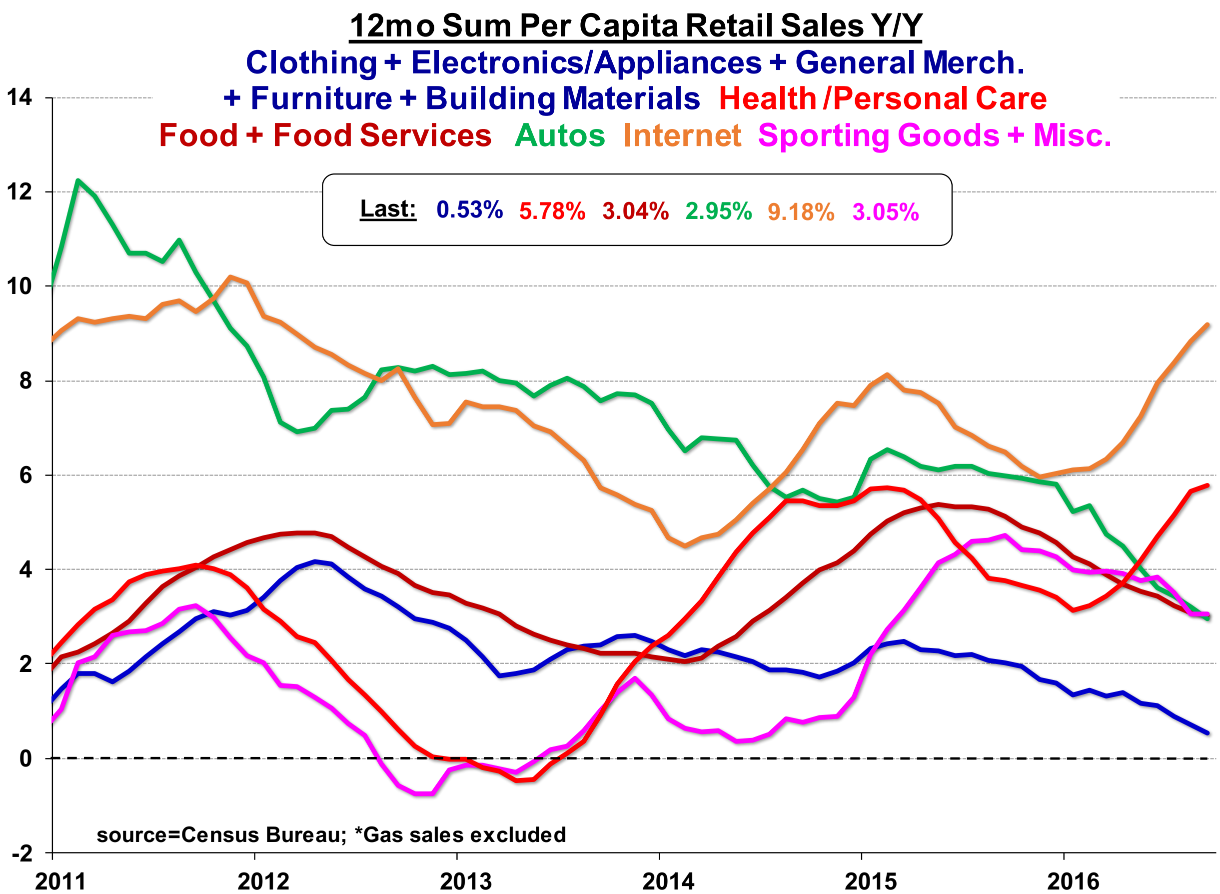
When discussing the consumer, you always have to touch on the subject of retail sales. And the consumer obviously has been under quite a bit of stress the last few years. So when we look at retail sales as we like to do with a lot of data sets, we look at the long term trends. Because you can look at every month to month, oh my gosh. Retail sales is up and you get mired in the retail sales up 0.6%. And you find out, oh my gosh, 0.4 of that was gasoline spending. And people just go nuts trying to figure this all out. And everybody's got their opinion on this stuff.

So we cut through the noise and say, let's look at this long term trend. And we do it on a per capita basis, which as well makes sense. So when you look at 12 month sum of retail sales year-over-year, the last time the Fed was in a rate hike cycle in 2004, total retail sales on a 12 month sum year-over-year were rising 5.8%. And in an up-trend. This was the beginning of a rate hike cycle.



So in December of last year, they raised for the first time in more than a decade. And retail sales were just almost 0 on that 12 month sum year-over-year basis. Now, they've ticked up to about 2%, still in a downtrend. So this is not exactly the ferocious retail sales you would want to think the Fed would be hiking rates into.

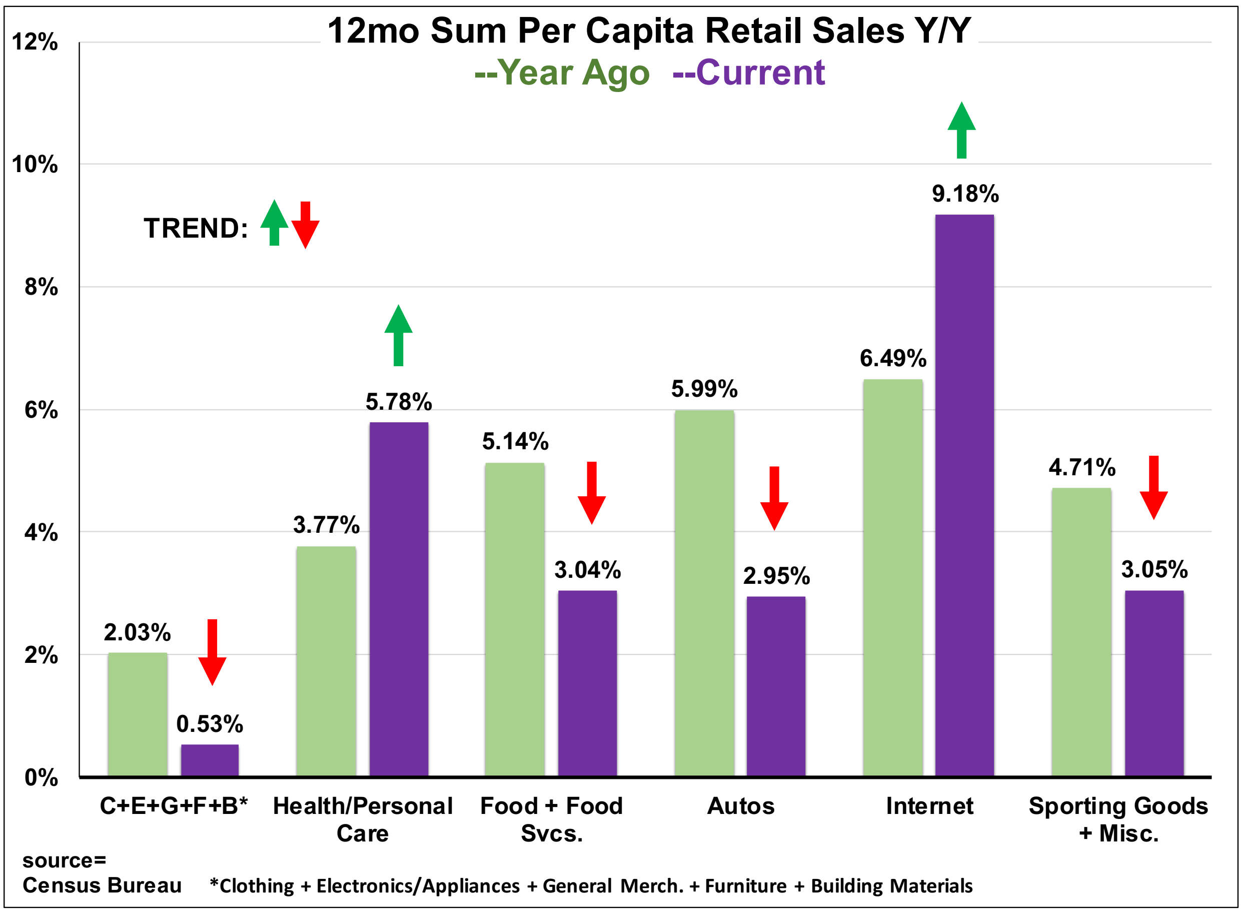
And then, if you look at the individual components– so we look at 12 month sum year-over-year of each component. And if we put them all together in one chart, we exclude gas because that's just too volatile. But we put a few of these together, apparel, electronics, general merchandise, and then autos. You can see that there's only two that are moving higher. And it's internet sales and health care, health product sales.



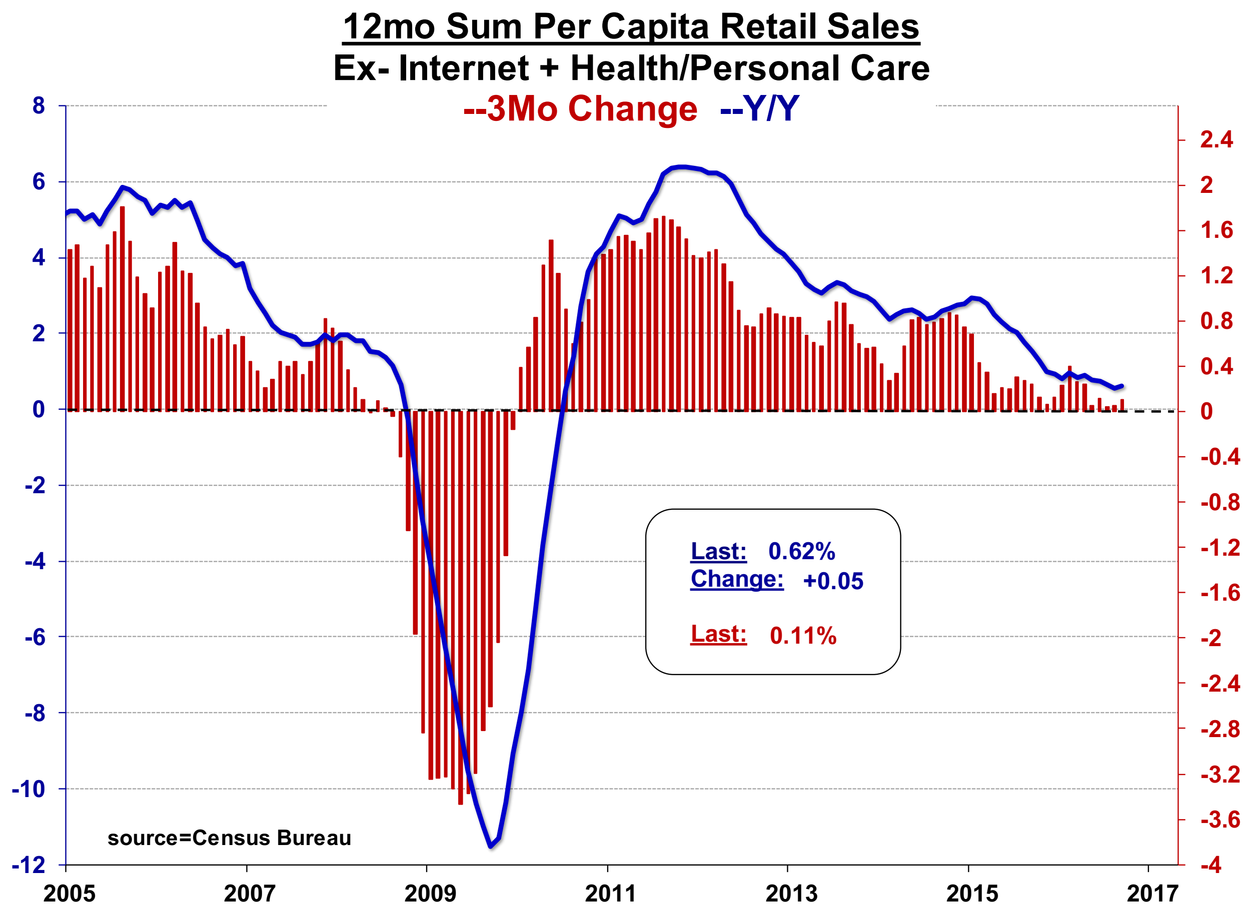
Now, the health product sales, that makes sense because prescription drugs and all CPI drug commodity costs are rising. And the other one, internet sales, which are just on fire. They've been on fire for a while. And OK, that's great. But what does that tell us about the consumer? Well, I would submit that it really doesn't paint a great picture. Because internet sales, sure, people go there for convenience. But I think it's because everything's a lot cheaper there.

You go to a brick and mortar store, whatever it is, your favorite clothing store or even electronics or whatever it might be, and then you look online. Wow, I can get this for 20% cheaper. Or instead of going to the store and buying a couple of shirts for $100, I get something comparable online for half of that. So people are going out less. They're going out less to the brick and mortar stores. And you're seeing that in the earnings of a lot of these retailers.

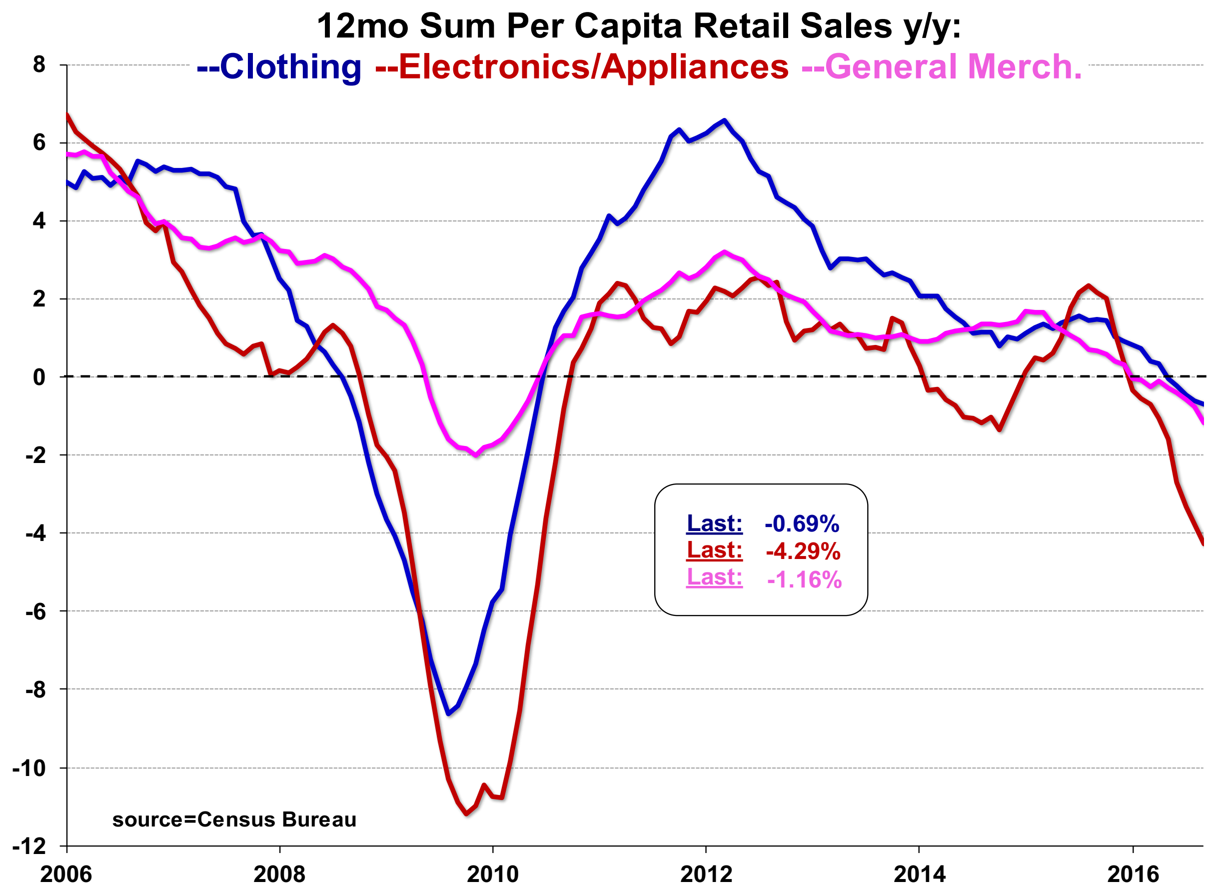
So not exactly something to entirely cheer about. And it is good. I mean, the sales are there, of course. But we really think that it may be a little bit of a sign of the consumer stress on that level. And then we have another chart where we get rid of all lines and we just look at it on a bar graph. And you see which is an uptrend, which is a downtrend. So this is very telling about the consumer.



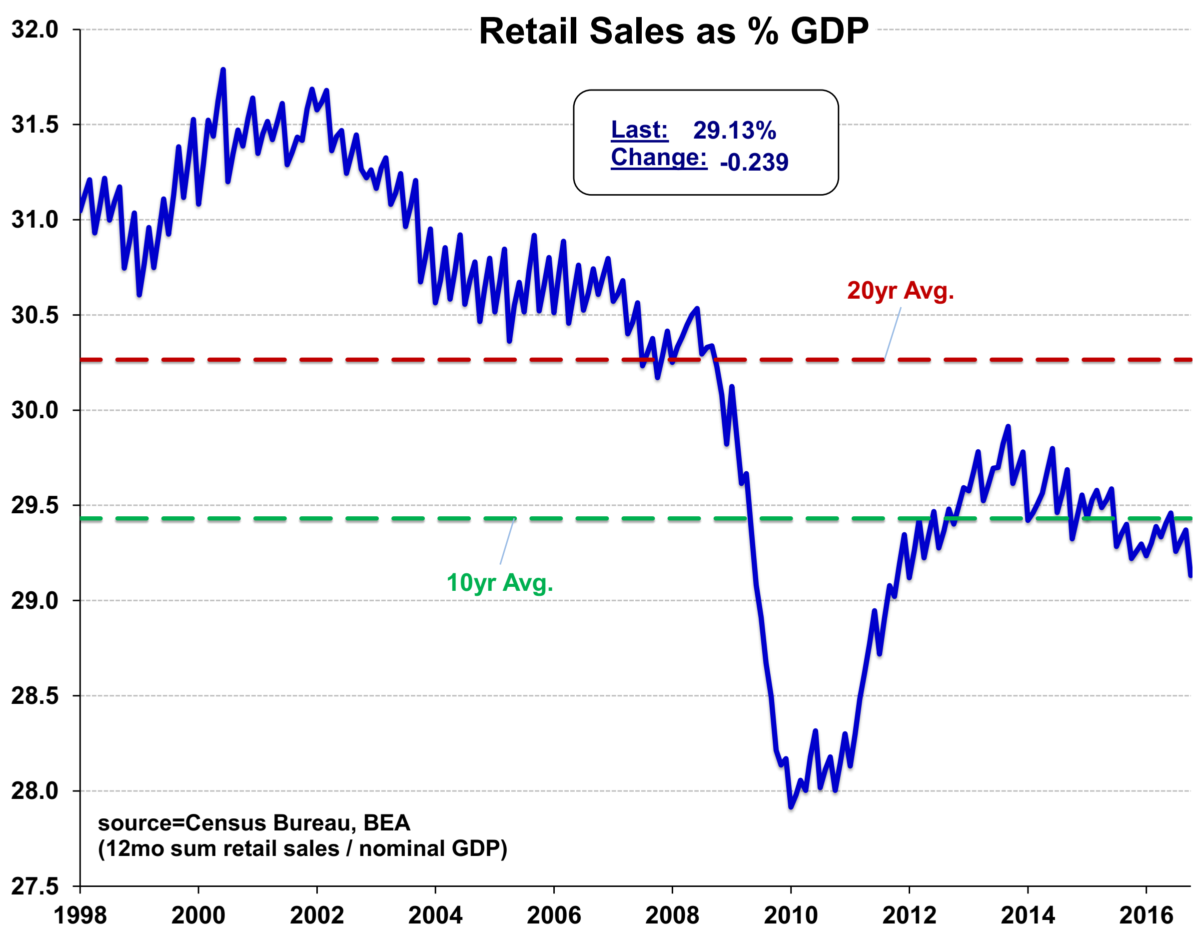
And if we peel away a couple of these components– so again, the health and personal care-related sales along with internet sales. If you strip those out and then you look at the 12 month sum year-over-year sales, this is the lowest since the recession. They're not negative, but it is a clear downtrend. So that's a very interesting chart to take into consideration.



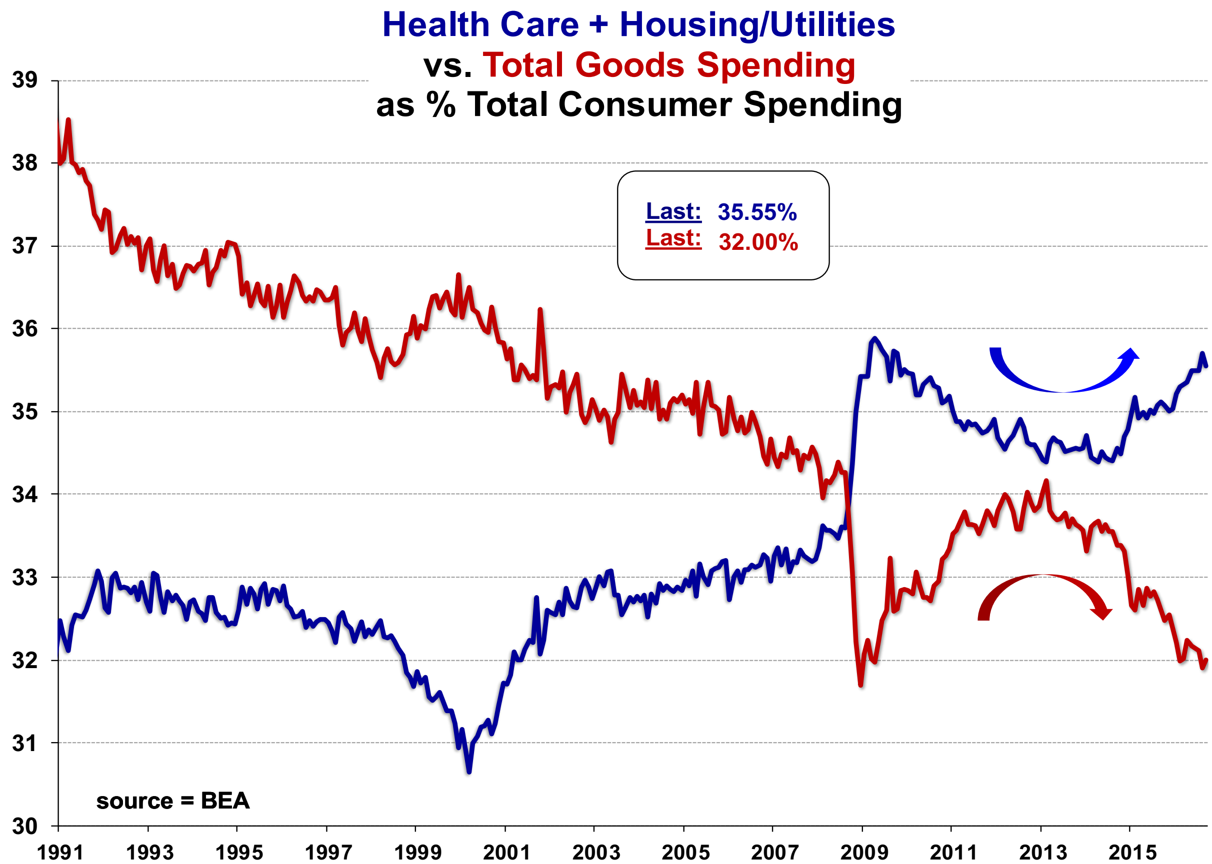
And also, on the other side, you have apparel, electronics, and general merchandise. And a lot of people perhaps may not be aware that the general merchandise accounts for over 12% of total retail sales. So this is general and miscellaneous sales, and this and that tends to be overlooked. But that's actually a pretty big part of retail sales. And that's the lowest since the recession, along with apparel, and along with electronics.



So everything is turning lower, except for the inflationary health/personal care, and internet, which may be a sign of a stressed consumer. OK, so let's pull back for a moment and look at the bigger macro picture with retail sales. Very simple chart. And it is 12 month sum retail sales as a percent of nominal GDP. And as you can see, it is below the 10 year average in a clear downtrend. And at present, it is the lowest since January or February of 2012. This is a very disturbing chart.

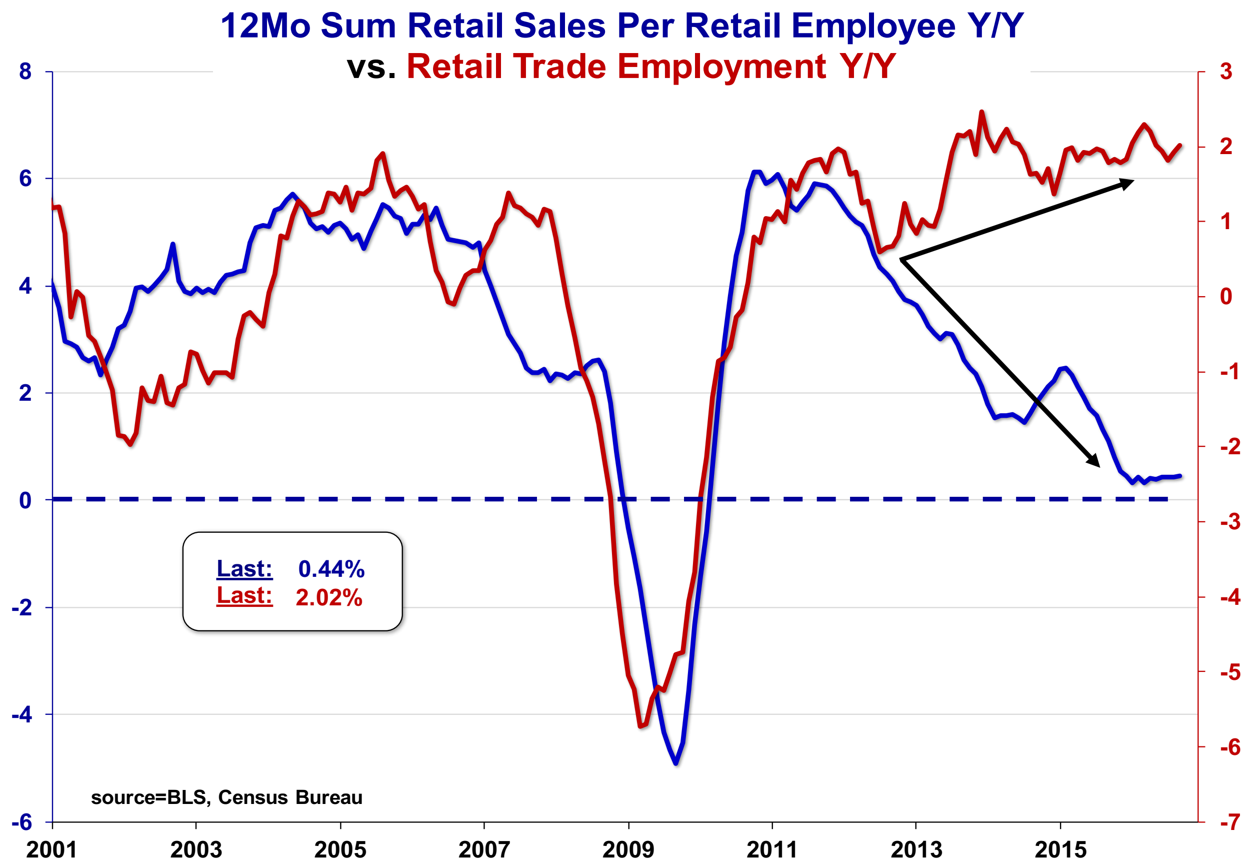


And then we have another chart of health care and housing, utilities versus total goods spending as a percent of consumer spending. And that really shows you what's going on with these retail sales as a percent of GDP. Because these health care and housing, utilities are jumping up at 35-some-odd percent. And total goods spending is declining. And we've excluded energy from that goods spending as well, and still, the chart is very much the same.



So you really have had over the years, this crowding out of consumer spending on stuff. And it's being replaced by these mandatory outlays, which just seems to be absolutely no end in sight, as to how high they can go. So this is a troubling scenario for the consumer.

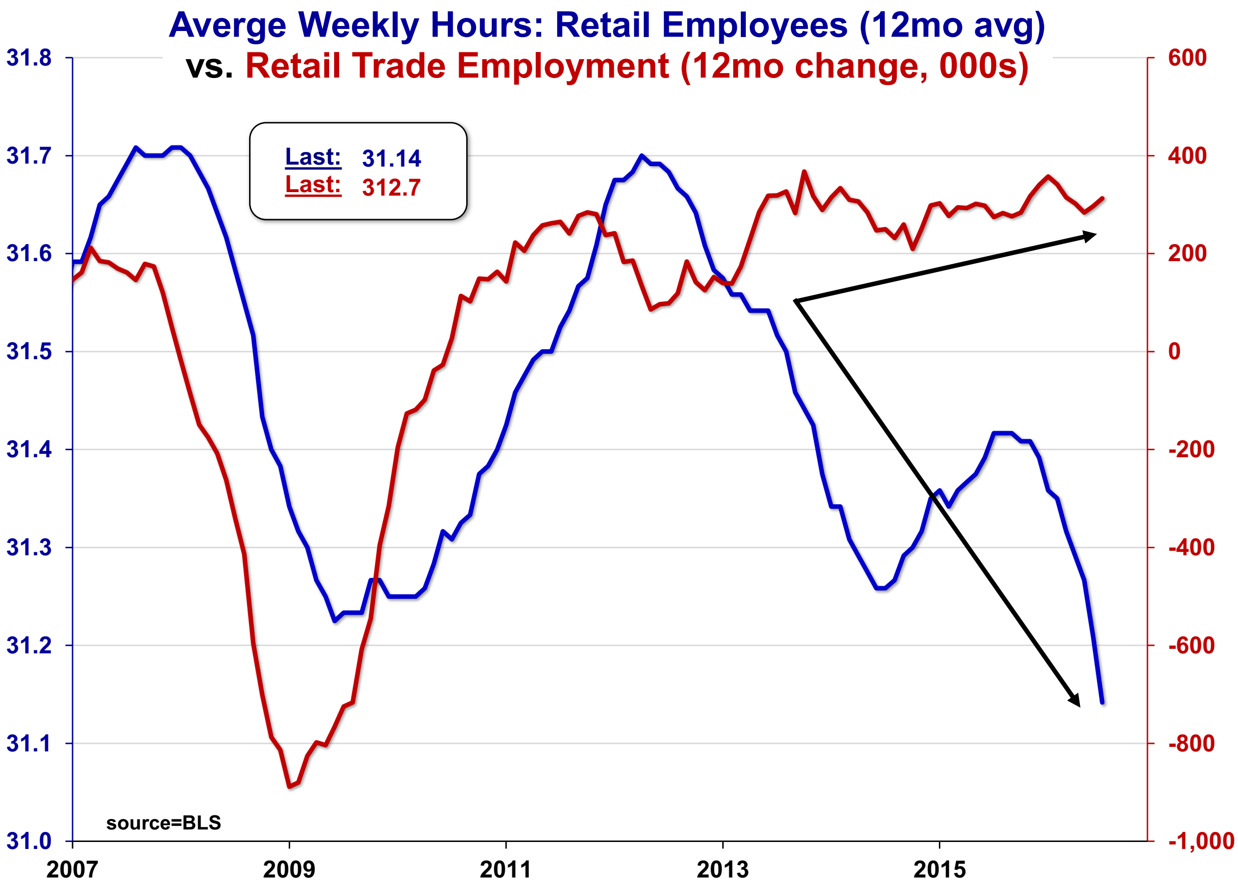
Now, another interesting thing to look at is retail sales and how it relates to employment. So if you look at retail trade employment as of the last payroll report, it's at an all time high, or just at 1,000 or 1,100 jobs shy of an all time high. And yet, retail sales per retail employee is hugging the flat line. It's less than half a percent year-over-year.



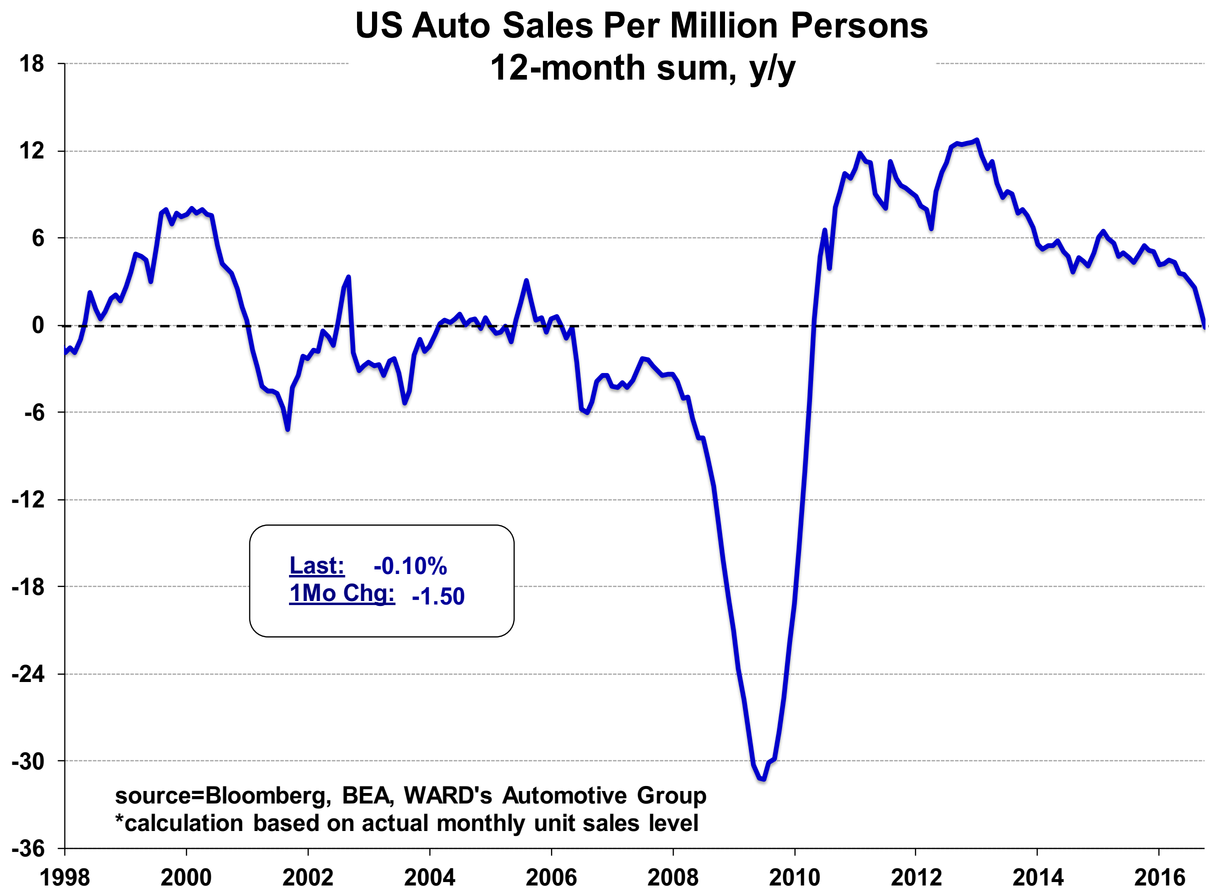
So what this tells us about employment– now, these typically always move together. Employment and retail sales, it makes sense. But you see this big divergence. And that tells us that a vast majority of these retail jobs are part time. So the question is how bad do things have to get with retail sales before employers say, OK. Well, we're going to have to start laying people off. And it may happen soon, maybe the retail sales will turn negative. Maybe they'll turn up. I don't know.

But if they do continue to drop, sales per employee– which is, I would believe, something that employers would pay pretty close attention to– you could see payroll numbers really start to move down. And especially, because a lot of these vast majority are part time jobs, it will be probably a lot bigger numbers than anyone would really think.

But then, if we move along and say, OK, this may be closer than we think. So if you look at retail trade employment again, and you overlay 12 month average of average weekly hours, the average weekly hours have dropped to 31 or somewhere in that vicinity, which is lower than it was during the recession. So hours are being cut at pace. And yet, employment is at a record high. So something's got to give, here. Retail sales really have to pick up, or you will almost certainly see a fairly sizable reduction in this retail trade sector.



And last but not least, with regard to retail sales, we look at auto sales. Now, this has obviously been a big bright spot since the recession. Auto sales have been just powering ahead. And if you look at the year-over-year data of just the seasonally adjusted and revised rate– which I think the last read was 17.9 million autos– you do a year-over-year of that, and it does show they're negative. But it's a little noisy.

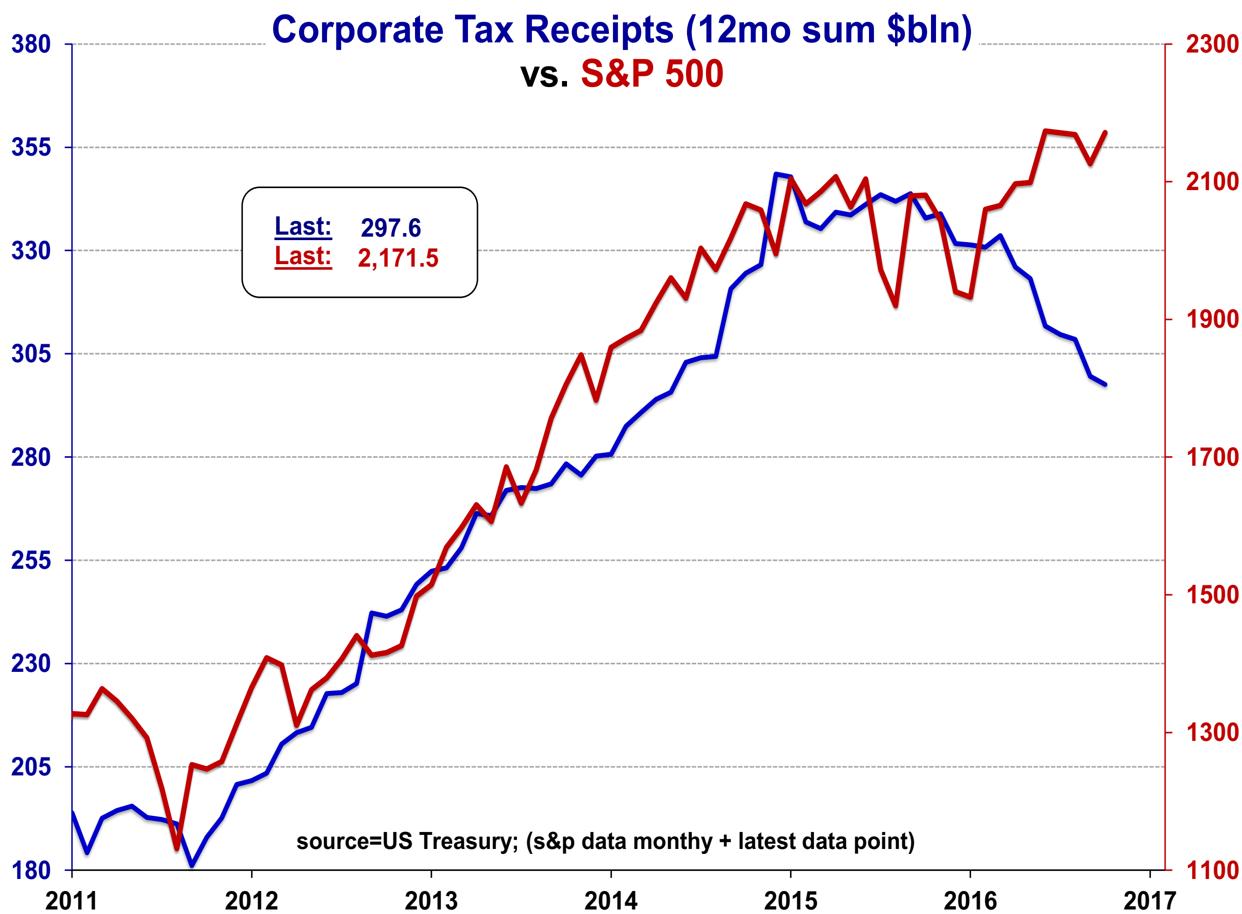


You can say, well, it's down, but it's not out. And it might go higher. So we got rid of that seasonally adjusted annualized rate. Again, we want to do the longer term trend. So we took the actual level of monthly auto sales historical, and we did it on a per capita basis 12 month sum. And we find that on a year-over-year basis, auto sales have turned negative for the first time since 2006.

So clearly, the sales have most likely peaked. And this is the first time they turned negative since 2006. And this with dealer incentives have just kept going higher this year, and they still are having trouble moving this. And if you look at the inventory to sales ratio– which is a little difficult to decipher because a lot of the inventory includes not only autos, but parts and dealers, but it's still up at recession levels.

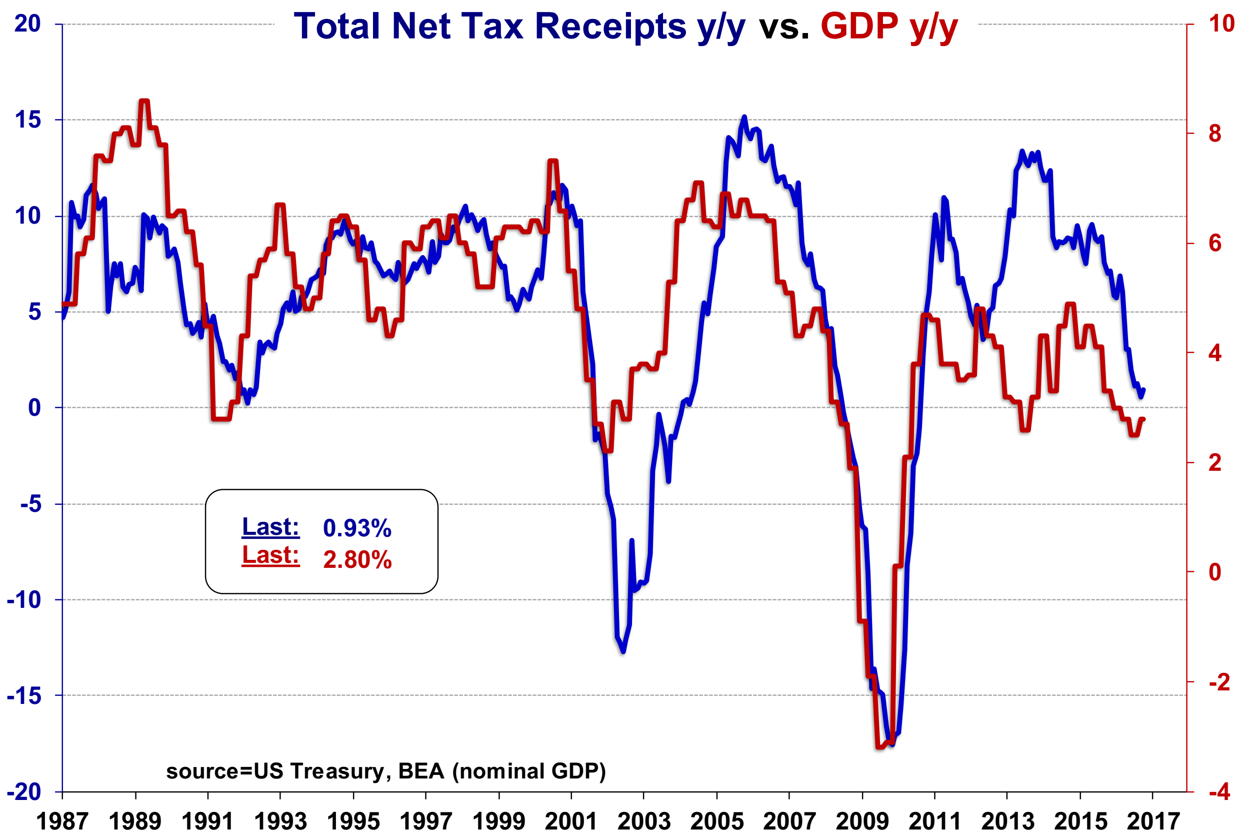
So this is definitely something to watch. But these trends as you can see in this chart, is probably fairly difficult to reverse. So definitely, something to watch this has been really quite a bonus for the economy as of late, and doesn't seem to be so anymore.

Along with the weak consumer, and effectively weak economic activity, and also a stronger dollar, we're seeing earnings have been declining 5 quarters in a row, I think. And after that, we see of course, that corporate tax receipts follow. And as you can see, the S&P is looking entirely the other way from the direction of corporate tax receipts. So on a year-over-year basis, corporate tax receipts are down 12% on a year-over-year basis. This is the lowest since June 2008.



And at that time, the S&P was declining right along with it at 14%, down 14% year-over-year. As opposed to now, the S&P is now I think, up about 6% year-over-year. So this is just a really astonishing divergence. And it's really something to pay very close attention to. And you just have to wonder how long the S&P can hang on before looking down at these corporate receipts and thinking, wait a minute. There's something not right here, before the S&P gives way.

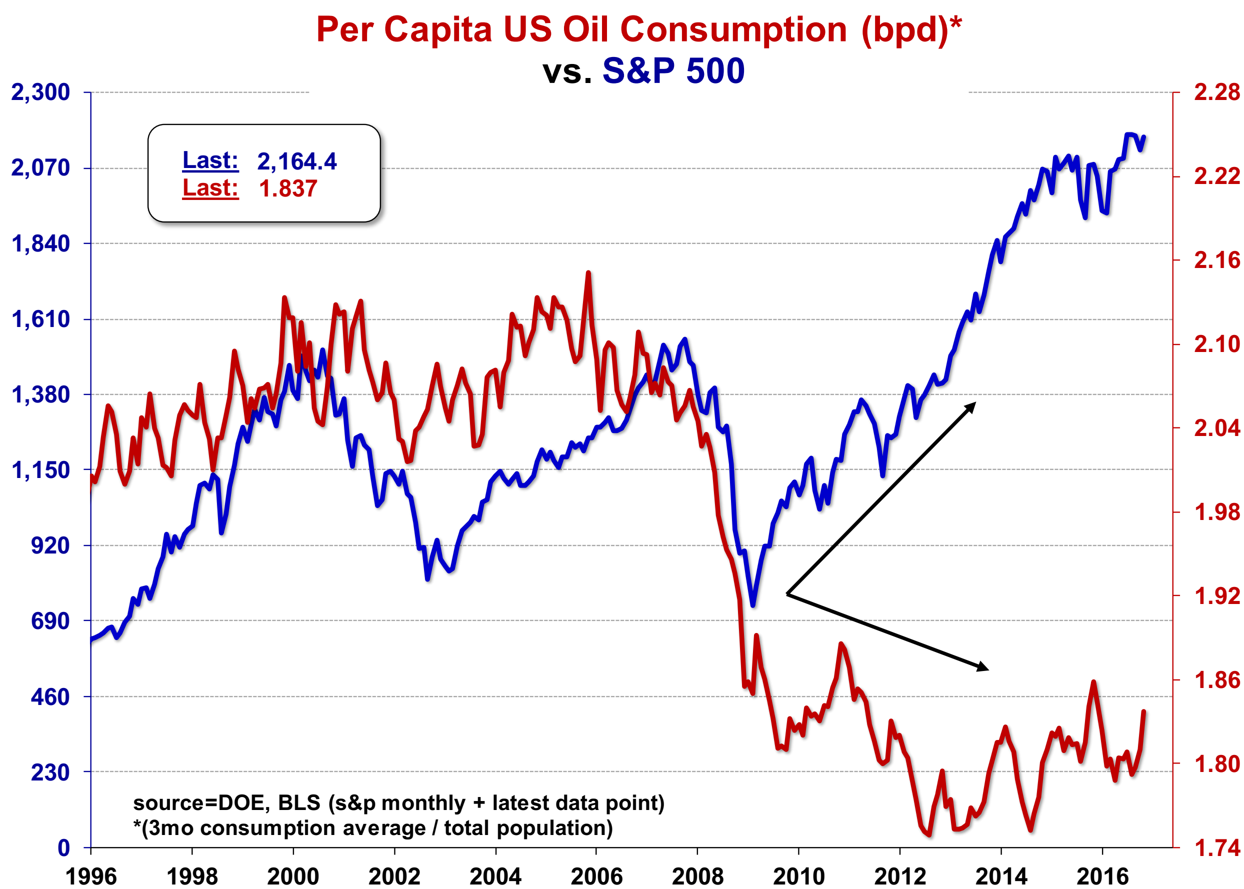
And then, if we also look at total net receipts. Again, these tax receipts data we're looking at 12 month sum, so we smooth it out. When you look at 12 month sum year-over-year, overall tax receipts and overlay GDP year-over-year with that, these are also a tight match. And this is also not painting a very good picture. GDP year-over-year is in a clear downtrend. And actually, excluding health and housing, utilities, it's actually even lower.



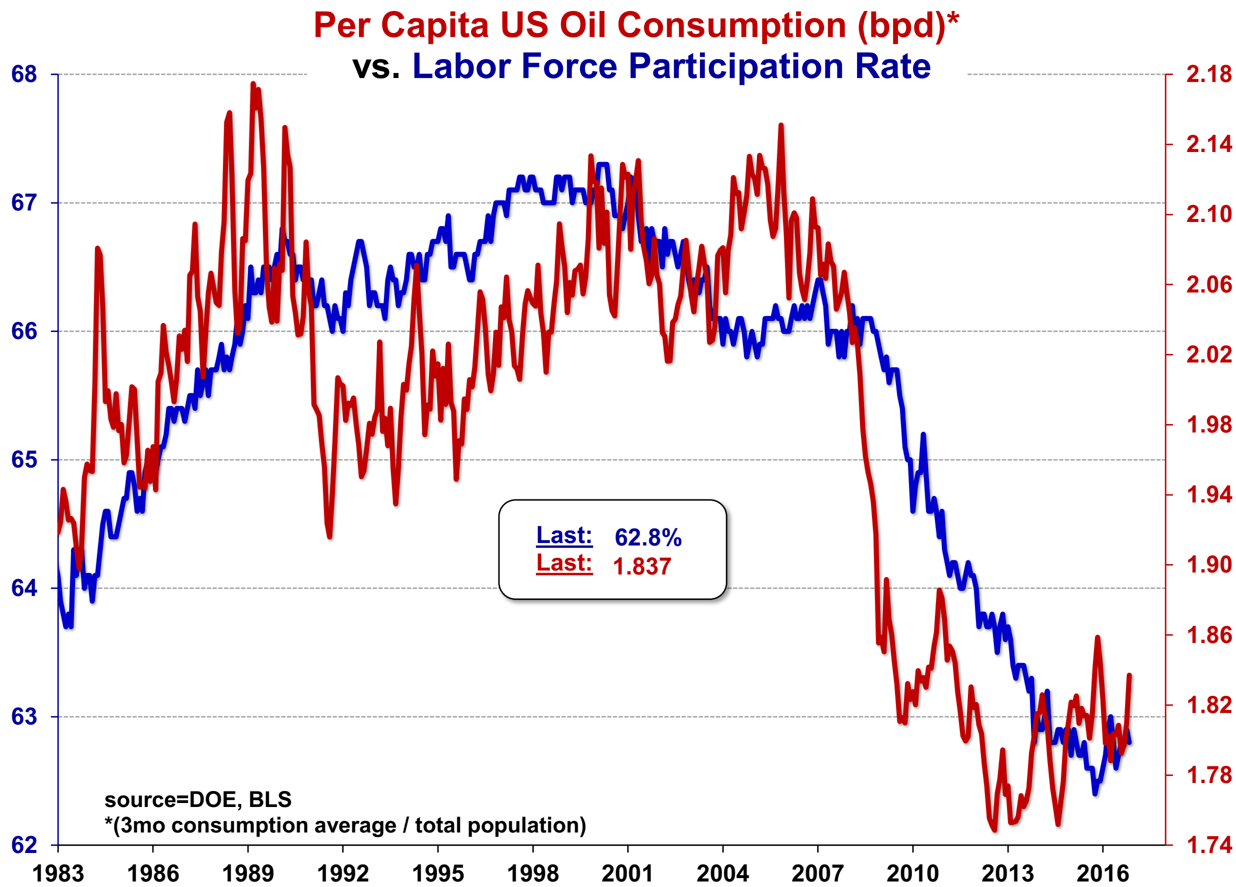
So again, tax receipts are something to keep a very close eye on. Individual tax receipts are hugging the flat line on a year-over-year basis. So there's a lot to be concerned about. And looking at the tax receipt data tells you quite a bit about the economy.

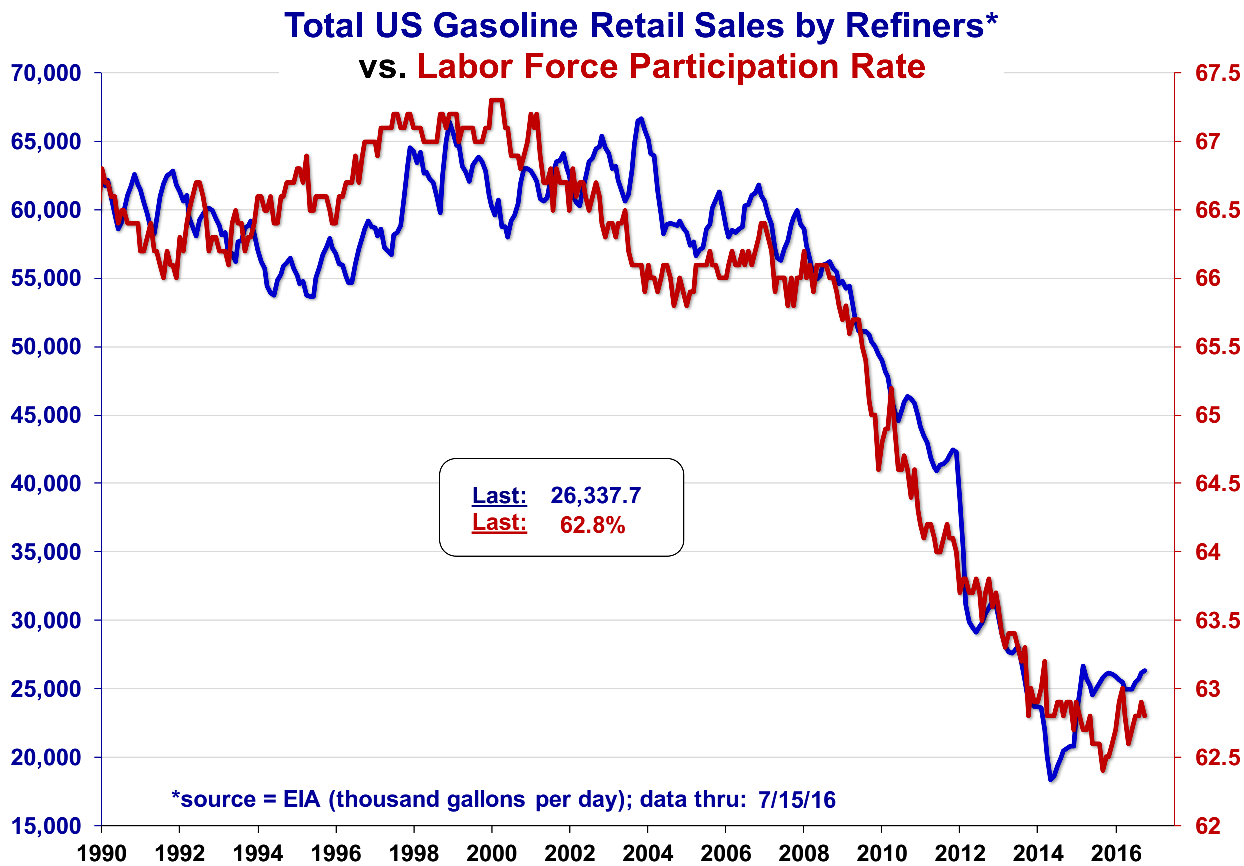
A couple more charts I'd like to go over. First of all, the energy sector is a very important topic with the discussion of OPEC freeze, or production cut. But I think what doesn't get a lot of discussion is there's a real demand side of the equation. Everybody is talking about, well, there's just too much supply.

Now, that is true. But if global growth were probably where it should be– at this point, in a recovery– that imbalance would be far narrower. So we wanted to look at per capita US oil consumption. And we came up with this chart and overlaying the S&P versus oil consumption. Now, again, as a lot of our other data sets, you find that things always tend to move together. And it's no different with this. And this makes sense, the economic growth, more people out driving around, economic activity, trucking, you name it is picking up. And it matches the rise in the S&P.



But now, since the recession, we have per capita oil consumption is at the lowest it's been since the late 60s. Now, this is pretty incredible. And also, we have another chart which I don't have here. But it is per capita oil consumption, and you overlay the labor participation rate. And those are a match as well. And you can also look at total US refinery gasoline sales, and overlay that with labor participation rate. They all match up.


Per Capita US Oil Consumption (bpd)*
vs. Labor Force Participation Rate
68
67
66
65
64
63
62
2.18
2.14
2.10
2.06
2.02
1.98
1.94
1.90
1.86
1.82
1.78
1.74
1983
1986
1989
1992
1995
1998
2001
2004
2007
2010
2013
2016
Last: 62.8%
Last: 1.837
source=DOE, BLS
*(3mo consumption average / total population)



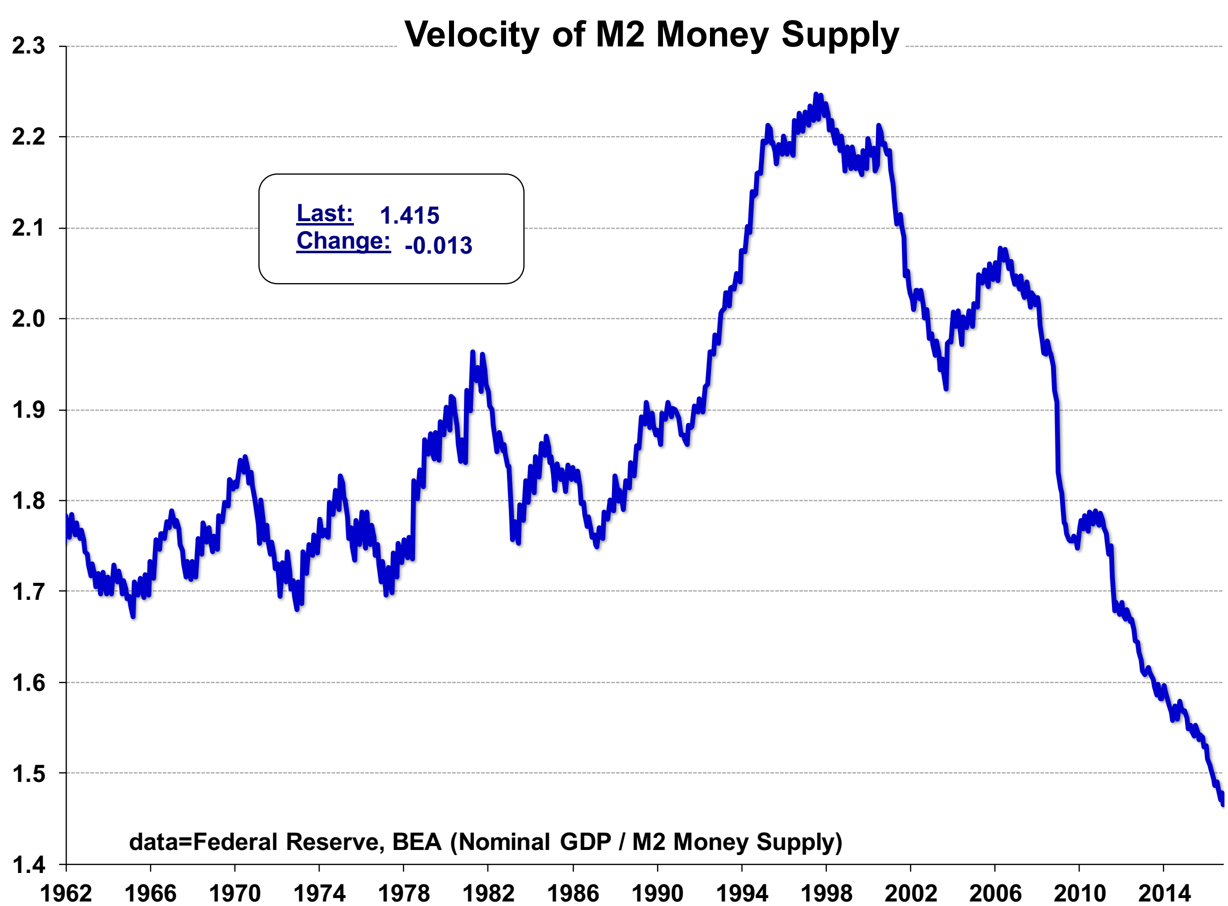
So the demand picture in the US happens to be one of the largest consumers of oil on Earth. So the fact that this demand is so weak is really, very telling. And then you have to ask yourself, OK, what happens if China– this has gotten a lot of discussion– announces that their SPR is full? Now, if you look at their consumption, their imports on a three month average, I think it is just about near an all-time high. It may have retreated just a little bit.

But what happens if or when they announce that they're SPR is full? And you also have OPEC, who can't make up its mind. And Iraq and Iran are talking about increasing their output. And then you look at the consumption data here in the US, which is very weak. It just really does not paint a good picture for oil.

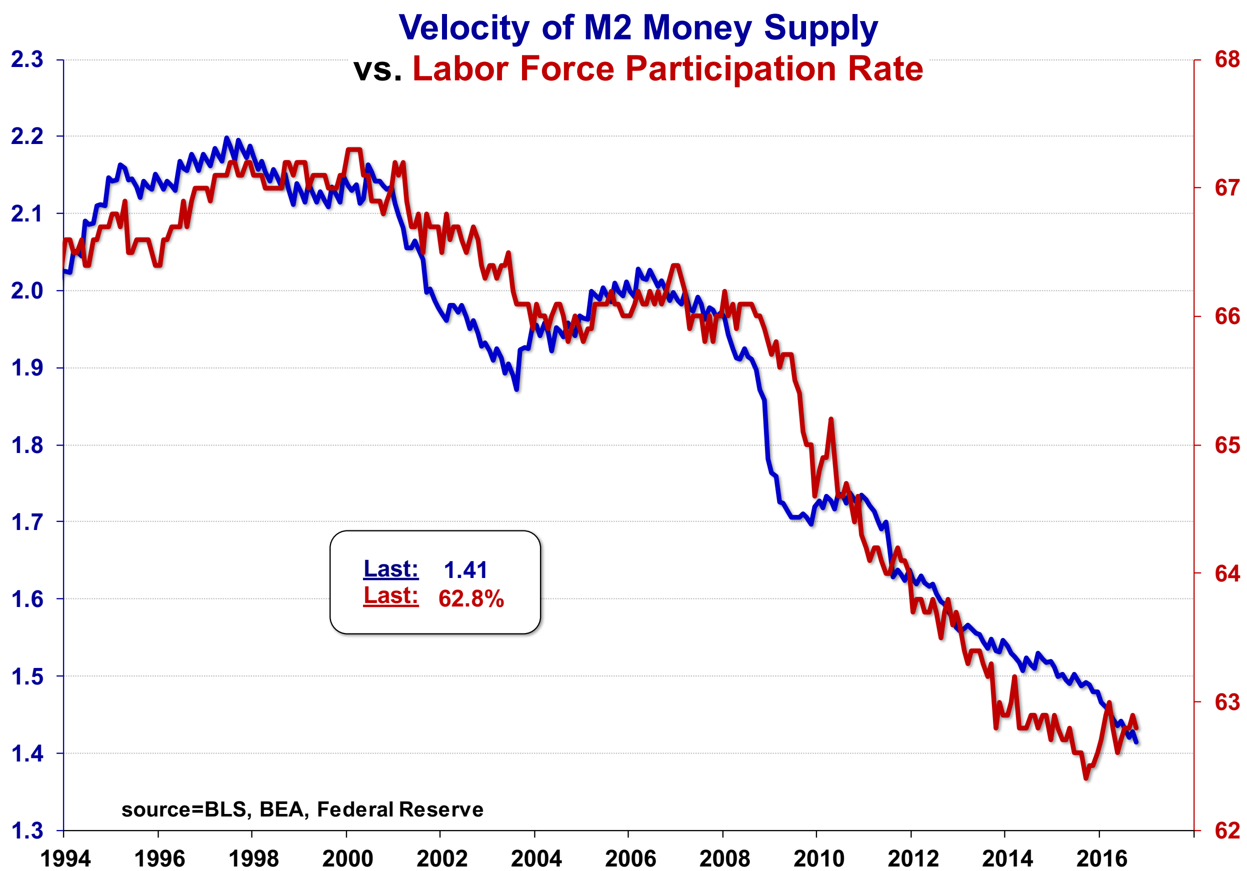
And this holds a key. This is a very important component. Because if oil begins to slide again, and we suspect there will be no OPEC agreement. And if it does slide, that also brings back into the fold this idea of the high yield credit sector. And people start worrying about defaults again. So this is obviously something you need to pay close attention to. And we think that oil is probably going to head lower, because OPEC would really have to cut– not a freeze– they would have to cut quite a bit to make it have a material impact.

If they do cut or freeze, it may jump up temporarily. But we think it is probably going to be heading lower than higher.

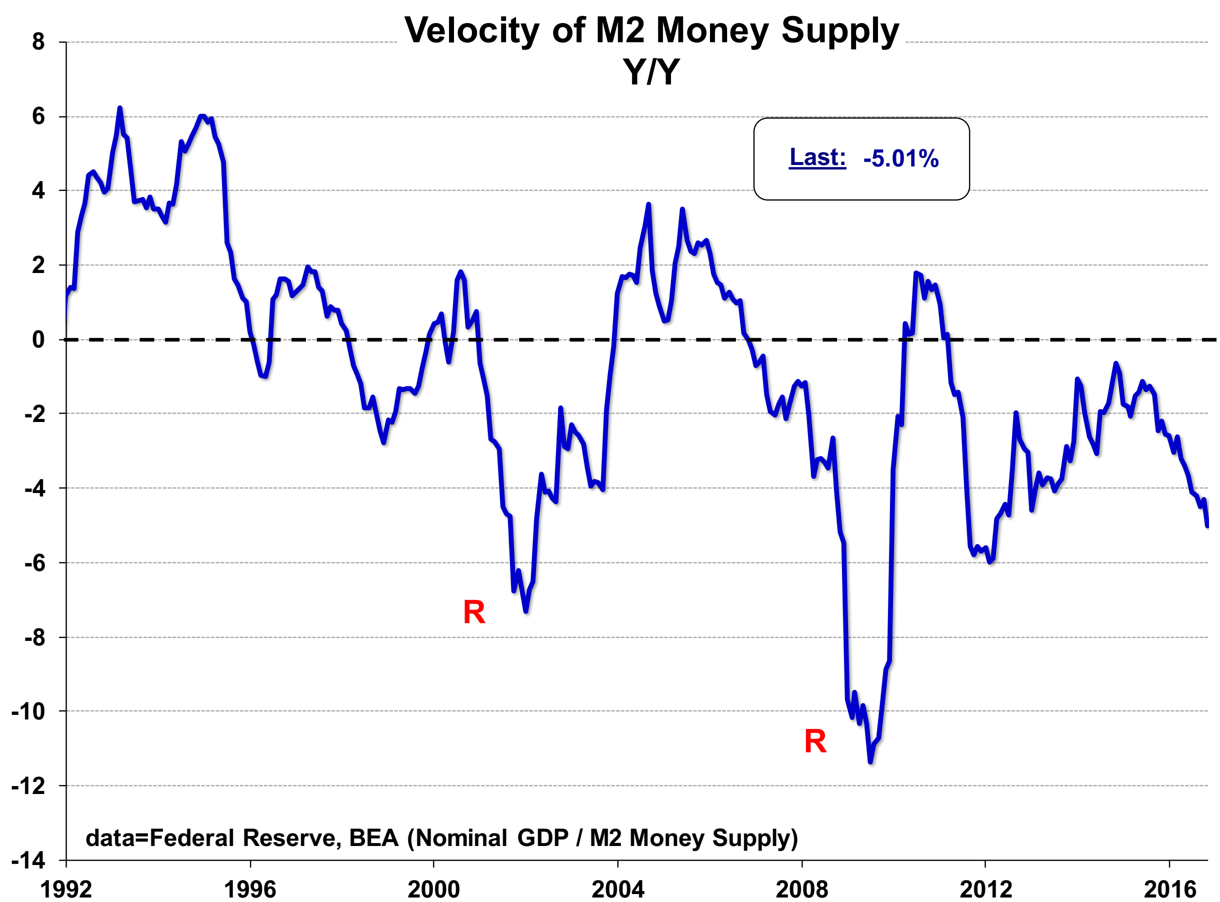
Lastly, we want to look at something that probably flies under the radar, or at least, doesn't get the attention we think that it deserves, which is the velocity of money. Which is essentially a measure of the flow of money through the economy, i.e., a measure of economic activity. So the measure is nominal GDP divided by M2 money supply. So if you look at this ratio, you can see. And people pointed out, we pointed out, and everybody knows that this is the lowest levels on record.



But you look at this chart and think, OK. I'm not really sure what this means. It sounds bad, so how do we clean this up? How do we have this make sense? So what we did is we said, OK. Let's first look at this as it relates to employment. Specifically, the labor participation rate. There's more people dropping out of the labor force. There's less income out there and less money moving through the economy. So this is actually a very tight match. Velocity of money and the labor participation rate is absolutely unmistakable. So this is something that really needs to turn around to get the economy going.



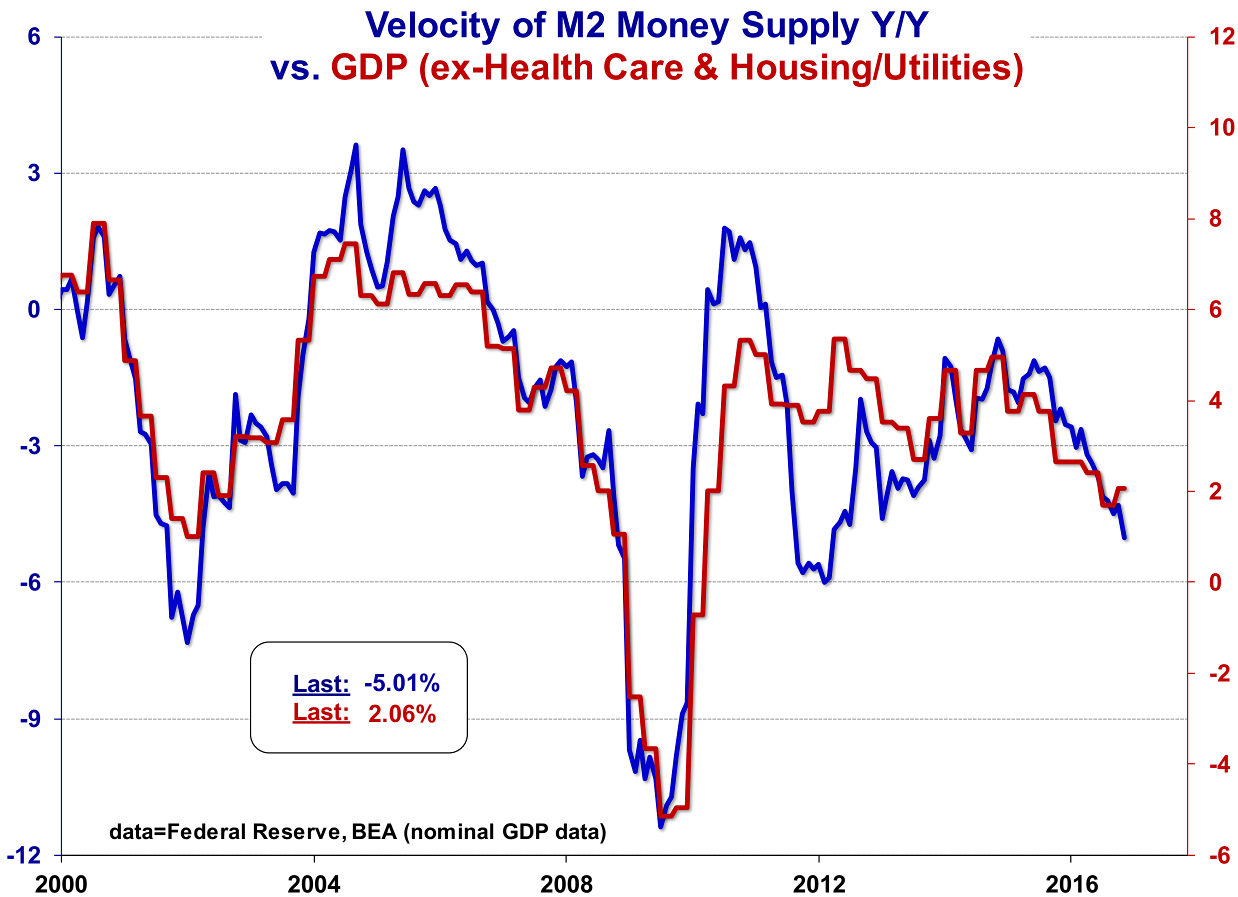
And the labor participation rate dropped at the last reading, this is not a good sign. And the velocity of money just keeps going down. Taking it just another step, is we look at velocity of money on a year-over-year basis. So it is declining at better than 5% year-over-year.



Now, if you exclude the post-recession noise data, so a lot of indicators is not the velocity of money in all sorts of GDP, you name it, consumer spending. Once you hit a soft patch or a recession, you see a snapback. And a lot of data points, a lot of them just jump wildly up above into positive territory year-over-year, before settling out. So we call that the post-recession bounce or noise data.

So again, looking at this velocity of money on a year-over-year basis, excluding that post-recession noise data, it has never turned positive on a year-over-year basis since the recession. This has never happened before.

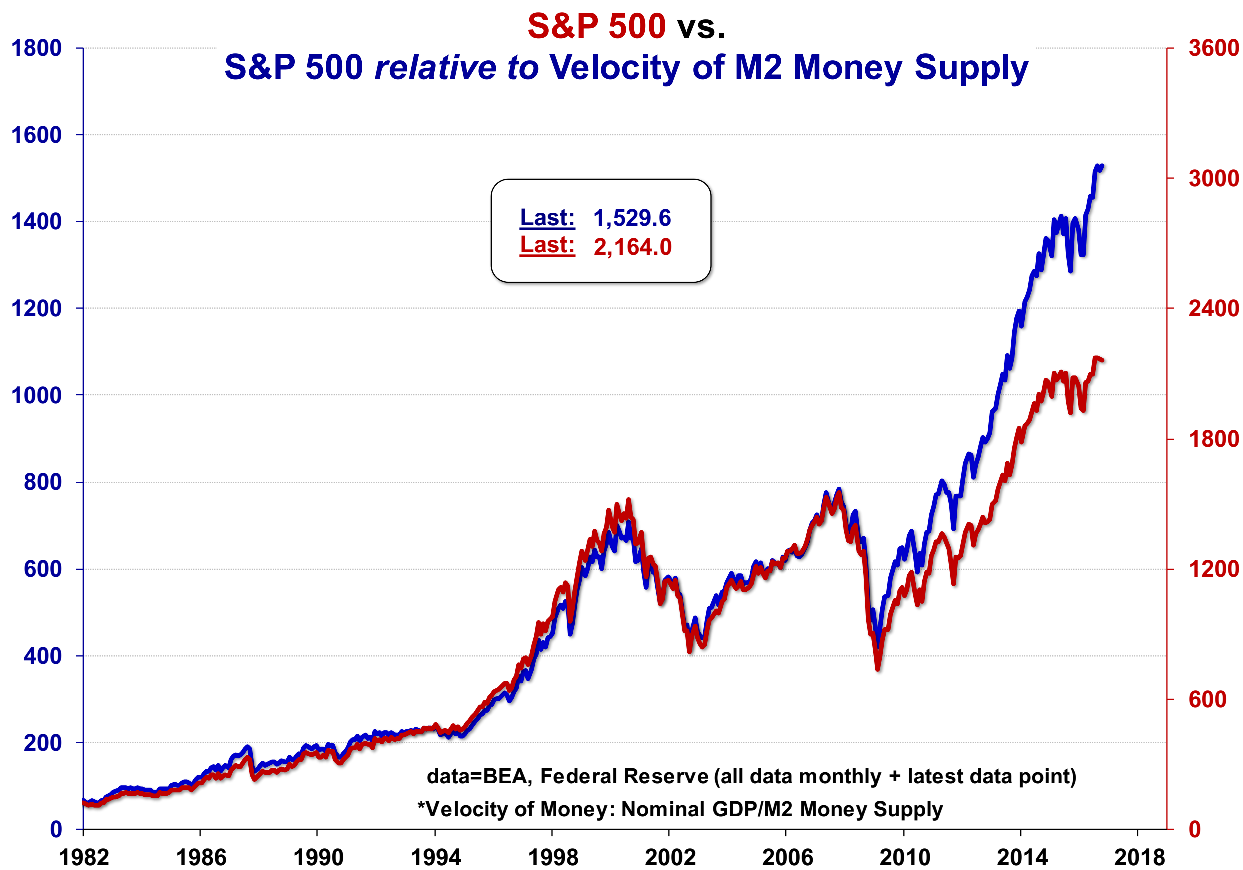
Now, if we then go ahead and overlay velocity of money with GDP, excluding health care and housing and utilities, you can see that this is also a very tight match. Because health care and housing, utilities help keep the nominal GDP higher. But it's also– as these are a tax – is pushing down or hindering the consumer from more money flowing through the economy.



And it's also important to note on a year-over-year basis that while the M2 money velocity is declining at 5% year-over-year, the last time it was at this level, it was October 2008. The S&P was dropping at better than 30% year-over-year. So again, another indicator to keep a very close eye on. You really do need this velocity of money to turn around.

Lastly, we wanted to come up with a chart. And something we've been talking about in our scribblings with clients is we keep saying that the asset prices, i.e. the S&P 500 are getting so far afield from economic fundamentals, we thought, OK. How do we come up with a chart that actually shows this? And we've come up with something that nobody looks at, and probably has never seen before, I would think. And that is– again, back to the velocity of money– how does it relate to the S&P 500?

So asset prices versus the flow of money through the economy. So if you look at a chart of the S&P 500 and then you overlay the S&P 500 relative to the velocity of money, you see that this correlation is very tight and is unmistakable. So the velocity of money and stocks move together through the ebb and flow of economic cycles. But that has completely broken down since 2009.



And what you have here is it just shows just how far stocks have gone the opposite way from fundamentals. And this is obviously a result of QE and ZIRP, and cheap credit fueling buybacks. And so we're getting further and further away from economic fundamentals. And as you can see in this chart, it is now at record extremes. We didn't find that surprising. Maybe others will.

And then we lastly, decided OK, what would it take? Where should the velocity of money be today? for it to make sense for the S&P to be at the level that it is? And again, the velocity of money on a year-over-year basis is dropping at better than 5%. As of today– all things being equal– it would have to be up near rising at plus 2% year-over-year. Now, that's really a tall order. And that turnaround does not happen on a dime. So this is something again, to watch very closely.

And the further the S&P gets away from these economic fundamentals– and we can also look back at tax receipt data, retail sales, all sorts of consumer spending metrics– the more dicey it becomes. And especially if we are in fact, apparently moving into a rate hike environment, and we have rates moving higher. So it's getting very interesting.